COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

Minutes of Evidence

LONDON: HER MAJESTY'S STATIONERY OFFICE
1960

Printed and published by
HER MAJESTY'S STATIONERY OFFICE

To be purchased from
York House, Kingsway, London W.C.2
423 Oxford Street, London W.1
13A Castle Street, Edinburgh 2
109 St. Mary Street, Cardiff
39 King Street, Manchester 2
Tower Lane, Bristol 1
2 Edmund Street, Birmingham 3
80 Chichester Street, Belfast
or through any bookseller

Price £7 0s. 0d. net

Printed in England

NOTE

This volume contains a complete record of the oral evidence taken by the Committee on the Working of the Monetary System, together with an appendix of supplementary notes submitted by witnesses in response to requests made by the Committee in the course of hearing oral evidence.

The written memoranda on which the oral hearings were based are published separately, together with certain other memoranda which were of substantial assistance to the Committee in its inquiry, in three volumes entitled *Principal Memoranda of Evidence submitted to the Committee on the Working of the Monetary System.*

Following this note are a list of the organisations and persons whose evidence is included in the published record of evidence and an alphabetical list of witnesses who gave oral evidence.

ORGANISATIONS AND PERSONS WHOSE WRITTEN AND ORAL EVIDENCE TO THE COMMITTEE IS INCLUDED IN THE PUBLISHED RECORD OF EVIDENCE

Name of organisation or person	Memoranda of Evidence Vol.	Part	Number	Minutes of Evidence Question numbers
The Bank of England	1	I	1 to 16 and appendices	1 to 971 1751 to 2336 2616 to 2887 9684 to 9734 11919 to 12188 12813 to 12900 13416 to 13477
H.M. Treasury	1	II	1 to 14	972 to 1750 2337 to 2615 2799 to 2995 3211 to 3308 9610 to 9734 13269 to 13415
Central Statistical Office	1	III	1 to 3	
Other Government departments, etc.				
Ministry of Agriculture, Fisheries and Food	1	IV	1	
Department of Agriculture for Scotland	1	IV	2	
Ministry of Agriculture for Northern Ireland	1	IV	3	
Capital Issues Committee	1	IV	4	6087 to 6248
Development Commission	1	IV	5	
Export Credits Guarantee Department	1	IV	6	8617 to 8856
National Savings Committee	1	IV	7	7982 to 8075
Scottish Savings Committee	1	IV	8	7982 to 8075
Post Office Savings Department	1	IV	9	6836 to 6950
Board of Trade	1	IV	10	2996 to 3210
Representatives of overseas central banks				
The Governor of the Commonwealth Bank of Australia	1	V	1	
The Governor of the Central Bank of Ceylon	1	V	2	
The Governor of the Reserve Bank of India	1	V	3	
The President of the Netherlands Bank	1	V	4	11742 to 11918
The Governor of the Reserve Bank of New Zealand	1	V	5	
The Governor of the Bank of Rhodesia and Nyasaland	1	V	6	
The Governor of the South African Reserve Bank	1	V	7	9273 to 9394
Mr. Winfield W. Riefler, Assistant to the Chairman of the Board of Governors, Federal Reserve System, United States of America.	1	V	8	9395 to 9609 9735 to 9890
Banking and other Financial Associations and Institutions				
Accepting Houses Committee	2	VI	1	5768 to 6086
Bank Insurance Trust Corporation Ltd.	2	VI	2	7594 to 7701
Barclays Bank D.C.O. Ltd.	2	VI	3	
The Building Societies Association	2	VI	4	7289 to 7425
The Credit Insurance Association Ltd.	2	VI	5	
The London Discount Market Association	2	VI	6	3309 to 3522
The Finance Houses Association Ltd.	2	VI	7	5116 to 5288
Gerrard and Reid Ltd.	2	VI	8	
The Industrial Bankers Association	2	VI	9	5289 to 5524
The British Insurance Association	2	VI	10	7075 to 7288
The Association of Investment Trusts	2	VI	11	7426 to 7593
Issuing Houses Association	2	VI	12	4001 to 4167
The Committee of London Clearing Bankers	2	VI	13	3523 to 4000 13045 to 13268
Municipal and General Securities Co. Ltd.	2	VI	14	
The British Overseas Banks' Association	2	VI	15	4327 to 4759
The Committee of Scottish Bank General Managers	2	VI	16	4760 to 5115

Name of organisation or person	Memoranda of Evidence Vol.	Part	Number	Minutes of Evidence Question numbers
The Council of the Stock Exchange	2	VI	17	7800 to 7981
The Association of Superannuation and Pension Funds	2	VI	18	7702 to 7799
The Trustee Savings Banks Association	2	VI	19	8076 to 8142
Industrial and Commercial Associations, etc.				
The Association of British Chambers of Commerce	2	VII	1 (A and B)	11114 to 11180
The Council of Scottish Chambers of Commerce	2	VII	2	8857 to 8992
The British Federation of Commodity Associations	2	VII	3	8570 to 8616
The Export Group for the Constructional Industries	2	VII	4	6996 to 7074
The British Employers' Confederation	2	VII	5	
The Engineering Industries Association	2	VII	6	6308 to 6411
The British Engineers' Association	2	VII	7	6249 to 6307
The Federation of British Industries	2	VII	8 (A and B)	5525 to 5767
The National Association of Retail Furnishers	2	VII	9	
The Locomotive and Allied Manufacturers' Association of Great Britain	2	VII	10	6951 to 6995
The National Union of Manufacturers	2	VII	11	
The Multiple Shops Federation	2	VII	12	8143 to 8210
The Retail Distributors Association	2	VII	13	6550 to 6687
The General Council of British Shipping	2	VII	14	
The Trades Union Congress	2	VII	15	8993 to 9139 10142 to 10189
The Federation of Wholesale Organisations	2	VII	16	6688 to 6750
Agricultural Associations				
The Farmers' Unions of the United Kingdom	2	VIII	1	6751 to 6835
The Country Landowners' Association	2	VIII	2	6412 to 6466
The Scottish Landowners' Federation	2	VIII	3	6467 to 6549
Local Authority Associations, etc.				
The Association of Municipal Corporations	2	IX	1	8211 to 8413
The County Councils Association	2	IX	2	8414 to 8569
The London County Council	2	IX	3	
Public Corporations				
The National Coal Board	2	X	1	11181 to 11249
The Electricity Council	2	X	2	11067 to 11113
The Gas Council	2	X	3	12189 to 12262
The North of Scotland Hydro-Electric Board	2	X	4	11708 to 11741
British Transport Commission	2	X	5	12263 to 12300
Directors of Large Industrial Companies				
The Rt. Hon. Viscount Chandos, D.S.O., M.C., Associated Electrical Industries Ltd.				11416 to 11472
Mr. F. A. Cockfield, Boots Pure Drug Co. Ltd.	2	XI	1	11605 to 11631
Sir Alexander Fleck, K.B.E., F.R.S. and Mr. P. T. Menzies, Imperial Chemical Industries Ltd.	2	XI	3	10740 to 10784
Lord Godber and Mr. F. J. Stephens, Shell Transport and Trading Co. Ltd.	2	XI	2	11520 to 11604
Sir Patrick Hennessy and Mr. J. M. A. Smith, Ford Motor Co. Ltd.				11352 to 11415
Lord Heyworth and Mr. J. F. Knight, Unilever Ltd.				11473 to 11519
Viscount Knollys, G.C.M.G., M.B.E., D.F.C., Vickers Ltd.				11303 to 11351
Sir Ivan Stedeford, K.B.E., Tube Investments Ltd.				11632 to 11707
The National Institute of Economic and Social Research	3	XII		
Individuals				
Mr. Thomas Balogh	3	XIII	1	11025 to 11066
*Mr. F. W. Barraclough				12982 to 13044
Lord Brand, C.M.G.				10697 to 10739
The Rt. Hon. Lord Bridges, G.C.B., G.C.V.O., M.C., F.R.S.	3	XIII	2	12558 to 12640
Professor A. J. Brown	3	XIII	3	9140 to 9209
The Rt. Hon. R. A. Butler, C.H., M.P.				12375 to 12445
Mr. J. L. Carr	3	XIII	4	
*Mr. C. J. Clipsham				12982 to 13044

Name of organisation or person	Memoranda of Evidence Vol.	Part	Number	Minutes of Evidence Question numbers
Mr. W. F. Crick ...	3	XIII	5	10513 to 10578
Mr. W. Manning Dacey ...	3	XIII	6	10043 to 10141
The Rt. Hon. Hugh Dalton, M.P. ...	3	XIII	7	12446 to 12506
Mr. A. C. L. Day...	3	XIII	8	9891 to 9977
Mr. J. C. R. Dow...	3	XIII	9	
Mr. H. C. Edey and Professor A. T. Peacock...	3	XIII	10	
*Mr. J. P. Furmston ...				12982 to 13044
The Rt. Hon. H. T. N. Gaitskell, M.P. ...				12324 to 12374
Sir Theodore Gregory ...	3	XIII	11	10785 to 10874
Sir Roy Harrod, F.B.A. (Mr. R. F. Harrod) ...	3	XIII	12	10255 to 10350
Sir Ralph Hawtrey, C.B., F.B.A. ...	3	XIII	13	9210 to 9272
Dr. R. F. Henderson ...	3	XIII	14 (I and II)	
‡Professor J. R. Hicks, F.B.A. ...	3	XIII	15	10875 to 10937
Sir Nutcombe Hume, K.B.E., M.C. ...	3	XIII	16	12753 to 12812
Mr. A. E. Jasay ...	3	XIII	17 (I and II)	
Professor H. G. Johnson...	3	XIII	18	10579 to 10649
Professor R. F. Kahn, C.B.E. ...	3	XIII	19	10938 to 11024
Mr. Nicholas Kaldor ...	3	XIII	20	10650 to 10696
†The Rt. Hon. Lord Kennet, G.B.E., D.S.O., D.S.C. ...				12301 to 12323
Mr. W. T. C. King ...	3	XIII	21	
Sir Frederick Leith-Ross, G.C.M.G., K.C.B. ...	3	XIII	22	4168 to 4326
Mr. I. M. D. Little, Mr. R. R. Neild and Mr. C. R. Ross ...	3	XIII	23	
‡Mr. H. F. Lydall ...	3	XIII	24	
Sir Donald MacDougall, C.B.E. ...	3	XIII	25	
‡Professor J. E. Meade, C.B., F.B.A. ...	3	XIII	26	9978 to 10042
*Mr. L. G. Millhouse ...				12901 to 12981
Professor E. V. Morgan ...	3	XIII	27	
Mr. W. H. J. de. W. Mullens, D.S.O., T.D. ...				11919 to 12065
Professor F. W. Paish, M.C. ...	3	XIII	28	10425 to 10512
Professor F. W. Paish, M.C., Mr. Graham Hutton and Mr. L. W. Robson ...	3	XIII	29	
Lord Piercy, C.B.E. ...	3	XIII	30	12641 to 12752
Lord Piercy, C.B.E. and Mr. L. G. Whyte ...	3	XIII	31	
Mr. I. J. Pitman, M.P. ...	3	XIII	32	12507 to 12557
Lord Robbins, C.B., F.B.A. (Professor L. C. Robbins) ...	3	XIII	33	10190 to 10254
Mr. H. B. Rose ...	3	XIII	34	
Mr. W. H. Salomon ...	3	XIII	35	
Mr. J. R. Sargent ...	3	XIII	36	10351 to 10424
*Mr. G. B. Speed ...				12901 to 12981
‡Mr. John Spraos ...	3	XIII	37	
Mr. H. B. Stott ...	3	XIII	38	
*Mr. H. R. Suttle ...				12901 to 12981
Mr. G. F. M. P. Thompson ...	3	XIII	39	
The Rt. Hon. G. E. P. Thorneycroft, M.P. ...	3	XIII	40	11250 to 11302
Mr. Thomas Wilson ...	3	XIII	41	

* See footnote to alphabetical list of witnesses.

† See footnote to alphabetical list of witnesses.

‡ The memoranda submitted by these witnesses have been (or are being) published elsewhere, and are not therefore reprinted in the Committee's record of evidence. In these cases references to the published sources are included in the record of evidence.

ALPHABETICAL LIST OF WITNESSES

Name of Witness	*Organisation represented or capacity in which witness was invited*
Allen, Mr. R. B.	Finance Houses Association Ltd.
Allen, Mr. W. M.	Bank of England
Althaus, Mr. F. R.	Council of the Stock Exchange
Anderson, Mr. A. P.	Committee of Scottish Bank General Managers
Armstrong, Mr. William, C.B., M.V.O.	H.M. Treasury
Atkinson, Mr. F. J.	H.M. Treasury
Bacon, Mr. F. W.	Association of Superannuation and Pension Funds
Bailey, Mr. Wilfrid	Gas Council
Balogh, Mr. Thomas	—
Banwell, Sir Harold	Association of Municipal Corporations
Barraclough, Mr. F. W.	*
Beck, Mr. E. C.	Export Group for the Constructional Industries
Bennett, Mr. W. J., C.B.E.	County Councils Association
Bentley, Mr. Fred	Building Societies Association
Birch, Mr. J. A.	Trades Union Congress
Blair, Mr. Arthur W., W.S.	Scottish Landowners' Federation
Bland, Mr. T. M., T.D.	County Councils Association
Bower, Mr. Frank, C.B.E.	Association of British Chambers of Commerce
Brand, Lord, C.M.G.	—
Bridge, Mr. R. A. O.	Bank of Bngland
Bridges, The Rt. Hon. Lord, G.C.B., G.C.V.O., M.C., F.R.S.	—
Brown, Professor A. J.	—
Burkitt, Mr. R. W., i.d.c.	Export Credits Guarantee Department
Butler, Mr. J. C., M.B.E.	Multiple Shops Federation
Butler, The Rt. Hon. R. A., C.H., M.F.	—
Cameron of Lochiel, Lt.-Col. Donald, T.D., D.L.	Scottish Landowners' Federation
Carnegie, Mr. R. M.	Council of Scottish Chambers of Commerce
Carnwath, Mr. A. H.	Issuing Houses Association
Carter, Mr. D. A.	Farmers' Unions of the United Kingdom
Chalcraft, Mr. R. D.	Export Group for the Constructional Industries
Chandos, The Rt. Hon. Viscount, D.S.O., M.C.	Chairman, Associated Electrical Industries Ltd.
Chesterfield, Mr. A. D.	Committee of London Clearing Bankers
Clipsham, Mr. C. J.	*
Clive, Brigadier A. F. L., D.S.O., M.C.	Country Landowners' Association
Cobbold, The Rt. Hon. C. F.	Bank of England
Cockfield, Mr. F. A.	Finance Director, Boots Pure Drug Co. Ltd.
Collingwood, Mr. G., T.D.	Locomotive and Allied Manufacturers' Association of Great Britain
Collison, Mr. H.	Trades Union Congress
Colville, Mr. Hugh	London Discount Market Association
Compton, Sir Edmund, K.B.E., C.B.	H.M. Treasury
Costain, Sir Richard, C.B.B.	Bxport Group for the Constructional Industries
Cotterill, Mr. K. W.	Export Credits Guarantee Department
Crawt, Mr. W.	Multiple Shops Federation
Crick, Mr. W. F., C.B.E.	—
Curry, Mr. G. R.	Locomotive and Allied Manufacturers' Association of Great Britain
Dacey, Mr. W. Manning	—
Dalton, The Rt. Hon. Hugh, M.F.	—
Dascombe, Mr. A. W. C.	Bank of England
Davenport, Mr. R. S.	Industrial Bankers' Association
Davies, Mr. G. L.	British Overseas Banks' Association
Davis, Mr. R.	Gas Council
Day, Mr. A. C. L.	—
de Kock, Mr. M. H.	Governor of the South African Reserve Bank
de Vigier, Mr. W. A.	Export Group for the Constructional Industries
Diamond, Mr. J.	Federation of Wholesale Organisations
Doodson, Mr. N.	County Councils Association
Dunse, Mr. J., D.S.C.	Retail Distributors Association Incorporated
Eccles, Sir Josiah, C.B.B., M.M.	Electricity Council
Edwards, Mr. R. S.	Electricity Council
Ellwood, Mr. L. A.	Association of Superannuation and Pension Funds
Erskine, Sir John Maxwell, G.B.E., D.L., J.F.	Scottish Savings Committee
Etheridge, Mr. P. B.	Federation of Wholesale Organisations
Ferrier, Mr. A. N., O.B.E.	North of Scotland Hydro-Electric Board
Fiennes, Mr. M. A.	Federation of British Industries
Fleck, Sir Alexander, K.B.E., F.R.S.	Chairman, Imperial Chemical Industries Ltd.
Fowler, Mr. A. J.	British Overseas Banks' Association
Frazer, Mr. G. D., C.B.B.	Post Office Savings Department
French, Mr. H. J. S., O.B.E.	Issuing Houses Association
French, Mr. W. J., D.S.O., O.B.E., T.D.	Council of Scottish Chambers of Commerce
Frost, Mr. O. H., M.B.E., M.C.	Multiple Shops Federation
Furmston, Mr. J. F.	*

Name of Witness	Organisation represented or capacity in which witness was invited
Gabriel, Mr. H. G. D.	National Savings Committee
Gaitskell, The Rt. Hon. H. T. N., C.B.E., M.P.	—
Gammell, Mr. J. G. S., M.B.E.	Bank Insurance Trust Corporation Ltd.
Gammell, Mr. W. S.	Association of Investment Trusts
Garratt-Holden, Mr. C. G.	Building Societies Association
Garrow, Mr. A., O.B.E.	Scottish Savings Committee
Godber, Lord	Chairman, Shell Transport and Trading Co. Ltd.
Goobey, Mr. G. H. Ross, J.P.	Association of Superannuation and Pension Funds
Gray, Mr. David	Engineering Industries Association
Greaves, Mr. P. J.	Finance Houses Association Ltd.
Greenwell, Mr. G. H., M.C., D.L.	Council of the Stock Exchange
Gregory, Sir Theodore	—
Griffith, Mr. B. N.	British Engineers' Association
Hall, Sir Robert, K.C.M.G., C.B.	H.M. Treasury
Hambro, Sir Charles, K.B.E., M.C.	Part-time directors of the Bank of England
Hanbury-Williams, Sir John, C.V.O.	Part-time directors of the Bank of England
Harrison, Mr. A., C.B.E.	Trustee Savings Banks Association
Harrod, Sir Roy, F.B.A. (Mr. R. F. Harrod)	—
Hawtrey, Sir Ralph, C.B., F.B.A.	—
Hembry, Mr. H. W.	National Coal Board
Hennessy, Sir Patrick	Chairman, Ford Motor Co. Ltd.
Herbert, Sir Edwin, K.B.E.	Association of Investment Trusts
Heyworth, Lord	Chairman, Unilever Ltd.
Hicks, Professor J. R., F.B.A.	—
Hill, Alderman Sir Francis, C.B.E. (Alderman J. W. F. Hill)	Association of Municipal Corporations
Hinton, Mr. Norman	Federation of British Industries
Hollom, Mr. J. Q.	Bank of England
Holtrop, Dr. M. W.	President, The Netherlands Bank
Horton, Mr. C.	Federation of Wholesale Organisations
Hume, Sir Nutcombe, K.B.E., M.C.	Chairman, Charterhouse Industrial Development Company Ltd.
Hunter, Mr. W. S.	British Overseas Banks' Association
Huntrods, Mr. J. W.	Industrial Bankers' Association
John, Mr. A. W.	National Coal Board
Johnson, Professor H. G.	—
Johnston, The Rt. Hon. Thomas, C.H.	North of Scotland Hydro-Electric Board
Jones, Mr. E. C. H., C.B.E.	National Savings Committee
Jones, Mr. F.	Trades Union Congress
Kahn, Professor R. F., C.B.E.	—
Kaldor, Mr. Nicholas	—
Kennet, The Rt. Hon. Lord, G.B.E., D.S.O., D.S.C.	†
Kipping, Sir Norman, J.P.	Federation of British Industries
Kirkpatrick, Mr. R. G.	Industrial Bankers' Association
Knight, Mr. J. F.	Finance Director, Unilever Ltd.
Knollys, Viscount, G.C.M.G., M.B.E., D.F.C.	Chairman, Vickers Ltd.
Knowles, Mr. J.	Farmers' Unions of the United Kingdom
Laing, Mr. J. M.	Export Group for the Constructional Industries
Lawton, Dr. C. L., O.B.E.	Trustee Savings Banks Association
Lee, Sir Frank, G.C.M.G., K.C.B., i.d.c.	Board of Trade
Leith-Ross, Sir Frederick, G.C.M.G., K.C.B.	—
Liddiard, Mr. R. B.	British Federation of Commodity Associations
Livsey, Mr. Percy, C.B.E.	Finance Houses Association Ltd.
Lochhead, Mr. R. K.	British Insurance Association
Lorimer, Mr. Michael, W.S.	Scottish Landowners' Federation
Macartney-Filgate, Mr. J. V., M.C., T.D.	Accepting Houses Committee
McClelland, Mr. W. G.	Multiple Shops Federation
McFadzean, Mr. W. H.	Export Group for the Constructional Industries
Mackinnon, Mr. Angus, D.S.O., M.C., T.D.	Accepting Houses Committee
Mackintosh, Viscount, D.L., J.P.	National Savings Committee
Macnaghten, Sir Antony, Bart.	London Discount Market Association
Makins, Sir Roger, G.C.M.G., K.C.B.	H.M. Treasury
Marsh, Mr. C. H.	Association of British Chambers of Commerce
May, Mr. Paul	Retail Distributors Association Incorporated
McNeil, Mr. Hector	Export Group for the Constructional Industries
McQuin, Mr. B. J.	British Overseas Banks' Association
Mead, Mr. J. R., J.P.	Engineering Industries Association
Meade, Professor J. E., C.B., F.B.A.	—
Meikle, Mr. Alexander	Building Societies Association
Messner, Mr. C. L.	British Overseas Banks' Association
Millhouse, Mr. L. G.	*
Montgomery, Mr. J. A.	Farmers' Unions of the United Kingdom
Morley, Mr. C. D.	Council of the Stock Exchange
Mullens, Mr. W. H. J. de W., D.S.O., T.D.	Government broker
Murray, Mr. A. F.	British Insurance Association
Murray, Mr. L.	Trades Union Congress
Musker, Mr. H., O.B.E., M.C.	British Overseas Banks' Association
Mynors, Mr. H. C. B.	Bank of England
Neil, Mr. Matthew	Council of Scottish Chambers of Commerce
Nelson, Mr. Bertrand, C.B.E., J.P.	Engineering Industries Association

Name of Witness	*Organisation represented or capacity in which witness was invited*
O'Brien, Mr. L. K.	Bank of England
Owen, Mr. R. H., C.M.G., i.d.c.	Export Credits Guarantee Department
Page, Miss G. S.	Federation of Wholesale Organisations
Paish, Professor F. W., M.C.	—
Parsons, Mr. M. H.	Bank of Bngland
Perry-Aldworth, Mr. S. W. P.	British Overseas Banks' Association
Piercy, Lord, C.B.E.	Chairman, Industrial and Commercial Finance Corporation
Pitman, Mr. I. J., M.P.	—
Pittman, Mr. R. A.	British Engineers' Association
Please, Mr. A. L.	Federation of British Industries
Pollard, Mr. C. H., C.B.B.	Association of Municipal Corporations
Pullen, Mr. W. G.	British Overseas Banks' Association
Reid, Sir Edward, Bart., O.B.E.	Accepting Houses Committee
Rickett, Sir Denis, K.C.M.G., C.B.	H.M. Treasury
Riefler, Mr. Winfield W.	Assistant to the Chairman of the Board of Governors of the Federal Reserve System, U.S.A.
Robarts, Mr. D. J.	Committee of London Clearing Bankers
Robbins, Lord, C.B., F.B.A. (Professor L. C. Robbins)	—
Roberts, Sir Alfred, C.B.B., J.P.	Part-time directors of the Bank of England
Robertson, Sir Brian, Bart., G.C.B., G.B.B., K.C.M.G., K.C.V.O., D.S.O., M.C.	British Transport Commission
Rodgerson, Mr. J. S.	British Overseas Banks' Association
Rowan, Sir Leslie, K.C.B., C.V.O.	H.M. Treasury
Rowntree, Mr. R. K.	Retail Distributors Association Incorporated
Samuel, The Hon. P. M., M.C., T.D.	Issuing Houses Association
Sangster, Mr. G. G.	Capital Issues Committee
Sara, Mr. E. T.	Association of British Chambers of Commerce
Sargent, Mr. J. R.	—
Scotcher, Mr. R. B.	British Overseas Banks' Association
Scott, Mr. A. M.	Electricity Council
Self, Sir Henry, K.C.B., K.C.M.G., K.B.E.	Electricity Council
Shenfield, Mr. A. A.	Federation of British Industries
Smith, Mr. F., M.B.E.	Association of Municipal Corporations
Smith, Sir Harold, K.B.E., D.L.	Gas Council
Smith, Mr. J. M. A.	Assistant Managing Director, Ford Motor Co. Ltd.
Smith, Mr. R. D.	British Overseas Banks' Association
Speed, Mr. G. B.	*
Stafford, Mr. J., C.B.	Board of Trade
Stedeford, Sir Ivan, K.B.E.	Chairman and Managing Director, Tube Investments Ltd.
Steel, Mr. J. L. S.	Federation of British Industries
Stephens, Mr. F. J.	Director, Shell Transport and Trading Co. Ltd.
Stewart, Sir Kenneth, G.B.E., J.P.	Trustee Savings Banks Association
Strath, Mr. B.	British Overseas Banks' Association
Suttle, Mr. H. R.	*
Swale, Alderman B., D.F.C., J.P.	Association of Municipal Corporations
Taylor, Mr. Frank	Bxport Group for the Constructional Industries
Thompson, Sir Edward, J.P.	British Engineers' Association
Thomson, Mr. A., O.B.B., J.P.	Trustee Savings Banks Association
Thorneycroft, The Rt. Hon. Peter, M.P.	—
Thornton, Mr. M. J.	Bank of England
Todd, Mr. R. W.	Export Group for the Constructional Industries
Toms, Mr. A. F.	Export Credits Guarantee Department
Tonkinson, Mr. B.	Association of British Chambers of Commerce
Touche, Mr. G. L. C.	Association of Investment Trusts
Trinder, Mr. A. W.	London Discount Market Association
Trustam, Mr. C. F.	British Insurance Association
Tuke, Mr. A. W.	Committee of London Clearing Bankers
Verdin, Lt.-Col. R. B., O.B.E., T.D., D.L.	Country Landowners' Association
Vincent, Mr. F.	Farmers' Unions of the United Kingdom
Walters, Mr. H. A.	British Insurance Association
Waters, Mr. John	Country Landowners' Association
Watson, Mr. T.	County Councils Association
Watson, Mr. William	Committee of Scottish Bank General Managers
Weeks, Mr. H. T., C.M.G.	Federation of British Industries
Whittle, Mr. A.	Federation of Wholesale Organisations
Whyte, Mr. Lewis G.	Bank Insurance Trust Corporation Ltd.
Wilmot, Mr. H., C.B.E.	Locomotive and Allied Manufacturers' Association of Great Britain
Wilmot, Mr. R. T. D.	British Insurance Association
Wilson, Mr. L. A.	British Federation of Commodity Associations
Wilson, Sir Reginald	British Transport Commission
Wilson, Mr. W. S.	British Overseas Banks' Association
Winegarten, Mr. A.	Farmers' Unions of the United Kingdom

* The six witnesses indicated with a * were branch bank managers selected at the Committee's request by the Committee of London Clearing Bankers to give evidence as to their experience of the reactions of customers of the banks to the credit restrictions of 1955 to 1958 (57th day, Qns. 12091 to 13044).

† Lord Kennet appeared on one occasion (24th day, Qns. 6087 to 6248) as Chairman of the Capital Issues Committee, and on a second occasion (53rd day, Qns. 12301 to 12323) in a private capacity.

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIRST DAY

Thursday, 11th July, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. B. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

L. K. O'BRIEN, ESQ., Chief Cashier, and J. Q. HOLLOM, ESQ., Deputy Chief Cashier, of the Bank of England, called and examined.

1. *Chairman*: Mr. O'Brien, we are proposing to start with your Paper No. 4, The Control of Bank Credit in the United Kingdom.* I shall call each paragraph in turn; the questions will come from the Committee and we will follow up each paragraph until we have finished with it ——*Mr. O'Brien*: Yes.

2. *Chairman*: Paragraph 1? Paragraph 2? Paragraph 3? Paragraph 4? *Mr. Woodcock*: Has this 8 per cent. varied over the years?——It has. Years ago it was higher than 8 per cent.—in fact 9½ to 10 per cent.—at a time when the banks used to go in for window dressing. They would come up to their 9½/10 per cent. at a particular point in the month, and each would do it in turn, in effect passing cash from one to another in order to achieve it. Some years ago they agreed to discontinue that practice, and they now keep a genuine 8 per cent. day by day.

3. The sole reason is the drop in window dressing? ——As I understand it.

4. *Professor Cairncross*: The figure of 8 per cent. is conventional? There is no suggestion that this is dictated by the amount of cash the banks would require to issue to the public?——I think it is the banks' view of what they ought to retain in cash in order to meet any likely drawings by the public at any time.

5. The ratio is very different, and sometimes a good deal lower, in other countries?——So I believe.

6. So the main reason why it is maintained is conventional?——Not necessarily so. After all the banks have to consider likely conditions in this country; they have different conditions from other countries.

7. *Chairman*: What does ". . . it has come to be accepted" stand for? It is observed from the monthly statements of the banks that they have this relationship? It is avowed by the banks as being their policy to keep 8 per cent.?——It is the figure at which they work and therefore I would say their policy.

8. *Professor Sayers*: Is it not a matter of policy between the Clearing Banks and the Bank of England?——I do not think we decided that 8 per cent. was a figure they ought to keep. They agreed with us that they should stop window dressing and keep 8 per cent. rather than a slightly phoney 9½/10 per cent.

9. You agreed on the stopping of window dressing, and at the same time you agreed with them that the figure of 8 per cent. which seemed to accord with the actual practice of the past should be maintained as the normal figure in the future?——To that extent, yes. We would have said: "You are keeping a 9½/10 per cent. so-called which is not quite honest. We would rather you had an honest figure and we agree with you that if you keep an honest 8 per cent., that would be reasonable"; but the actual figure—and after all 8 per cent. and 10 per cent. are very much of the same order—is a decision by the banks themselves.

10. You said a day by day figure. I have understood in the past from some—I will not say all—of the banks that in fact it is their Wednesday figure, and that cash is allowed to run down from that figure to a minimum—on Friday afternoon, say, or Saturday morning—and then work up again with the normal weekly influx to the peak of Wednesday. That is a movement within the week that does not necessitate any calling from the market. They simply allow their cash to fall, I understand, below the 8 per cent.?——I do not think there is any regular pattern of that kind. In fact the banks vary from day to day. They would say that a large part of that variation is fortuitous—is because they have added it up wrongly. My understanding is they do not aim at an exact 8 per cent. on Wednesday and a less exact 8 per cent. on the other days.

11. *Mr. Woodcock*: If they did, that would be window dressing again?——Yes.

12. *Professor Sayers*: But the public need for notes varies very greatly during the week?——Yes.

13. There is a great peak on Friday afternoon and Saturday morning, and then on Monday morning the notes begin to come back into the banks. If the banks aimed at a regular 8 per cent. each day—never mind whether they missed it by a point or two some days—they would have to have more cash provided by the Bank of England for Fridays than for Wednesdays. In fact I understood from certain banks that they do not require more cash. They will allow their cash reserve to run down during the week, but only by so much as they consider the normal weekly run-down?——We are concerned, of course, with the 8 per cent. in total, which consists of notes and coins in their tills and also their balances at the Bank of England. We know each morning after a day's operations what they hold at the Bank, how far each bank falls short of or has overshot the target which it has set itself, they having told us in the first instance what they at the present time require to maintain 8 per cent. If a bank falls seriously short we enquire why, because unless the banks keep a pretty regular 8 per cent. throughout the week, throughout the months, throughout the year, it is very difficult for us to do our ordinary management of the market because we never know where we are. We start the day on the assumption that the market will be short of money, and also on the assumption that the banks will require so much. You cannot tell how short the market is going to be unless you know what the banks will require. If the banks were to run their balances down during any particular day our idea of the state of the market could be completely falsified. From time to time that happens because, as I say, they get it wrong—and I will not deny that on occasion some may do it deliberately. That might happen on a Friday. They might have been content to be the other way—over—on a Friday in order to avoid having to make painful adjustments on Saturday. But it is understood by us that

* Memoranda of Evidence Part I No. 4.

they endeavour to maintain 8 per cent. pretty consistently throughout the week as a general rule.*

14. *Chairman*: Would it be right to say that so far as the Bank of England has exerted influence on the banks, it has supported the 8 per cent. ratio?——Yes.

15. When was that correction made?——I cannot off-hand recall the date, but I can get it for you.†

16. More or less immediately post-war, I imagine?——I should think so.

17. *Professor Cairncross*: My understanding is that at one time in the 'twenties one particular bank reduced its cash ratio deliberately and that that reduction was not regarded very favourably by the Bank of England at the time, but did lead to a general fall. Is there anything to prevent the same thing happening again, except the disapproval of the Bank?——If the banks in general were to revise their views on what they need to hold in the way of cash, and if they were able to persuade us that it was a reasonable revision of opinion on this subject, I expect we should agree that it should be done, but obviously we have influence in such decisions.

18. *Chairman*: But would your interest in it be what amount of cash would be needed as a ratio to provide the full readiness of the bank to meet its cash claims, or would it be some other reason?——That would be the first reason, under existing arrangements. Under any revised arrangements we might take quite a different interest.

19. As things stand, you would be interested in the untouched reputation of the banking system?——Yes.

20. *Professor Sayers*: As things stand is not your interest in the banks maintaining a pretty well fixed ratio?——Yes.

21. That is your interest as controllers. From that point of view it would not matter whether it were 5 per cent. or 8 per cent. or 20 per cent.?——From that point of view, no. If we never knew where their cash was I think our market management would be made much more difficult.

22. *Professor Cairncross*: I think Mr. O'Brien was going further, and saying that the figure had to be 8 per cent. at least to meet the requirement set out in paragraph 3 that each individual bank should be able to provide its customers with cash whenever called on.——Yes, I think it is true to say that at the moment it is generally regarded as a reasonable figure to hold in cash in order to be certain to meet all such demands, and to make customers feel that such demands can at all times be met.

23. Supposing the banks put it to you as a body that it should be 6 or 7 per cent., would you be able to dispute that?——It would be a question of one point of view against another point of view. We have our views on all these subjects which might differ from the banks, and might influence the banks.

24. *Professor Sayers*: At this point my idea of what happens during the week becomes highly relevant. As I understood it, the Friday night figure probably runs down to something like 5½ or 6 per cent.; that is, 2½ per cent. is about the amount of notes that goes out at the weekend. If in fact the authorities provide that weekly expansion of cash, then 8 per cent. begins to look extraordinarily high from the point of view of the commercial bank, does it not? On the other hand, if the commercial banks allow this weekly run-down at the weekend, then 8 per cent. does not look so extraordinarily high?——I can only speak of the facts as we see them doing our operations day by day, and we have no evidence that the banks allow their cash to run down regularly to Friday each week: on the contrary I should say it is more usual than not for Friday to be high rather than low. It just happens that Friday is a day when the banks receive a lot of cash by way of Government disbursements, in the same way as Thursday is a day for paying out to the Government.

25. You mean their balances at the Bank?——Yes, part of their cash.

26. *Professor Cairncross*: The note issue might be different?——The notes in tills might be down at the end of the week. We do not for that purpose look at one separately from the other. We are concerned with the overall 8 per cent. figure which consists of notes, coin and cash with us.

27. *Mr. Woodcock*: Did I understand you to say that your interest is solely in the ability of the banks to meet demands for cash?——Not solely. That is the consideration which led them to set 8 per cent. as their normal figure, and we have agreed with them that that is a reasonable figure. We have an interest in that 8 per cent. as a fixed point, so to speak, in the various matters which we have to look at in managing the market week by week, and if it were not a reasonably fixed point our processes of market management would be more difficult.

28. If the banks made a case from their point of view for, say, 6 or 7 per cent., you would be very considerably involved in that?——If we agreed with them that it was a reasonable revised figure for their purposes of holding cash to meet calls by their customers, we would be just as content from the point of view of market control with 7 per cent. as with 8 per cent., as long as it still remained a reasonably fixed point.

29. *Professor Cairncross*: I think that this is a little relevant to the suggestion that is made from time to time that cash ratios might be specified by law: that is partly why we are putting these questions to you. Each individual bank would be differently placed, would it not? The cash ratio required might be very different in a small bank from what would be required in a large bank?——It could be, I suppose.

30. It depends a little on the fluctuations of payments to be made?——Yes.

31. If it is true that you find there is not very much day to day variation, then of course regulation of the ratios might be easier than if there were violent fluctuations?——I will not say that there is not in practice much day to day variation; there is quite a lot, but I would say that the banks try to set 8 per cent. more or less continuously. They fail for a number of reasons, quite often some that they cannot help and others that they could perhaps help a little more; and it is not infrequent for us to go round to them and say: "You are not keeping to your 8 per cent. very well; what about trying harder?"

32. Acting as policemen without any law?——Yes.

33. *Sir John Woods*: For what sort of reason would a commercial bank deliberately not keep to its 8 per cent.?——It might be that it knew that on the following day it was going to get a great deal of cash when it would have much more than 8 per cent.; rather than call money from the market to restore its 8 per cent. on Thursday it would wait for the cash on Friday to restore it without any effort.

34. You would regard that as naughty, because inconvenient to you?——If it were persistently indulged in it would make our task more difficult.

35. *Mr. Jones*: Does the increase in the fiduciary issue at holiday time and Christmas time have any serious effect on the liquid balances of the banks?——Not as such. It is merely a preparation for increased withdrawals of notes which we expect to take place, and so the banks' balances with the Bank of England are drawn down to pay for the notes.

36. *Chairman*: Within what sort of limits do these variations from 8 per cent. appear?——These matters are not solely of course within the control of the Bank. We smooth out excesses and shortages of money from day to day. On some days it may suit us not to smooth out. If we leave the market—which of course has its own recourse to the Discount Office of the Bank to get money—with more cash than it requires there is nothing it can do; the money is unlendable, and in those circumstances the banks would be well above their 8 per cent. involuntarily.

37. Does "well above" mean one per cent., or two per cent.?——*Mr. O'Brien*: It would be rare, I think, for the notes and balances at the Bank, the 8 per cent., to be more than one per cent. above.—*Mr. Hollom*: Not as much—perhaps 7·5 or 8·5 per cent. would be a wide variation.

38. *Professor Sayers*: Would one per cent. imply £2 million unlendable in the market? It sounds an extraordinarily high figure?——*Mr. O'Brien*: There has

* See Appendix to Minutes of Evidence, note to Qn. 3849.
† See Appendix to Minutes of Evidence.

often been much more than £2 million. Let us take a rather exceptional example. At the end of the half year and at the end of the year the bankers' balances tend to be higher than during the rest of the year. It is customary on those occasions as far as possible to make the market borrow that excess from us so that it quickly runs off; it has to be repaid in seven days. It may be that until it is run off bankers' balances will be very high indeed. Let me just make one point clear: you may have been thinking of one per cent. of deposits: I was thinking of one per cent. of cash.—*Sir Reginald Verdon Smith*: I was thinking of the difference between 8 and 9 per cent.

39. *Professor Sayers*: May I come to the half-yearly variation. If we ignore for the moment the Scottish banks and outside banks generally and confine ourselves to the London clearing banks, their half-yearly balance sheets show not 9 or 10 per cent. but pretty closely 8 per cent. They appear to have the same cash ratio for those dates as in their monthly statements. If they in fact worked to 8 per cent. on a daily basis, that yearly and half-yearly making up of balance sheets would not occasion any shortage of funds on the market. But 30th June and 31st December fall, more often than not, on some day other than Wednesday, and it is because of that that there is a shortage in the market. If 30th June falls on Wednesday there is not the same shortage because they are working to 8 per cent. anyway on that Wednesday. If 30th June falls on a Friday, then, in order to make their 8 per cent. appear in their balance sheets, the clearing banks have to call on an abnormal scale. Is it not only because there is this weekly run-down that the half-yearly balance sheet means heavy calls by the clearing banks (excluding now the Scottish banks and outside banks generally)?——I think that question is one which should be addressed to the clearing banks themselves. I can only give you our understanding, that at the half-year and end of a year their balance sheets are inflated both by special entries of their own and, I think, by action taken by important customers. I would not say that that has any bearing upon the 8 per cent. that they maintain throughout the year, and I would still say that in fact there is no sort of regular pattern of run-down.

40. *Chairman*: There is another question I should like to ask you, on the latter part of this paragraph. You say:—

"As a general rule the banks will be very reluctant to see the ratio to their deposits of their cash plus other liquid assets—their 'liquidity ratio'—fall below 30 per cent."

That is based, I suppose, on the view that it would be dangerous from their point of view if they did allow themselves to be less liquid?——Yes. That again is a convention, but it is nowadays a pretty well established one.

41. You continue: ". . . and at times they will be content to see it somewhat above 30 per cent."?——We are painfully aware of that.

42. Why "painfully"?——Because in present times it rises far above 30 per cent. when we would rather see it closer from the point of view of credit control. Liquidity is influenced by the issue of Treasury Bills by the Government throughout the year to finance its needs, Bills being issued mainly in order to finance the Government through the first nine months of the financial year, pending the receipt of revenue through the last three months. During those last three months there will be heavy demands on the banks for cash by their customers to pay in revenue. The banks would be content to see themselves more than usually liquid in the immediately preceding months, knowing that they will come into difficulties in January and February and so on. That is the pattern. Correspondingly, by the time they get to April, they are frequently at a low level of liquidity, but they would look upon that with some complacency knowing the normal pattern: the Exchequer will be borrowing more heavily in succeeding months and liquidity will restore itself.

43. So far as they are provided with excess liquidity, they are protected from the money market?——Not so much that; they have more elbow room in which to expand deposits if they wish to do so.

44. *Professor Sayers*: They attend to their 30 per cent. liquidity over the year in much the same way as I have imagined that they attend to their 8 per cent. cash over the week: they are content to see their liquidity ratio vary over the year provided it does not fall below about 30 per cent. in March?——The statement about the cash is one which I think should be checked with the banks themselves. My understanding may be imperfect on that, but I would agree, if one takes that assumption, that how they look after their liquidity is very much on the same lines.

45. *Mr. Jones*: As I understand it, 8 per cent. of the deposits is the working safeguard of the stability of the banks to meet demands over the counter, and the 22 per cent.—the 8 per cent. and 22 per cent. together making up the liquidity ratio—the 22 per cent. is something that is working, earning money?——Certainly.

46. To the extent that that 8 per cent. runs down, I take it that they realise some part of the 22 per cent. in order to have a working balance available?——That is correct.

47. Is there very much activity in the realisation of short-term bills and the rest in this 22 per cent. liquidity?——A great deal.

48. To what extent do they run down liquidity in those circumstances? Could you see liquidity ratios run down as low as 20 per cent.? Would you be nervous if that happened?——*Mr. O'Brien*: The banks would not allow it to happen, and we should not be happy to see them allow it happen. The fact is that 30 per cent. is the point when they begin to get uneasy.—*Mr. Jones*: You are above blood heat below 30 per cent.

49. *Sir Reginald Verdon Smith*: I would have thought that 8 per cent. was a norm, but 30 per cent. was a minimum?——*Mr. O'Brien*: By and large, yes.—*Professor Sayers*: I would have thought 8 per cent. was a maximum and 30 per cent. a minimum.

50. *Professor Cairncross*: Is 30 per cent. a minimum? How well established is this convention and is it one to which you attach the same importance as you do to the 8 per cent. ratio, in the sense that you are able to go along to a bank and remonstrate?—Certainly.

51. You attach exactly the same importance?——In some ways more.

52. Nowadays; but did anyone mention it before the war?——I do not think anybody can say precisely when the 30 per cent. convention became as important as we now believe it to be. I think that, at the time when the Macmillan Committee was sitting, the banks did in fact hold more or less 30 per cent. in this way, though not so much attention was focused on it then as is focused on it nowadays.

53. I would like to be quite clear on this. I have seen attempts to check this—I do not know that they were very good attempts—and it did not seem that 30 per cent. was preserved uniformly throughout the banking system in pre-war years or even, for that matter, in post-war years?——The post-war years were very much befogged by things like the Treasury Deposit Receipt; according to whether you include or exclude those you get a very different figure. I will not deny that it seems to be a comparatively recent thing, but I could not say when it first assumed the sort of importance which we now believe it to have.

54. I would like to get to the bottom of how the convention is established. Is it something which the banks, in their discussions with you, avow as their policy?——I believe, Mr. Chairman, the Governor could probably answer these questions better than I, because it is he who has discussions with the banks on these things. I must not say anything to prejudice what he says on these matters, but I believe that it arises in the first instance from what the banks think it is reasonable to hold for their purposes as good bankers, and that this is given more precision in agreement with us, because obviously it is easier to keep control and keep an eye on things which are fairly precise than if they are all over the place. But I would prefer him to say if that is wrong, or to remark upon it*

55. *Professor Sayers*: Is it not a fact that from your point of view of control, as with the 8 per cent. so with

* See Qn. 1754.

the 30 per cent., it does not really matter whether the minimum is 20 per cent., 30 per cent., or 40 per cent.: what matters is that there should be a yearly minimum?——For control purposes, yes.

56. And it is simply the fact that 30 per cent. has grown up in the banking system as the convention that has made you take it?——Yes, though I suppose from the point of view of control, the lower it is the bigger expansion you can have on the base.

57. There are two ways of looking at it. There is the multiplier effect, but there is also the point of view of debt management, and from that point of view your interest now would be to have a very high ratio?——Yes.

58. *Sir John Woods*: Is there any similar conventional figure in any other banking system, for instance the Federal Reserve system, and is it round about 30 per cent.?——I feel sure there are conventions of that kind, but I cannot be more precise. At a later stage I would hope to give you more information on what other countries do.

59. *Chairman*: A banker carrying on his business for profit has no wish to be more liquid than security requires?——Certainly; for he makes nothing out of his cash, and less out of his remaining liquid assets than out of advances and investments.

60. *Mr. Jones*: Would he get Bank Rate out of his liquid resources or less than Bank Rate?——Less than Bank Rate, because most of his liquid resources would be invested in Treasury Bills, on which he would receive at the present time approximately £3 17s. per cent. as against the Bank Rate of 5 per cent. He would in fact get less than £3 17s. per cent. because he does not buy them at tender, but after they have run half their life at the market rate.

61. *Professor Sayers*: The 22 per cent. is a cushion for the 8 per cent. On the face of it it looks rather a big cushion?——Yes.

62. *Chairman*: Are there any more questions on paragraph 4? Paragraph 5?——*Mr. Woodcock*: You say: "An individual bank may in normal times seek to adjust its position by bidding for deposits". How does a bank bid for deposits?——In normal times there is competition between the banks for customers.

63. What form does it take?——Taking one customer away from his bank by offering better services.

64. Not better rates?——It might be. The banks are operating under a self-denying ordinance during the period of the "credit squeeze", when they are responding to an official request to restrict their advances, and they are not competing for advances. A customer might go to his own bank and ask for an advance for a particular purpose, and that bank, turning down the request in the interests of national policy, would not expect one of its competitors to take the business away, but normally that might happen.

65. Do they go out deliberately to seek deposits?——I believe the bankers would be the best people to answer that.

66. *Chairman*: What is the argument in this sentence? We are envisaging a bank which is trying to restore its cash ratio. You say:—

"An individual bank may in normal times seek to adjust its position by bidding for deposits. . . ."

That means it is going to improve its balance at the Bank of England by getting a transfer from another bank, and so improve its position as an individual bank?——Yes.

67. *Sir John Woods*: I am a little puzzled by this. You say:—

"If the ratio shows signs of falling further, they will take steps to prevent it from doing so, if need be reducing their deposits. . . ."

Then you go on to say:—

"An individual bank may in normal times seek to adjust its position by bidding for deposits. . . ."

It sounds contradictory. Are you talking of different kinds of deposits? Is it seeking deposits of cash?——No. I think the reducing of the deposits comes at a later stage. Let us start from the beginning. Supposing that there is adequate cash in the market held by the banks as a whole to enable them all to cover their 8 per cent. in notes and balances at the Bank of England, but that as a result of a day's operations cash shifts from one bank to another. One bank may find itself short of cash. If it does it will call money from the discount market to restore its cash. But, since there is adequate cash for all on the market, another bank which is over will lend to the discount market which, as a result, will square its books, and everybody is happy. This sentence envisages that one bank short of cash might restore its position either by getting deposits transferred to it from another bank or by the more normal method of calling from the discount market.

68. *Mr. Jones*: Is it the discount market all the time that is adjusting this equilibrium, and nobody else? Is there no direct association between one bank and another?——No, it is the discount market all the time. That is one of the main functions it fulfils, and we believe a very valuable one. If the banks had to deal directly with each other it would undoubtedly be a much more clumsy business. The discount houses go round and find out the position, whether banks are going to call money or have money to lend. Then they balance their books and see how the day is going to come out. As the day goes on they see more and more clearly what the position is going to be. Later they may decide there is not enough money—more people are drawing out than paying in——

69. There must be a tremendous amount of liquidity about the discount market?——Yes, they are essentially liquid from that point of view.

70. *Sir John Woods*: I am still not clear about this. I am talking about not the cash ratio but the liquidity ratio. If there is a fall in the liquidity ratio caused by loss of cash, their first reaction would be to restore their cash?——Yes, they always can.

71. If the slide still continues, they will try by various means to restore their cash, while continuing to bid for deposits. If it goes still further then they will try to reduce their deposits and reverse the process?——Yes, because they would have less than the percentage of liquidity they would like to have, and they can only restore that either by realising investments or by reducing advances.

72. *Chairman*: Paragraph 6? *Sir Reginald Verdon Smith*: Is the operation of retiring Treasury Bills performed by the Exchequer or by the Bank of England for the Exchequer?—We perform it for the Exchequer.

73. Does it happen purely on a chronological basis, first Bills first, or how is it done?——This is mainly done in the first three months of the year, when revenue is coming in; the Exchequer has a great deal of money and the market is very short of money. We would buy Bills in the market in order to put cash back into the market, keeping the banks' cash at 8 per cent., but reducing their liquidity, because we are taking the Bills away from them.

74. So that the sources from which the Bills come when retired are not susceptible of control? That is entirely a market question?——They come from the market. They might come from discount houses, or the banks, or they might even come from outside holders; and what is bought depends upon what we consider desirable to buy for the purposes of market management.

75. I asked the question because the last sentence in that paragraph starts:—

"For to the extent that the Treasury Bills so retired were held by the banks . . ." etc.

I wondered whether that was something about which you had any knowledge in advance, or whether it was wholly casual or fortuitous?——We have a certain amount of knowledge but not complete knowledge.

76. *Mr. Jones*: In the event of the situation referred to in the last sentence in paragraph 6, the 8 per cent. would be substantially increased and Bills and other liquid short-term holdings would be less?——No, the 8 per cent. would not be increased. They would restore their cash to the 8 per cent.

77. Yes, but to the extent the Treasury Bills so retired were held by the banks themselves, their liquidity would be reduced?——Yes.

78. In compensation for that reduced liquidity you have bigger deposits, more cash with the banks? *Chairman*: I am rather puzzled by this too. I think that it would be

helpful if you worked through the whole process. It begins with a drawing of money from the taxpayer to the Exchequer?——Yes. The first thing is that we all of us, paying our taxes, draw cheques on our banks and those cheques are in favour of the Inland Revenue, a public account at the Bank of England, and the money therefore comes off the deposits of the commercial banks, off their bank balances at the Bank of England and is transferred to the Exchequer. Therefore the commercial banks in the first instance have lost their deposits; we—the taxpayers—have paid them to the Exchequer. In the initial process the banks have lost cash because they have paid out. They must have their 8 per cent. of cash; they restore that from the discount market or maybe by selling Treasury Bills; in other words by reducing their liquid assets. So the final broad analysis is that, to the extent we have paid taxes to the Exchequer, total deposits at the banks have been reduced by that amount, and the reduction has taken place within their liquid assets in their call money or Treasury Bills, so that the banks' liquidity has come down. Their cash has remained virtually unchanged because they remain in a position to restore it and they have no reason to have it lower than the 8 per cent. they normally keep.

79. *Chairman*: If you use the money paid for taxes to retire a Treasury Bill, the payee creates a new deposit with the money he receives?——That was a variation which I did not explain. I said that the bank in restoring their cash would do so by calling loans from the discount market; that is in fact what they do, but if the discount market is losing the money which the banks have left with it it must get money from somewhere to be able to carry its book of Treasury Bills and so forth. If we at the Bank are retiring Treasury Bills we relieve the market of its shortage by taking the bills off and putting the cash back. We put back the cash which the banks are drawing from the market to maintain their 8 per cent.

80. *Mr. Jones*: The credit you are receiving in Treasury Bills is reduced? You are losing that amount of your responsibility for Treasury Bills?——Yes.

81. *Professor Cairncross*: In the first instance there is an equal drop in the assets and liabilities of the banking system. The question is what happens subsequently if the whole of the funds then obtained by the Government are applied to the redemption of debt and all Treasury Bills involved are taken from the banks? You bring in the discount market here. What happens if the whole of the money is then returned to the banking system directly through the purchase of Treasury Bills from the banks?—*Mr. O'Brien*: The whole of the money, of course, is not returned to the market; only sufficient is returned to restore their 8 per cent., and it is returned by buying Treasury Bills in the market.—*Professor Sayers*: It is a lower amount because the deposits are down.—*Professor Cairncross*: Much lower. If the whole of the money were returned to the banking system the deposits would be recreated.

82. *Chairman*: That is what I am still puzzling over. In paragraph 6 you are talking about retiring Treasury Bills, by which I understood you to mean paying them off.—*Mr. O'Brien*: They are taken into the ownership of the public departments. We buy the Bills from the market for cash, take them into the internal portfolios of the public departments, where they are held until they mature and are paid off in the normal way.

83. *Lord Harcourt*: You do not in fact repay the Bill; it continues to run for its full period, but with the interest on it (represented by the discount) payable from the Exchequer to some other public account?——Yes, because the department concerned has bought the Bill at the market rate and benefits from the discount for the rest of its life. It is a question of mechanics. To cancel Bills in the middle of their life is not easy.

84. *Mr. Jones*: What is their life to maturity?——91 days normally. We do issue some nowadays of 63 days towards the end of the year to help in smoothing out the revenue surplus in the early part of the year.

85. *Professor Sayers*: When the inflow of tax payments allows the authorities to retire Treasury Bills (those Treasury Bills being held by the banks at the end of the process), there are not merely less Treasury Bills in the financial system but there are also less deposits?——Certainly.

86. And that remains so even when all the ratios have been restored?——Yes, because if the banks are going to restore the liquidity ratio, assuming that that bad got below 30 per cent. as a result of the operation, they could only restore it by reducing other deposits, selling securities or reducing advances.

87. *Chairman*: Why does this operation produce less deposits? You begin with the deposit of a taxpayer with his bank; he transfers that to a public account by paying his tax. The money is then used to put money back into the market by acquiring a Treasury Bill which is passed back to the public departments. The money so received in exchange for a Treasury Bill creates a new deposit?——I think the short cut to this would be as follows. Supposing heavy tax payments were being made by us all in this period, and it were possible for the banks to pay by tendering Treasury Bills to the Exchequer: that would reduce the banks' deposits by those amounts, these being assets which they have held against liabilities which had been extinguished because they have been paid to the Exchequer. It would be easier to say that deposits would come down by that amount, which in effect is what happens.

88. *Lord Harcourt*: Is this not really a question of where the liquidity ratio operates? When I pay my tax, say £100, my bank's deposits are reduced by £100, but you only go into the market and replace 30 per cent., £30. ——Perhaps I am confusing you a little by going through the whole process and referring to cash. Working from the point that the banks will always strive to keep 8 per cent. in cash, subject to any deposit variation, let us leave the cash alone. Supposing they say: "We must have 8 per cent. cash; we have 8 per cent. cash and we intend to keep it, therefore we will not pay these liabilities by cutting our cash; we will call on some of our other assets, Treasury Bills, and we will pay by putting Treasury Bills into the Exchequer". In the last analysis that is what happens. They must have their cash back; having paid cash first they must have the same amount back. They in fact meet these liabilities by running down their liquid assets.

89. *Chairman*: Are there any more questions on paragraph 6? Paragraph 7? Paragraph 8. You say:—

"Emphasis has been placed above on the liquidity ratio because a loss of cash need not in itself cause the banks to fail to maintain their cash ratio at 8 per cent. of deposits or bring them under pressure to reduce their deposits."

Then you go into the facility with which the banks can restore their cash by calling on the discount market.——Yes, and it in turn calls on us if it is short.

90. You say:—

"Since . . . the Bank of England will never refuse to lend to one of the recognised Discount Houses, at a price (now normally Bank Rate) and given satisfactory security, the authorities will end by returning to the market the cash they had previously drawn in."

What is the origin of this rule which, *prima facie*, thwarts the policy, with which we began, of trying to keep money short?——If the discount houses, having been to all the banks and found out what they are doing, whether calling cash or lending cash, have finally come to the conclusion that the supply of cash on that day is not going to be sufficient to enable them to carry their books of Treasury Bills and short bonds, they can come to us, and we can repair the shortage in one of two ways. The Chief Cashier can buy bills from the market at the market rate. There is no pain to the discount houses; they merely exchange part of their bill portfolios at the going market price for cash. That puts them square. If we are not disposed to help them in that painless way, they then have to come round to the Discount Office, and nowadays borrow at Bank Rate on the security of market Treasury Bills or short bonds. If neither of those facilities were available, and particularly if the second were not available —because that is the lender of last resort in operation— the market would not be certain of being able to carry the amount of Treasury Bills which the Government needs to issue to finance its requirements, and the system would not work.

91. At the time when you want to make the cash short, you provide the way through the Bank by which the discount market's position is restored?——We make cash short, and we can virtually always do that when we wish to do so, primarily in order to influence rates in the market. If the discount market has to borrow a substantial amount from the Discount Office at Bank Rate, substantially above the market rate, the rates for money generally go up; the cost of the finance it has acquired is increased, and rates rise.

92. *Professor Cairncross*: Surely if you were not acting as a lender of last resort Bank Rate would be inoperative and the rates would be higher. If the banks needed money, they could sell investments and get it that way, but the whole structure of rates would move above the structure which would be indicated by the Bank Rate and the simpler way is to raise the Bank Rate. If you feel reluctant to act as a lender of last resort, you express your reluctance by an increase in the Bank Rate?——If we are only lending as a lender of last resort, that makes the cost of money which the market needs for its requirements rise, and the more it comes to us for money the more the cost of money rises, to the point where market rates would be close to—if not up to—Bank Rate, in which case the Bank Rate would no longer have a penal effect on the market.

93. That is what I was trying to suggest, because where you are acting as lender of last resort, you are lending at Bank Rate?——Acting as lender of last resort, it is at Bank Rate. The other method, of buying in Bills, is not lending; it is putting cash out in exchange for securities.

94. *Sir John Woods*: When the discount market requires, you lend at a price "now normally Bank Rate". In what circumstances do you lend not at Bank Rate?——Nowadays not at all. In the past we have lent at ½ per cent. above Bank Rate, and in 1951 there was a special rate ½ per cent. below Bank Rate.

95. We really could cross out "normally" here?——We reserve the right to charge more than Bank Rate, so I would prefer to keep "normally".

96. *Professor Sayers*: It is a fact that Bank Rate remains a minimum, and that you reserve the right to charge a discount house or other customer more than the announced Bank Rate?——Yes, we reserve the right. And of course the other minimum is that we lend to the discount market for a minimum of seven days, which makes the penalty that much greater. And if we lend large amounts we may decide that we shall lend no more than a certain amount for seven days, and then go on to eight, or nine.

97. *Mr. Jones*: Why does that make the penalty greater?——They are paying a higher rate for seven days instead of only for one day.

98. *Professor Cairncross*: Your object is really to dictate the complex of interest rates. When you say you are a lender of last resort, that means that, once you have got the rate of interest where you want it, you are prepared to sustain it by providing cash. Is not this in effect what you are doing?——If we wanted to raise interest rates, then we would give less or possibly no help in the ordinary way, and we would say: "If you want cash you must come to the Discount Office for it". And moreover we could if need be so arrange things that the market needed a great deal of cash; the influence can be graded almost infinitely.

99. *Professor Sayers*: May I put it this way? You keep the market tight in order to put a floor under interest rates. You operate as a lender of last resort at Bank Rate in order to put a ceiling. If you did not operate as lender of last resort the system would break down by interest rates rising to the sky?——Operating at Bank Rate through the Discount Office does not effectively put a ceiling, because if you pulled market rates right up by that procedure, in order to retain a penalty you would have to raise Bank Rate.

100. *Professor Sayers*: You could raise your ceiling if you chose but if you did not choose that would be the ceiling?——It would be the ceiling, but it would not serve any useful purpose because if market rates rose to that point the penalty would have disappeared.

101. *Professor Cairncross*: But you could have a Bank Rate that was fixed and yet it would be possible for rates to climb above that rate, if you withdrew, and ceased to act as a lender of last resort?——If we were no longer a lender of last resort the system would break down.

102. *Chairman*: Could you analyse what you mean by saying the system would break down?——It would break down because the discount market, not having any assurance that it would have the necessary cash available, would not be prepared to cover the Treasury Bill tender and thus ensure that the Government got each week the money that it required for its disbursements. Moreover, without the assurance of adequate cash the banks could not be certain that they would be able to maintain their 8 per cent. cash ratio, because the banks cannot create cash. If it was gradually being withdrawn and not being restored, they would be placed in that position.

103. They have large investment funds to draw on?——Yes, but if they sell their investments in order to get cash they can only get cash out of the diminished pool.

104. *Professor Sayers*: They cannot sell unless there is cash to buy?——No.

105. *Professor Cairncross*: There is cash; one would get by, but with much higher reserve ratios and a quite different structure of the market. As you say the system would break down, but there would be a different system, not perhaps a satisfactory one. Could I ask one specific question of you? You mentioned short bonds as well as Treasury Bills as being eligible for discount?——Not for discount; as security against advances.

106. These are short bonds of what maturity?——Up to five years.

107. Any Government bonds up to five years, or particular named ones?——Any Government bonds up to five years.

108. *Mr. Woodcock*: Is no commercial paper accepted?——It has been in the past. It is the Treasury Bill in particular that has so outshone commercial paper; now they almost invariably put in Treasury Bills.

109. *Lord Harcourt*: You do not accept finance bills of any kind?——No.

110. *Professor Sayers*: The Bank Rate is not merely a discount rate but also the rate at which the bank will make advances to discount houses for the minimum of seven days against the security of Treasury Bills or short Government bonds. In the old days the advances rate, which also applied to advances against commercial bills, was ½ per cent. above the Bank Rate. If a discount house puts in commercial bills now, is it charged Bank Rate or is it charged ½ per cent. above?——It would be charged Bank Rate.

111. Are there in fact any cases in recent years of paper other than Treasury Bills and short bonds being put in?——*Mr. Hollom*: I think not. In recent years there has been an advantage in borrowing against Treasury Bills rather than in discounting commercial bills, in that an advance against Treasury Bills is taken for seven days, but if commercial bills are offered for discount we insist on a rather longer period, a minimum of 15 days and an average life of 21 days. It is therefore equivalent to taking an advance for a longer period and is less attractive to the borrower.

112. *Lord Harcourt*: Am I right in inferring from that that you do not accept commercial or bank bills as security for advances, that they can only be discounted?——No, they are acceptable as security for a seven-day advance, but in practice usually Treasury Bills are offered because they are generally available to the borrower and are more easily handled.

113. *Chairman*: What you are concerned with is to get as perfect security as you can; the distinctions are all based on that?——*Mr. O'Brien*: Yes—first-class security.

114. But apart from that anything that could be regarded as first-class would be equally congenial?——The security which we would accept has been formally laid down by the Governors.

115. *Professor Cairncross*: For instance, if it was in connection with hire purchase, you would not be too happy?——No.

116. *Chairman*: What are the various policy distinctions?——As for security for advances to the discount houses, that is merely a question of getting first-class security for an advance. I do not think policy decisions

enter into that, except that we define the security—Treasury Bills, short bonds and acceptable commercial bills (which, as I say, are a completely unimportant element in these days). The question of the Bank buying commercial bills for its own portfolio as a means of sampling the market and seeing that the quality of the bills is all right is a separate question.

117. Does the Bank buy various kinds of obligations in order to find out by experience whether they are valid and good?——It buys first-class commercial bills for its own portfolio as an earning asset, and in so doing sees what kind of bill is circulating in the market—whether too much of one kind of bill is circulating or whether too much of an indifferent kind of bill—and generally keeps an eye on what is going on in the market. That is a different function of central banking, outside this function of money market control.

118. *Professor Sayers*: When the bank buys a parcel of commercial flavour does it insist on the bills being accepted by London accepting houses?——Yes.

119. That enables the Bank to keep an eye on what the accepting houses are doing? It does not enable it to keep an eye on what the discount houses are doing in the way of buying commercial bills?——No; its prime interest is to keep an eye on the quality of bills and what the acceptors are doing.

120. The Bank is only thereby keeping an eye on the accepting houses and not on the discount market. May I develop that a little? If the discount houses buy the bills accepted by American banks in London they cannot put those bills into a parcel that goes to the Bank. They may nevertheless be holding such bills—they might be holding from some points of view too many of such bills—but the Bank's operation in this particular would not be checking that at all; it is simply checking the activities of the London accepting houses?——*Mr. Hollom*: That is true, I think, but there is of course an automatic limit of a kind to the extent which discount houses can afford to carry bills which are not accetable at the Bank of England; that is, the extent to which they can be sure of either disposing of them elsewhere or borrowing against them elsewhere, or the extent to which they can afford to carry them on their own capital knowing that they perhaps cannot discount or place them elsewhere.

121. But are not these commercial considerations for the discount houses, not subject to any check by the Bank of England? I am only wanting to establish the point that the Bank's operation in this buying of parcels is a check on the working of the accepting houses, not on the working of the discount houses?——*Mr. Hollom*: Primarily, yes; but it is perhaps an exaggeration to go further and say there is therefore no check on the discount houses.—*Mr. O'Brien*: It would certainly be an exaggeration to say that.

122. *Chairman*: Are there any more questions arising out of paragraph 8? Paragraph 9? Paragraph 10?—*Sir John Woods*: I am not quite sure that I follow paragraph 10 entirely. The banks transfer a cash shortage to the discount market only by exchanging other liquid assets for cash. You go on to say:

> "Whether this process leaves them with a shortage or near shortage of liquid assets determines whether the banks come under pressure to reduce or restrict the credit they create."

If they exchange liquid assets for cash does not the total remain unchanged?——We are back, I think, to the same point, that when the revenue is flowing in, the banks will want to keep their 8 per cent. in cash, and, although revenue may be paid with cash in the first instance, that cash must be restored, so that in effect in the last resort payment is made by disposing of Treasury Bills, the cash remaining at 8 per cent. The Treasury Bills contained in the remaining 22 per cent., the liquid assets, are reduced; therefore overall liquidity is reduced, and deposits. And if that reduction goes below 30 per cent. the banks would he anxious to bring it back to 30 per cent.

123. I still have not quite followed it. If you are short of cash and you can only rebuild your cash by reducing by the same amount your other liquid assets, it looks to me on the face of it as if your total liquid assets, including cash, remain the same.——No. Supposing you have cash, and liquid assets; if you lose cash you can only restore it by paring away from liquid assets.—*Mr. Hollom*: The word "process" includes the stage of losing cash in the first instance.

124. *Mr. Jones*: Could Mr. O'Brien give us the meaning of paragraph 10 in relation to what is said in the middle of paragraph 8? It gives an illustration. Then it follows up that illustration by saying:

> "The bank concerned can, however, restore its cash if required by calling for repayment some of the funds it has lent to the London Discount Market."

Now this question in paragraph 10 deals with the transferring of a cash shortage from the banks to the discount market. Could you associate the two statements?——*Mr. O'Brien*: Yes. The cash having been lost from the system in the first place by being transferred, shall we say to the Exchequer, the 8 per cent. which the night before was sufficient to satisfy all requirements is reduced by that amount.

125. It could be reduced to 7 per cent. if it was a big sum?——Yes; the figure is reduced, and it must be restored, since they must keep that amount in cash. In effect it can only he restored by disposing of part of their liquid assets. The authorities will give back the cash which the banks have given them provided the banks will part with some of their liquid assets in exchange.

126. It is a case of securities in exchange for cash?——The securities, i.e. Treasury Bills, are reduced; therefore total liquid assets are smaller. If they go below the 30 per cent. they are too small, and in those circumstances the banks must restore them. They can only do that by calling on their other assets, which are their investments or their advances.

127. When you talk about transferring the shortage to the discount market, that is *via* the call money?——When the banks transfer the shortage to the discount market they withdraw call money. The discount market goes round the banks. Some banks have an excess which they put into the discount market; others have a shortage, so they take out. If there is a net shortage in the end, the banks transfer that to the discount market, and it in turn comes to the Bank to make it good. It can only make it good by giving us something for the cash we are giving back, usually Treasury Bills.

128. *Mr. Jones*: In the event of their being in difficulty they have to come to you on the basis of borrowing at the minimum of Bank Rate?——We should make them borrow at Bank Rate if we were wishing to make money tighter.

129. *Chairman*: In paragraph 11, you say: "It should be noted that the creation of a cash shortage is not without effect." The effect is that pressure is put on the short-term interest rate, and it rises?——Yes.

130. *Professor Sayers*: You say at the end of that paragraph that this situation "is likely to be taken by the banks and the market as an indication that the authorities desire to exert pressure on the supply of bank credit." Is this the only way in which the authorities indicate their intentions to the market?——It is one of the most important ways. If the market were forced into the Bank for substantial amounts, say on several occasions during one week, it would be regarded by the market in general as a sign that the authorities wanted to stiffen rates.

131. *Professor Cairncross*: You do not say anything?——No. We can say something, of course.

132. *Professor Sayers*: Supposing that, whether intentionally or not, the market were forced into the Bank one day this week and then again one day early next week, is it open to the discount houses to go round to you and say, without waiting for further pressure: "Does this mean you want us to go higher?", or do you just leave them to find out by what happens in the next week or so?——There is a lot of contact with the discount market, with whom we have very close relations, both more or less informally with the discount houses, and more formally by weekly meetings which the Governor has with the Chairman of the London Discount Market Association. I think if you wanted to hear more about what influences are brought to hear, if any, it would he for the Governor to talk on that.*

* See Qns. 1755 to 1757.

133. *Mr. Jones*: "Market" presupposes a dealing in values, trading. Supposing that banks are short of their 8 per cent. and they have got to give up some part of their liquid reserves, are the discount houses able to buy at a further discount from the banks in those circumstances? Is there any variation in value on the basis of pressure to maintain the 8 per cent.?——The price paid for Bills does vary from day to day according to the shortage of money.

134. That is between the banks and the discount houses?——*Mr. Hollom*: The adjustment between the banks and the discount houses does not generally take place by the banks selling something to the discount houses, but by their recalling from the discount houses money that they have previously lent.—*Mr. O'Brien*: Their next most liquid assets—their call money. The banks would have a spread portfolio of Treasury Bills designed so far as possible to meet expected calls on them, and they would not disturb that as readily as that.

135. That money is at call; it is not a 91-day contract?——No; it is money at call.

136. *Chairman*: How far ought we to take this last sentence in paragraph 11? The effect of driving up short-term interest rates is of course to affect the cost of the public borrowing. Surely if that is being done deliberately and as a matter of Government policy the thing cannot be left to inferences drawn by the market from actions—something on a high level must also be said?——It may or may not be said, depending upon the circumstances. I think, Mr. Chairman, the Governor would be the best person to explain what he may or may not do in that sphere.*

137. *Professor Cairncross*: When the tender is put in for Treasury Bills you have no influence on the quantation, I take it, and you have no prior advice from the discount houses?——I think that ties up with the other question put by the Chairman, and I should have thought the Governor would prefer to answer that.* But the Bank obviously has considerable influence, and may from time to time exert it.

138. *Chairman*: Paragraph 12 is to some extent a repetition of an earlier paragraph, I think. You say:

"If, for example, Treasury Bills sold by the Government are taken up by the banks, the banks' liquid assets will be unchanged in total since they will merely have exchanged one liquid asset, cash, for another, Treasury Bills."

That sort of phrase occurs from time to time. What do you understand by "sold" in that connection?——There are two ways; one by offering Bills at a tender; and we, on behalf of the Departments, may from time to time sell Bills in the market to mop up an excess of cash. That is a comparatively rare occurrence.

139. But offering Bills at tender, what I call issuing, is covered by the word "sold"?——Yes.

140. *Professor Cairncross*: Are you in a position to advise us how far Treasury Bills are held outside the discount market?——I think our information on that is imperfect, although nowadays it is pretty clear that there are substantial holdings outside the banking system and the discount market. The Bill has certainly become more popular with outside holders since the rate of interest has become more attractive, and its convenience is becoming known to people who did not know of it before.

141. It is a total variable within fairly wide limits?——Yes, within wide limits.

142. Clearly, if the amount of outside holdings could be kept steady and was known to you, your task of management would be simplified?——The existence of outside holders and the fact that Bills they already have may vary very much in amount is an additional complication in this system of credit control.

143. *Sir Reginald Verdon-Smith*: Are Bills freely negotiable?——*Mr. Hollom*: They are in general bearer documents.

144. *Chairman*: What is the significance of an increasing disposition for Treasury Bills to be held outside the banks and the discount houses?——Assuming that the Government is issuing Bills as it requires, and assuming also that this will not for the time being inflate the total of Treasury Bills in the market, then the more that were taken up by holders outside the banks and the discount market, the more that would reduce bank deposits and bank liquidity, since outside holders would pay cash for them from their banking accounts to the Exchequer, getting Bills in exchange. It is, so to speak, very short-term funding. It has the same effect temporarily as would be had by selling long-term Government securities to members of the public.

145. It is a 91-days funding, and has no very great significance?——*Mr. O'Brien*: For the time being it can have a great significance, but it does not give us any assurance that it is going to continue.

146. *Professor Cairncross*: You were telling us in effect that, if you could disregard non-bank holders, monetary policy would really be settled by the Government's short-term borrowing operations. If the supply of money is governed by the liquidity ratio, and liquid reserves are governed by the issue of Treasury Bills, and these are held exclusively by the banks, then the total output of Treasury Bills dictates the sum of money. It is important to know whether this chain is broken or not, and if it is how it is broken, by the possibility of Treasury Bills being bought by other purchasers; if these purchases are large or variable, does not that reduce the degree to which the policy of the Government dictates the money supply?——They have from time to time recently been very substantial. They are certainly variable. I agree that, if that could be excluded, it would be a simple question of Government borrowing dictating what could be done in the field of credit control. I believe it very largely is now. It may be a defect—a wart on the system—but it is no more than that.

147. *Professor Sayers*: I understand that there are figures showing the distribution of the holding of Treasury Bills between banks, discount houses and others. I believe that those figures show that over the last two years the variations in the holdings by others have run into hundreds of millions. May we have those figures put before us?——I would like to reserve that, if I may. I do not know to what extent they are available. I would like to refer back.†

148. *Chairman*: If you would. The question has been put whether these particulars can be supplied. Can you let us know in due course?——Yes. I did not mention that a very substantial element in the outside holders is the overseas central banks.

149. *Professor Sayers*: If you have the split between such holders and others, may we have it?——Yes.

150. *Chairman*: And the overseas central banks are people for whom the Bank of England would be acting in making application?——Yes; we would buy bills on their behalf at the tender. We run their Treasury Bill portfolios for them in so far as they bank with us.

151. *Professor Cairncross*: If they were the only element holdings bills outside the banking system your job would be governed entirely by the Government's borrowing operations and foreign central banks?——Yes, but they are not the only ones by any means.

152. *Chairman*: Paragraph 13. Paragraph 14. Paragraph 15?—*Sir John Woods*: I have just one question on this paragraph. In paragraph 5 you discuss various stages of action by the banks if they are in trouble over the liquidity ratio. There you say:—". . . it may sell securities and eventually encourage customers to repay outstanding advances". Here you say that their most likely action is "either to sell investments or slow up in granting advances". Do I take it that the governing words are: "If sufficient pressure is put on the banks' liquidity ratios . . . ?" Judging from paragraph 5 it is when they get really alarmed about the position that they sell securities and try to pull in advances?——*Mr. O'Brien*: Yes. When I say it is really getting serious, I think anything at all below the 30 per cent. they would regard as serious and we would encourage them to regard it as serious.—*Mr. Hollom*: There is also the difference that the last part of paragraph 5 is looking at the position of an individual bank. It may be able to ease its individual position by in effect transferring its difficulties to some-one else, whether that bank is equally in difficulties or in a more comfortable position. Paragraph 15 is speaking of a shortage or pressure on the banks as a whole.

* See Qns. 1755 to 1757.

† See Appendix to Minutes of Evidence, note to Qn. 2248, and Memoranda of Evidence Part I Appendix 2.

153. *Lord Harcourt*: And of prolonged pressure? As I understand it, paragraph 5 was talking rather about the day to day position perhaps in one or two banks; paragraph 15 is talking about a prolonged pressure from which any particular bank or banks can see no immediate relief without taking steps to reduce their difficulties?——Pressure which threatens to be prolonged, looking ahead.

154. *Chairman*: We should, I suppose, link paragraphs 15 and 16 together so far as your argument goes?——*Mr. O'Brien*: Certainly.

155. There is no strong reason why the banks should not be ready to sell investments.——No.

156. *Mr. Woodcock*: I have a question on paragraph 16. How would you define an investment other than short-dated Government stock?——The banks would regard as an investment any Government stock outside a Treasury Bill, from the shortest. This year's 2½ per cent. Serial Funding Stock, which matures on 14th November, is an investment from the banks' point of view, although now it has little more than three months to run, and is therefore from the point of view of liquidity not much worse than a Treasury Bill.

157. Is that the limit of their investments?——Their investments are not only Government securities, although preponderantly so.

158. Have you any idea what they are?——I think that any question on the details of this ought to be addressed to the bankers themselves. Clearly they have other investments than Government securities.

159. *Professor Cairncross*: Is it possible for the Bank to supply, or do you collect, figures of their investments divided between short-dated and long-dated, for instance for less than five years and more than five years?——I do not believe we have that information.

160. May I also ask about the figures in paragraph 16? From these it would seem that liquid assets must currently be about 36 per cent. At any rate liquid assets at the moment are clearly much higher than they were before the war, when they seem to have been 29 per cent.?——I have not any figures with me for liquidity stretching back earlier than the war.

161. I was not wanting to push the comparison. I meant merely that it would seem that, when the banks are faced with the situation they are now faced with, in which they cannot increase, or are not supposed to increase, their advances, they clearly do not automatically add to their investments, but prefer to let their liquidity ratio rise. Are there any general rules in this? It would seem this is what has happened and it does usually happen, but are they just as reluctant to buy, for instance, as they are to sell?——I should think that is probably true. It is demonstrated by the fact that their investments do not go up. If their investments were to go up, while at the same time they maintained a hold on their advances, as they have been requested to do, their liquidity of course would go down.

162. So when the banking system is invited not to make advances, it does not do what perhaps would suit the Government in some ways, buy Government bonds?——It is not doing it at the present.

163. *Lord Harcourt*: I have just one small point following on Mr. Woodcock's question about what is an investment and what is not. Am I right in thinking that a British Government bond having less than 91 days to run to maturity is counted as a Bill?——In the bank's statements, it is counted as an investment right up to maturity, even though it has less than 91 days to run.

164. *Sir John Woods*: Is that the same thing as saying that any Government paper that is not a Treasury Bill is an investment?——Yes.

165. *Professor Sayers*: A few years ago—I cannot remember how many—the banks differed in their practice in this respect. Some did it one way, some the other way. When did the practice as you have stated it become the universal practice? There has obviously been a change.——I think that that is a question for the banks. The present system has been in operation as long as I have been with these things, which is admittedly not a very long time. I could not put a date on it, if they have changed it.

166. I wondered if any change was associated with the provision of more information for the Bank of England; whether the Bank of England now gets more information about the holdings of the banks?——I cannot say what may have happened at an earlier time.

167. May I ask one final question about the present position? What information does the Bank of England now receive from the clearing banks about their investments?——I should like to take that one away, Mr. Chairman; you see, the banks are our customers.

168. *Chairman*: I do not want you to plunge into anything, but we should like to follow it up. In so far as a bank treats what is almost short-term money—that is, a Government bond which is nearly mature—as an investment, it really has a greater liquidity ratio than appears?——It is an easy way of reinforcing its liquidity whenever it is threatened.

169. It would not appear from its statement that it had this extra liquidity?——Not from the bald statement.

170. *Professor Cairncross*: Would it not also follow that, if there had been any change in maturity of investments, the statement might be entirely misleading, not only on the liquidity ratio; the investment portfolio could change radically but that would not appear?——You mean it might be substantially shorter? It could be so.

171. *Chairman*: Would it be important to the Bank of England for the monetary operations which it tries to carry out to know how the banks' investments were distributed?——I think the Government is already aware, at least in general terms, that the banks hold large portfolios of short-dated Government securities which give them a comparatively painless means of reinforcing liquidity when it comes under pressure, less unpalatable to them than reducing advances. Indeed in 1955 we had a practical demonstration of the banks keeping their liquidity, at a time when we were able to press down consistently and for some months, up to the 30 per cent. by selling a great many securities and not reducing their advances.

172. *Mr. Jones*: Would it be possible for a bank to give credit or to make investments in excess of 70 per cent. of its deposits, when it had 30 per cent. of its deposits in cash or liquid assets?——They could do so if they were prepared to see the 30 per cent. reduced to some lower percentage, but in practice they do not willingly do so, although from time to time liquidity ratios do go down below 30 per cent.

173. But by book-keeping arrangements and the rest what can the banks do?——I do not quite understand; in a sense it is all book-keeping.

174. But must there be pound for pound of deposits to investments?——Pound for pound of liabilities as against assets, certainly.

175. *Professor Sayers*: Might I come back to this point of the short-dated Government stock held by the banks? The last sentence of your memorandum looks really terrifying as it stands. It looks as though there is this huge volume of maturities growing every year for the next five years, and it looks almost as though, no matter what could be done this year, next year would be just as bad. I want to put it to you whether things are really as bad as that. If one year's maturities could be really successfully dealt with that would mean a £600 million or £900 million reduction in the liquid assets of the financial system as a whole. If you had that "once for all" reduction in liquidity, by some extraordinary manoeuvre, would not the maturities in the succeeding years lose most of their worry?——Some. We attempted—or in fact did—such an operation in 1951 with our Serial Funding Stocks. We went straight to the liquid assets, Treasury Bills, and funded those in a series of stocks maturing in one, two or three years. It gave us a breathing space, and it did help us, and I agree that if we could get rid of one year's maturities, perhaps even in a more drastic way, it would certainly help.

176. In that the succeeding years' maturities would be readily replaced by short-term securities for which the financial system would have a big appetite, if you deprived them of six or seven or eight hundred millions one year by a "once for all" operation?——This year, in dealing with the two maturities of 15th June last, totalling in all some £400 million, we did do something of that sort. Previously we had sold longer-dated stocks, which enabled us not

to make a conversion offer for those securities at all, but merely to issue £100 million of the 4½ per cent. Conversion Stock 1962 to replace the balance on the market.

177. *Professor Sayers*: Would it not be fairer to say that so far you have succeeded in holding the line? I am suggesting that if by some extraordinary operation you could reduce the supply of liquid assets in the entire financial system by £600 million to £1,000 million in one year, then the maturities of the succeeding years would not be so frightening?——I agree.

178. Is not the last sentence much more frightening than it need be?——It is frightening. It is a constant preoccupation each year when the problems of the year itself are so greatly increased by the need to refund a large block of maturing stocks.

179. And the worries of these constant maturities arise from the relatively short periods of the issues?——Yes.

180. If we could shake ourselves free of this inheritance in one year, should we not be out of our troubles so far as the difficulty of controlling the banking system is concerned?——I would question whether being completely successful in one year would be sufficient to bring us into calm waters entirely. I think we would have to do better than that.—*Mr. Hollom*: Even your one-year assumption is a fairly remarkable assumption.

181. I was making a supposition in which Mr. O'Brien is perhaps reluctant to follow me—that there was some extraordinary operation?——*Mr. O'Brien*: I do not think we are permitted to ask you how it could be done!

182. If by some drastic operation one year's maturities were really out of the way, then the deprivation of liquidity in the financial system would be enough to put you in control, despite the continuing maturities of the following years—that is all I am suggesting?——I would agree that, if it could be achieved, it would be well worth achieving. I do not, I confess, see how it could be achieved. I would not like to say that I agree that it would solve the problem.

183. *Professor Cairncross*: What relevance has the 30 per cent. ratio? It appears to be your experience that the banks have large liquid investments—I will call them investments but from their point of view they are just as good as Bills, or very nearly—and they are able to and do sell some of these Bills whenever the squeeze is put on them. Does that mean that the liquidity ratio is a flexible one, and to a certain extent not really any more a minimum than the 8 per cent.?——It means, I think, that the degree of control theoretically available to us by operating on a 30 per cent. ratio is very much diminished at the present time by the existence of these short-term Government securities. If we could get ourselves into a position in which the more normal distribution between investments and advances was achieved, assuming it is the desire of the banks to go back to such a distribution, and if the investments did not consist of so much short-term Government stock, then obviously it would be far easier to work on the 30 per cent. ratio.

184. Let me put a supplementary point to you. Clearly if you are operating to restrict bank advances the banks may be disposed to put some of their money into short-term investments, but certainly not long-term if they can avoid it. You might find that the tighter you squeezed them on their advances, the more their portfolio of short-term investments was expanded in compensation, and the scope for control by pressing them on liquidity would be still further diminished?——If we were successful in squeezing the banks' advances I think we would be less concerned about the extent of their short-term investments.

185. You would not be interested in the money supply?——We are interested in the money supply, yes.

186. But you think that the nub of the matter is bank advances?——Not entirely. Even if advances were restricted and the banks had such excess liquidity that they were able to expand their investments, that might not be desirable.

187. There is a theory that if people can get money elsewhere, if there is enough money around and you deprive the banks of the chance of lending money, then people go elsewhere?——You mean that the banks might buy investments and leave the money with other people to lend, instead of lending it themselves?

188. Quite so. And the amount of money in the system would not be determined by Treasury Bills, but would be supplemented in a way that is difficult to gauge?——If you mean it is highly desirable that we should get ourselves into a position to make the 30 per cent. really effective, of course I agree. That is to say, we should not only squeeze bank advances but bank deposits in total.

189. Yes, but I was asking whether the banks were not able to replenish the 30 per cent., as they do the 8 per cent., out of their liquid assets?——*Mr. O'Brien*: The significance of 30 per cent. is reduced by the fact that it can be nowadays so easily replenished.—*Mr. Hollom*: I think part of the answer to Professor Cairncross is that the approach toward the 30 per cent. forces the banks to take action. The action they take may be to reduce advances, or it may be to sell investments, but either of those would reduce deposits, and hence the money supply. —*Professor Cairncross*: I was putting it on a par with what happens if you reduce cash reserves to 8 per cent. I wondered if we were not in danger of swinging from one theology of 8 per cent. to another theology of 30 per cent.

190. *Chairman*: There is only one final question. You call this paper "The Control of Bank Credit in the United Kingdom." Have you any opinion with regard to the raising of interest rates on advances as a supplement to raising Bank Rate?——This is intended as a paper on the mechanics of this fairly limited subject. The subject of interest rates generally is covered by a separate paper which I think will be in your hands this morning, dealing with some general considerations and with the influence of interest rates.

191. *Chairman*: The next paper is "The London Discount Market"—Paper No. 5*. Are there any questions on paragraph 1? Paragraph 2? Paragraph 3? Paragraph 4?——*Sir John Woods*: I have a question on the last sentence of this paragraph: "When Bank Rate is 5 per cent., normal day to day money rates will be from 3½-4 per cent." Is that the rate at which the discount market borrows from the banks, the day to day rate?——From the banks and other lenders, yes. At the moment, for instance, the clearing banks' call money rate is 3½ per cent., while £3 17s. per cent. is the Treasury Bill tender rate. Market dealings in bills vary from 3¾ per cent., to $3\frac{27}{32}$ per cent. according to the length of the life of the Bill.

192. *Sir Reginald Verdon-Smith*: With regard to the words in brackets in the middle of paragraph 4: "(The smaller firms on the fringe of the market do not have access to borrowing at the Bank.)", is the market completely conventionally stabilised?——There are now twelve firms which have access to the Bank of England, and there has been no recent change, but I would not say that change is impossible. The number of firms in the market has varied a great deal over the years. Our object has been to make sure that the market is adequate to perform its function, and we have in the past encouraged various firms to strengthen their position, and I think further firms have been added in order to provide adequate facilities. There is nothing holy about the present figure of twelve.

193. *Mr. Jones*: When it is not at your initiative, but at the initiative of people who are trying to build up business, what are the entrance qualifications that you require for the privilege of access to borrowing, which I suppose means having a discount account at the bank?——The Discount Market Association would have to say that they would be prepared to accept them as members of the discount market. I think that we would have to agree that additional facilities in the market were desirable, and to be satisfied with the financial standing and resources of any new entrant.

194. Has it been a long tradition for there to be twelve houses in this particular field?——Not all that long. When the Macmillan Committee was sitting it was almost double that number.

195. *Chairman*: But probably to some extent smaller concerns?——Yes, I think so.

196. *Sir Reginald Verdon-Smith*: Is there any particular characteristic about the market which makes it desirable from your point of view that it should be larger or smaller, or that the firms in it should be larger or smaller?——I think the only considerations are that we should wish them

* Memoranda of Evidence Part I No. 5.

to be capable of performing efficiently the functions which they exist to perform.

197. Do you consider that twelve houses of about the present size do the job adequately?——*Mr. O'Brien*: I would think so.—*Mr. Hollom*: There was a movement amongst the discount houses after the war to increase their capital, which had been rather overtaken by the increase in the volume of business they handled, particularly during the war years.

198. *Mr. Woodcock*: Shall we be getting any information on their capital?——*Mr. O'Brien*: I think that it would be right for you to ask the discount houses that when they come.

199. *Professor Cairncross*: Have there been any amalgamations since the war between discount houses?——Yes.

200. There is no convention among the discount houses, as there is among the clearing banks, that Government approval should be necessary for any amalgamation?——I do not think so, no.

201. The number might drop to the point where you were perplexed?——*Mr. O'Brien*: That might happen.—*Mr. Hollom*: I think it is fair to say no amalgamation would take place without our being approached beforehand, because the amalgamated firm would want to be certain that its discounting facilities would continue.

202. *Chairman*: I suppose we can get from the discount houses when we see them the order of magnitude of their different branches of operation?——*Mr. O'Brien*: Yes. I have some such information available, but it might be better to get it from them.

203. There is no doubt that the bulk of the business is in Treasury Bills?——That forms a large part of it, but the short bond business is at least equally as large.

204. *Sir John Woods*: Could I ask for a personal expression of opinion on one point, and that is about the commercial bills? It is sometimes loosely said outside that so far as the commercial bills are concerned the discount market does not matter at all. You say here in paragraph 5 that its role is "important in the finance of commerce but less significant nowadays from the point of view of monetary policy." I take it that in general the amount of business they do in commercial bills is less than it used to be, but do you feel they are an important element?——It is less important relatively, but still very large; I would say that they are a very important element in the marketing of commercial bills.

205. *Professor Sayers*: Does this phrase "important in the finance of commerce" mean that the bills handled by the market represent a large amount in terms of money, or does it mean that if there were not these facilities for the discounting of bills the traders concerned would have serious difficulty in getting finance?——The market is important not only because the amount is still important, but also because where a market does not exist it is always more difficult for people who have to dispose of bills, or any commodity, to have their needs met efficiently.

206. But if the discount market suddenly disappeared would the people who are now getting the money experience any real difficulty in getting the finance from the banks? Is the discount market important in this sense?——I think the system would be more clumsy, and therefore there would be increased difficulty.

207. *Professor Cairncross*: I thought your general contention in the paper was that if the discount market did not exist it would be necessary to invent it, and if it was not operated independently it would be operated as an auxiliary by the banks themselves. Do you think they would have to create institutions for this?——Institutions or departments; they would have to assemble experts to look after the business.

208. *Mr. Woodcock*. Would you want all the business done in the same way?——Yes; after all, if the banks did not hold a substantial portion of their assets in the form of call money they would have to invest it in something else, presumably in Treasury Bills, short bonds and commercial bills, which at the present the discount market hold and manage in effect for them.

209. *Mr. Jones*: Is each of these twelve discount houses separately capitalised?——Yes.

210. To what extent, if any, have the banks an interest in that capital?——I think that is something which they should be asked; I could not answer it.

211. *Professor Sayers*: To go back to this question of the finance of commerce, which has an independent importance. You say they are important in the services they give. Supposing they were not there; are not the big banks quite familiar with the business of discounting bills of exchange?——They are familiar with it because they are the people who buy them in the end.

212. From the discount market?——Yes.

213. And therefore if you had not got the very finely organised facilities of the discount market in this, each bank would have to have an enlargement of its own existing department, and the finance of commerce would in effect be available just the same?——*Mr. O'Brien*: It would be available, but I question "just the same". I think it would be less efficiently performed.—*Mr. Hollom*: You would still have your buyers and sellers. Whether the sellers and the buyers could efficiently get together without an intermediary is a matter of opinion. Our feeling is that the intermediary serves a useful purpose.

214. *Lord Harcourt*: It would necessitate the seller of a bill hawking it around until he could find a buyer?——He would have to find a buyer who wanted a bill of that length, at that price, and of that quality, and perhaps dealing with—or, I will put it in the negative, *not* dealing with—a particular trade in which the buyer had already invested a considerable amount in bills.

215. *Professor Sayers*: You assume all the time that the business would continue to be financed by the discounting of bills. Is it in fact necessary to assume that? Is not a great deal of similar business done by ordinary bank advances?——*Mr. O'Brien*: Yes.

216. And is there anything peculiar to the business that is now done by the discounting of bills that would make the other system clumsy?——I should have thought that the financing of the movement of goods was very efficiently carried out on the bill of exchange, although undoubtedly some of that business would move over to bank advances if the facilities for dealing with bills of exchange became more clumsy and less attractive. I should have thought that would be a pity.

217. But if the bill method of finance has been so efficient for that kind of business, why is it that it has lost ground so in just that kind of business in most trades over the last seventy years?——That is true.

218. *Sir John Woods*: Would you think that the commercial bill had a special virtue as against other methods of financing in the export trade?——I think that in the past it has been regarded as giving a good security to both parties and has been regarded as a convenient method of financing the movement of goods, but I agree of course that it has diminished in importance.

219. *Professor Sayers*: This was a system that grew up when banks wanted to shift their assets much more on to other sources of finance. Now they do not, and as a consequence of that the discount business has tended to decline. In most trades it has gone right out. I was trying to discover whether there is any peculiarity about the facilities required by those trades which still continue to use it that would make it awkward for the bank advances to take over completely?——*Mr. O'Brien*: I suggest that the accepting houses are the people in the first instance to ask about that, not even the discount houses who, after all, are brokers.—*Mr. Hollom*: One assumption that it seems reasonable to make is that those who use bills find them cheaper.

220. *Professor Cairncross*: What about those who have given up using them?——*Mr. Hollom*: Presumably they have not found them cheaper.—*Mr. O'Brien*: From time to time they certainly have not been cheaper, and that has led to a switch.

221. I was thinking of the long period between the two wars when I should judge that bills were generally cheaper, but nonetheless they seem to have declined in favour.——As I say, I think the accepting houses are the people to question on that.

222. *Chairman*: I think this might be a good moment to break off. You will be available to come back to this paper on Tuesday, 16th July?——Yes. *Chairman*: Thank you very much.

(*The witnesses withdrew.*)

(*Adjourned until* 2.30 *p.m.*)

C. F. COBBOLD, ESQ., Governor, H. C. B. MYNORS, ESQ., Deputy Governor, L. K. O'BRIEN, ESQ., Chief Cashier, and J. Q. HOLLOM, ESQ., Deputy Chief Cashier, of the Bank of England, called and examined.

223. *Chairman*: Mr Governor, I wrote to you explaining that our main object at this stage was to work through these papers paragraph by paragraph, asking our questions as we went along, to enlighten ourselves, but not abstaining from comments as they arise. But I do not want to tie you down, if you yourself would like to make any introductory statement to us.——*Mr. Cobbold*: You were good enough to see the Chief Cashier this morning, but if I might regard myself as opening for the Bank, I would like to re-state, as the Chancellor said when he was announcing the appointment of the Committee in the House of Commons, that the Bank of England very much welcome this inquiry. We felt until recently that, after the upheavals of the war period and the readjustments of the immediate post-war period, there had not been a sufficient experience of monetary management in new conditions to warrant a monetary inquiry. Now, however, we are some twelve years from the end of the war, and it is some six years since we started to operate a more flexible monetary policy; and the Bank have felt that an inquiry could be both valuable and constructive. As we have set out in the various papers submitted, the conditions in which we are now operating are very different from what they used to be. The Bank are very conscious that both policy and technique in this field are experimental, and feeling its way, and we look forward to a great deal of help from your Committee. The Bank will be anxious to give the Committee as much information as it properly can, and we hope the Committee will freely call on the Bank to submit further papers, if they can help you, and any evidence, as the inquiry proceeds.

I would like to add three points, if I may. I understand, as you said, Mr. Chairman, that the Committee wishes these first hearings to be introductory and exploratory. The discussions at this stage will, I understand, not be the last word and the Bank will be free to return later on any points of importance. I infer from that—I hope, correctly—that, with the sort of procedure you are contemplating, if Bank witnesses feel in doubt about a question the Committee would prefer them to give a considered answer later, orally or in writing, rather than say something which could be wrong.

Chairman: That is so.

Mr. Cobbold: Secondly, and this is I think a point to which you attach great importance, I would like just a word of clarification, if we might. I gather that the Committee's desire is in general that all evidence given to them should be published. I am very anxious that this consideration should not interfere with the freedom with which the Bank witnesses will want to give evidence to the Committee. There are certain general subjects and certain specific points on which I personally and, I think, my colleagues, would not think it in the national interest to talk for publication quite as frankly as we want to talk to the Committee. I do not think this will arise very often. I will endeavour to draw the Committee's attention to any points where I think it is going to arise. But I would just ask that we might be allowed to look at the record with that point in mind, and at any point where we feel strongly in the national interest that publication would be unsuitable, we might ask the Committee to consider omission of that from the public record. I do not wish to make too much of this point, but I am anxious that Bank witnesses should not have to be thinking all the time: "is there anything in that which might be damaging in the public interest when published". I do not ask for more than an understanding that we may just have a look through the record on this, and, if there is any point on which we feel very strongly, we may make representations to you.

Chairman: Yes, I think we may take it that way but, as you said, I hope those occasions will be exceptional.——I think they should be. There are one or two subjects where it would certainly arise, and there I hope, so to speak, to warn the Committee before we start on that subject.

The third point I would just like to make is that the Bank witnesses will be giving evidence on behalf of the Court of Directors, which is in an effective sense the governing body of the Bank, and I would like to emphasise that the papers being submitted to the Committee are submitted by the Court and not by the Governors. It may be that the Court will wish, as the inquiry proceeds, to supplement or modify evidence given in the early stages in these exploratory discussions by Bank witnesses, and I think the exploratory procedure you have suggested fully covers the possibility of our reappearing at a later stage to amplify, or even correct, if that becomes necessary.

224. *Chairman*: I am much obliged. Shall we take Paper 2*, paragraph by paragraph? On paragraph 2, what is the statute which regulates the form of the Bank Return, and what is its date?——*Mr. Mynors*: The Bank Charter Act, 1844, as modified by the Currency and Bank Notes Act, 1928. It is substantially the form of 1844 with certain small changes in 1928 to allow of the currency note issue.

225. *Professor Cairncross*: Do you think the distinction between the Banking and Issue Departments, made in 1844, still has significance?——Yes.

226. *Chairman*: There were some recommendations of the Macmillan Committee, I think, about the form of the Return. As it stands at the moment, as the statute requires, is it satisfactory to the Bank?——*Mr. Cobbold*: We regard it as satisfactory.

227. *Professor Sayers*: Have you thought of an alternative form that would be more instructive to the public?——I would not say we have considered it very seriously.

228. I wonder if you would like to pursue your answer to Professor Cairncross's question, and say what significance you attach to the difference between the Issue Department and the Banking Department in this Return?——Perhaps the first significance is that the Issue Department, at least to the extent of profits, is directly accountable to the Government and the Banking Department to the Court of the Bank.

229. Could not the division of the profits of the Bank be arranged otherwise than by publishing the statement in this form?——I do not say that it could not be arranged, but it would mean a wholesale change in a great number of things. From the point of view of the balance sheet and profit and loss account there is an absolute division at the moment between the Issue Department and Banking Department, though not from the administrative and organisational points of view. You cannot come to the Bank of England and see the Issue Department or the Banking Department functioning separately, because they are run by the same people, but from a balance sheet and profit and loss account point of view they are wholly separate and treated wholly differently.

230. I am trying to relate these considerations to the necessity for weekly publication. When you are considering what statement the Bank should publish weekly, is there any reason why considerations of distinction between Bank and Government accounts should be admitted?——At the moment I see advantage in continuing this present system. It divides quite definitely two things which, at least in our minds, are quite different. That was the original purpose of the division and I should have thought it was still material.

231. *Professor Cairncross*: The issue as to profits seems a curious one. I am not quite clear from the paper before us what you do about profits. The Bank is nationalised, and therefore profits ultimately accrue to the Government; but you seem to go through a number of calculations about profits?——The profits of the Issue Department go directly to the Government. The profits of the Banking Department accrue to the stock of the Bank—I think that would be a proper way of putting it—and the stockholders are the Government; but we see a real difference between those two things.

232. What is the force of the difference? I ask because I remember in the Macmillan Committee questions were put on the assumption, perhaps, that whether you made a profit or not helped to determine your policy. No one would hold a view of that kind now, I suppose, but it appears that the way in which profits are calculated and allocated affects your view of what you publish?——I think I was making the point more from the balance sheet and profit and loss account point of view, that the

* Memoranda of Evidence Part I No. 2.

two things are absolutely separate, and therefore there is a convenience in treating them in the balance sheet way absolutely separately, purely for convenience so far as weekly publication, if you like, is concerned. Would you like me to go into the profits aspect of the Banking Department a little further at this stage?

233. *Chairman*: A little later, because I wanted to invite my colleagues to follow up their questions by asking what kind of change they had in mind about the form of Return, and what the change would be.—*Professor Sayers*: I was thinking that, when the Return was devised in 1844, it was devised as a weekly instruction to the public as to the position of the Bank in certain respects that were then considered vital. If you had no history at the Bank, if you said:—"We can do what we like about calculating profits separately and we are thinking solely of what weekly or monthly statement is to be published to the public, to instruct the public on the vital points in the position of the Bank," would not something different emerge from this?——As a quick answer, I would still think it would be convenient from that angle to have the Issue Department shown separately.

234. I am arguing that you should stick to the principle of 1844, that the Bank should publish each week or month a short statement of its position which should instruct the public on the vital points in the Bank's position at that date. Would it not be very extraordinary if, pursuing that principle of 1844, which, I should have thought, stands today, you arrived at this form of balance sheet?——*Mr. Cobbold*: There have been one or two modifications made, have there not?—*Mr. Mynors*: Yes. The breakdown of the securities in the Banking Department and the division of Other Deposits in the Banking Department between Bankers and Other accounts are beyond the statutory minimum.

235. *Professor Cairncross*: My only reason for raising this question was that I thought that the form of Return attached too much importance to the note issue, which is now a very subsidiary affair. But the way in which you publish the information does not matter a great deal; the question is, what you think is important. What do you want the public to look at?——*Mr. Cobbold*: I want the public to look at the note circulation.

236. You think that is important, and not just derivative from the total money supply? Is it not questionable whether the note issue as such has the importance it used to have, first, because notes are a small proportion of the total money supply (they were a much larger proportion at the time when the legislation was originally passed), and secondly, because you do not operate on the note issue directly; that is left to occasional Parliamentary debate?——*Mr. Cobbold*: It still remains very important that the public should know what it is.—*Professor Cairncross*: Do we know what it is?

237. *Professor Sayers*: But in any case the amount of notes issued by the Bank of England would be shown in an amalgamated Return of the form suggested by the Macmillan Committee, if that is what you want the public to look at. Is not the only merit, if it be merit, of the division that it shows what is the gap between the amount of notes outside the Bank of England and the total authorised fiduciary issue at the moment? Is that not the only result, for the public looking at the Bank Return, of showing the Issue Department and Banking Department separately?——I should think it is the only result, but I do not accept that it is the only advantage.

238. If you want to direct public attention to the notes outstanding, then what you want is not a divided return but an amalgamated return of the Macmillan Committee form, is it not?——I would have thought the form was so well known that every financial journal deduces the information from the existing form of Bank Return.

239. You mean that teachers of the subject have done their work so thoroughly that everybody understands this?——I should think so.

240. *Chairman*: The reference I had in mind to the Macmillan Committee recommendation is on page 145:—"We recommend further that the form of the Bank's statutory weekly return should be unified by the amalgamation of the statements relating to the two departments, so that the consolidated Bank Return . . . would appear as follows". Has that recommendation been considered in the past?——I could not tell you whether it was considered in the early 'thirties; it has not been considered since I was Governor.

241. What were the reasons for not giving effect to it?——I could go into research, but I could not tell you over the table.

242. I think, if your records show that the recommendation was considered, and record the reasons for not giving effect to it, we would like to know. There is no hurry about it.*——Would it be in order for me to make one further comment about profits? As the question of profits of the Banking Department was raised, I think I ought just to put on record one or two things that were said about that in the Select Committee on the Bank of England Bill, when Lord Catto was under examination by yourself, Mr. Chairman. Of course it will be appreciated that the question of profits is closely bound up with the question of reserves—I do not think that needs any developing. Might I just quote a few words Lord Catto used in reply to yourself?

"I know of no cases where a Bank, when there has been an amalgamation or a purchase, has disclosed to the public the inner reserves of either institution. Inner reserves are essential to the strength and prestige of any great institution such as the Bank of England; . . . those reserves . . . are in no sense excessive considering the magnitude of the operations of this great institution and the unique prestige and confidence that it has all over the world. I would consider that any disclosure of those inner reserves would be greatly against the national interest and might be very detrimental to the position of the Bank of England itself, and for this reason: that if those reserves were disclosed, many people would think the figure very high; many people would think it not quite as high as they thought; because all kinds of wild suggestions have been made as to what are the reserves of the Bank of England. I assure you those reserves are important; they are in no sense larger than is necessary for the proper conduct and prestige and confidence of the institution all over the world."

As you will recollect, Mr. Chairman, that view was accepted in the Committee, and in fact references to the Banks' profits in the Bank Act were kept to a very limited reference indeed, on the ground that as a matter of policy it was extremely important in the Bank's interest and in the national interest that the profits and reserves should remain a secret matter.

243. *Professor Cairncross*: It is not your suggestion that the element of profit affects your policy in any way?——Not at all.

244. It is the allocation of profits that you are discussing? That is, you are still interested in making a profit, not like other nationalised industries which are asked to break even?——We like to make a profit but I can assure you that policy in such matters as Bank Rate and so on is not affected by profit considerations.

245. *Chairman*: Your reference to the Select Committee as really to this effect, is it not, that when the set-up of the Bank of England was considered by Parliament, at that time it did not put you under any conditions as to the form of your balance sheet and so on?——That is correct.

246. *Professor Sayers*: Or as to the form of an annual Report?——I am afraid I forget the exact wording, but I think the Chancellor of the Exchequer of the time undertook that an annual Report would be produced and laid. There was an undertaking during the debate in the House, but it is not statutory.

247. The undertaking says nothing about what should be in it?——Nothing about the form.

248. *Sir Reginald Verdon Smith*: On paragraph 5, is there some particular significance in the payment of income and profits taxes?——I think I could put it like this: we wanted to go on as a commercial concern, and consider ourselves, and leave it to our successors to consider themselves, a commercial concern run in a business way. That was part of the whole conception at the time of the Bank Act, that the Bank should continue to run as an individual separate institution, with close links with the Government, but still as an independent institution.

* See Qns. 748 and 749.

249. *Chairman*: On paragraph 6, you are telling us the constitution of the governing body. Was that set-up laid down in the 1946 Act?——Yes, in the Act and the Charter, read together.

250. You say: "It is customary that no Director shall be on the board of one of the large banks". How far back does that go?——As far as the great clearing banks are concerned, certainly since the amalgamation of the clearing banks. We have one director now who is a director of one of the eleven London clearing banks, but not one of the Big Five.

251. Is the basis of this to exclude from directorship people who are in specially close touch with the Bank of England in their other capacity? Would that not apply to other bodies as well?——I think it would apply to other bodies. I am only giving you my own reasons. I could not tell you why it was started, but my reason for wishing to perpetuate it is that I find it convenient to discuss policy and maintain the Bank of England's contacts with the clearing bank system through the Chairman of the Clearing Banks Committee. I should find it a little embarrassing if I had on the Court the Director of Bank A and not the Directors of Banks B, C, D and E, and I think it would complicate our relations with the Clearing Bank system rather than otherwise. I think that would be the main reason. I dare say some of the difficulty could be got over by some form of rotation, but I nevertheless feel that there would be some difficulty in having one of the Big Five and not all five of them.

252. *Professor Sayers*: Would you apply this exclusion only to the Big Five clearing banks, or are there other financial institutions you would automatically exclude?——I would certainly exclude discount companies. I do not know whether it would be of interest to go through the present composition of the Court.

253. *Chairman*: Yes, if we may have that for the record?——Besides the Deputy Governor and myself there are four full-time Directors; as you know, the Court has the power to appoint four full-time Directors. Then there are five, broadly speaking, who could be called "financial"; there are five who could broadly speaking be called "industry and commerce"; one "trade union"; and one "shipping". That is the present composition. There is no representation here, but the Crown have pursued the earlier policy of appointing people of first-class standing primarily on their individual merits, but at the same time seeking to ensure a reasonable division between different sections of industry, commerce, banking and so on.

254. *Professor Cairncross*: You state the formal composition here. Is this the way things work out, that nominations are made by the Crown and approved, presumably, by the Court, or is the Court brought in earlier on?——I believe, technically, that is a question which should be addressed to Her Majesty's Government. I think I could say, without improperly disclosing any secrets, that Her Majesty's Government are good enough to discuss with the Governors.

255. It is a joint affair?——The responsibility clearly lies with the Government, but every Chancellor of the Exchequer with whom I have worked has been good enough to consult the Governors.

256. *Chairman*: In paragraph 8 you say:—"The Treasury may from time to time give such directions to the bank as, after consultation with the Governor, they think necessary in the public interest." That is a statutory power?——Yes.

257. *Sir John Woods*: Are these the precise words of the Act? In some of the other nationalised bodies the Government can give directions only on matters of policy. ——The exact words of the Act are: "The Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest".

258. It does not involve consideration of what is a matter of policy? It is entirely a matter for the Governor to persuade the Treasury if he can, if he thinks it is not proper to give a direction?——I believe that would be the case.

259. *Chairman*: Then you say that no such direction has been given. There must lie behind that a great deal of exchange of views, ascertaining by the Bank of the views and wishes of the Treasury, or am I wrong in that?——You are quite right in that, Mr. Chairman.

260. How does it work? How can one put it so that what may be in effect a direction, but is not a statutory direction, is in fact obtained? What goes on?——I have prepared a quite informal statement on Bank-Treasury relations, if it would be convenient to make it at this stage. It is rather informal, and not meant to be a "document", but rather the basis that we are talking on. It does not actually cover your point, which I will go into later, but I think it is necessary to note this first.

On the practical working of relations between H.M. Treasury and the Bank, the main effect of the Bank Act was to bring the statutory position into line with the factual position.

The principal relationship is, and has been over the centuries, that of banker and customer. The Bank holds at the Treasury's disposal its banking services and its advice over the wide range of financial problems with which the Treasury deals. As the part played by Government in the general economic and financial picture has grown, so have the Bank's services, both technical and advisory, expanded. At the top policy level, there is regular contact between the Chancellor and the Permanent Secretary for the Treasury and the Governors for the Bank. This is supplemented by continuous contact between senior officials of the Treasury and Executive Directors and senior officials of the Bank, on policy and operational questions with which they are particularly concerned. More particularly in the overseas field, the Treasury rely heavily on technical assistance and advice from the Bank, and both in Whitehall meetings and in overseas negotiations it has become normal practice for the Treasury to be assisted by Bank officials on technical subjects.

In the field of domestic monetary policy the Treasury and the Bank each have their own responsibilities. The Bank have the first responsibility for the management of the money market, including the fixing of Bank Rate and the management of Issue Department securities. By statute this responsibility lies with the Bank unless they are given directions by the Treasury: in practice, in recent times both before and since the Bank Act, it has been the policy of the Bank to accept this responsibility but to consult, and in the last resort to defer to, the Government. At the same time many decisions which directly affect the management of money (e.g. Government borrowing and debt management, the finance of public bodies and local authorities, control of hire purchase terms) are the direct responsibility of the Government. In these circumstances it is clear that the Treasury and the Bank must act (as in fact they do) in the closest consultation and in absolute confidence.

In their functions as managers of the Exchange Equalisation Account and Exchange Control, the Bank act purely as agents. The responsibility for policy lies with the Treasury, though the Bank are charged by the Treasury with the responsibility for day-to-day dealing in the exchange markets and for administering the Exchange Control within rules laid down from time to time. In practice the Treasury naturally consult the Bank on policy issues, and the Bank keep the Treasury closely informed of market conditions.

In that statement I have endeavoured to give you the general picture. It does not, as I said, answer the question you asked me. It is extremely difficult to say exactly where ideas start from. What happens in practice is that I see the Chancellor once or twice a week, and I see the Permanent Secretary to the Treasury once or twice a week. Sometimes we agree about everything, sometimes we do not. Sometimes one of us has a suggestion to put forward, sometimes the other has a suggestion. I repeat, the relations are very much those of a bank and customer over a wide field. I think I can say that relations have been extremely close. Certainly throughout the period while I have been Deputy Governor and Governor, successive Chancellors have been good enough to take me very closely into their confidence on any matters affecting financial administration. Sometimes they take my advice, sometimes they do not. I have found it very difficult to say just where any particular

idea starts or finishes, or exactly where the initiative comes from.

I think it follows from the statement I have just made that in matters like Bank Rate and interest rates and credit policy the initiative normally rests with the Bank of England. There again, week after week, sometimes more often, one is obviously discussing these questions with the Chancellor. I could never say at a precise moment whether an idea originally started with us or with the Treasury. It is very difficult to say, but by and large we should regard the first responsibility about Bank Rate, monetary policy and so on as lying with the Bank. Under statute the ultimate responsibility in the general framework of the economic policy would lie with the Treasury if they chose to give directions after consultation, as is laid down in the Act.

261. *Chairman*: In some aspects of the monetary field there might be Treasury interests and Bank interests. In deciding what particular action is to be taken, somebody at the top has got to weigh one cost against another, and there may be other considerations, social and so on, as well. When a decision is made, it is made in effect by discussion between yourself, representing the Bank, and the Chancellor or the Permanent Secretary. That having been done, is there then an effective system on both sides, under which all those in the Treasury who are concerned with the implementation know what to do and carry it out, and the same on your side, the Bank?——I can only answer for my own side, where I think it works all right.

262. *Professor Sayers*: A top level decision is always made in the face of recognised disadvantages. Did I understand you to tell us that any top level decision about credit policy, Bank Rate, and that sort of thing, is made in effect by the Chancellor on your immediate personal advice?——No. I would say a Bank Rate decision is not made by the Chancellor acting on my advice, but made by the Court of the Bank of England. I think I could say that normally, certainly invariably in recent practice, it has been made by the Court after I had assured myself that the Chancellor would approve the decision.

263. It is made after weighing up the pros and cons. You yourself are no doubt well aware of the cons as well as the pros. Is there any written record of your view of the pros and cons made at the time, or immediately after the decision is taken?——No. The great majority of the to-ing and fro-ing will be in informal discussion, within the Bank in the first instance, and between the Chancellor of the Exchequer and myself at another stage. I would not say that it is at all regular practice to have a full record of pros and cons, though we have often explained things either in public, or for example to such people as the central banks of the sterling area and our other central banking friends; we very frequently send a telegram, after a change of Bank Rate, explaining the main reasons for the change, what it implied and what it did not imply. But I would not regard that as a full statement of every pro and con in our mind.

264. I was wondering what kind of explanation could be found if we were arguing about a specific change of policy in, say, the last five years. Should we have to rely on your memory, aided by such papers as happen to have been written at the time?——I am afraid you would.

265. Your memory, and nobody else's?——And the Deputy Governor's. I am saying "I" rather a lot; I am saying "I" as representing the Court. As I made clear, these are Court decisions and I am the servant and representative of the Court in these matters.

266. May I go further into the matter of the Court? When a change of policy is made, is it fully debated in the Court?——I am entirely aware that the Court as a body approves any decision that is taken and knows the full reasons.

267. *Mr. Woodcock*: May I put it this way? The decision on Bank Rate rests, as you say, with the Court of Directors; but, from what you said, I assume that what the Directors know about the Treasury view is what you tell them, because you alone discuss this with the Treasury?——Yes.

268. Therefore you explain to the Court all the considerations and they make the decision in the light of your report to them?——Yes.

269. *Sir John Woods*: You said just now that the decision to change the Bank Rate is the decision of the Court, but you said it always took place after you had consultations with the Chancellor. But I thought I heard you say earlier on that, in relation to that side of the Bank's work, the policy of the Bank in recent years had been to consult, and at long last if necessary to defer to the view of, the Government. Would that apply?——I do not think a Governor would normally recommend to the Court a change in the Bank Rate which he knew would be opposed by the Chancellor of the Exchequer, nor do I think that in present circumstances the Court would make a decision to change the Bank Rate if they knew the Chancellor of the Exchequer would oppose that decision. In fact it would be an absurd thing to do because the Chancellor or the Government could give directions under the Act to reverse the decision. In practice it would not make any sense. There are of course all sorts of things that might happen if there were disagreement. I could conceive of circumstances in which the Bank might want to ask for formal directions, to protect themselves if they felt that the way in which the Treasury wished a decision to be made was wrong. I can conceive of circumstances in which the Treasury would wish to give directions, and I can conceive of circumstances in which some or all members of the Court might wish to resign after further discussion and debate. All sorts of varieties and stages of consultation and argument are possible.

270. *Mr. Jones*: To what extent do the Chancellor and the Treasury impose their will upon the Court of Directors, and on yourself as Governor of the Bank of England, in these informal discussions, thus avoiding the necessity for the Treasury to give directions?——In my experience as Governor it has always been possible in operating the more flexible monetary policy of the last few years for us and the Treasury, the Court represented by myself and the Treasury represented by the Chancellor in the last instance, to agree about every Bank Rate and credit policy decision. The decision about a change in Bank Rate has been taken by agreement on each occasion.

271. Would the association between the Chancellor of the Exchequer, as the head of the Treasury, and the Court of Directors be roughly similar, say, to the Minister of Power's association with the public corporation running the coal mining industry?——I am afraid I do not know enough about the latter association to say.

272. In that case the Minister of Power is responsible to Parliament for the running of the fuel industries. To what extent is the Chancellor responsible for the actions and conduct of the Bank of England?——I am not quite sure what the Parliamentary position is; I suppose he has some responsibility, because he has power to give directions, but he has no responsibility for the current administration of the Bank of England. That is a matter for the Court, and the Chancellor would only enter in if he found it necessary to give directions. I speak in ignorance of the law, but I think that is the position.

273. *Professor Cairncross*: There is one question which might give rise to ambiguity. On whom does the responsibility for the exposition of policy to the public rest, the Chancellor or the Governors?——I wonder if that does not come in on the rather more general question of exposition of policy. I understand that that is one of the points in which the Committee are interested. I was thinking that it was probably a matter for discussion by itself, though I am perfectly willing, if you would wish, to take it now.

274. *Chairman*: Although it would be a good thing to go into detail later, a general answer now might help us to get our own thinking forward?——If I might first take the financial markets, the banking community and so on, that we regard as the Bank of England's function. If there were any doubt about policy, I should certainly either have a meeting with the Clearing Banks Committee, or the Chairman of the Clearing Banks Committee, and probably the Chairmen of various other City organisations, and make sure that what we were doing was understood in the financial communities in the City. In so far as our central banking friends are concerned, particularly the Dominions and, for example, the Federal Reserve system of the United States, with whom we always keep in close touch in these matters, and the main European banks, if we felt there was any likelihood of doubt or any point we wished to stress in a new decision, we should certainly let

them know and tell them our reasons and what the move implied. Does that cover the financial market side?

275. *Professor Cairncross*: Partly. We may want to ask further questions.——*Mr. Cobbold*: On the more general question about how much the Bank says or how much the Treasury says about monetary policy in general and how much they explain their actions, this is one of the points on which I would ask your agreement that I should speak rather more freely to you than I would wish to have on the record.—*Chairman*: I would rather not have that at the moment.—*Mr. Cobbold*: I think, then, that at this stage I would say that, even if we have some responsibility, it is mainly the responsibility of Her Majesty's Government to explain to the public the economic and financial policy of the Government, with which monetary policy and the monetary authorities are very closely connected.

276. *Professor Cairncross*: And you regard yourself more as the instrument?——I should reckon it to be my fault if one of the big banks did not know what I was doing.

277. *Professor Sayers*: You have put the emphasis rather on general economic policy. It may be that what is necessary at some time is to explain just what contribution monetary action is intended to make to the general ends of Government economic policy?——It is very difficult for me to answer the question as fully as I see it, if I am to be on the published record.

278. *Professor Cairncross*: It might be better to go back to the earlier line of the discussion about the various powers. I want to take a particular case, restriction on bank advances, and ask whether this is regarded as a matter of monetary policy or whether it is regarded as something the Treasury would initiate itself?——I regard that as a matter of monetary and credit policy. The initiative primarily rests with us.

279. Let me go a little further and ask you if you regard, say, hire purchase restrictions, as in the sphere of monetary policy, or over the line?——The Bank are not very happy about the position at the moment; it falls between the Board of Trade and someone else.

280. Are you in a position to make suggestions to the Chancellor about down payments, for instance?——I am in a position to make suggestions to the Chancellor on any subject.

281. But only in the way you might make it on taxation and so on?——It is clearly the Government's responsibility. The down payment is on that side of the house, so to speak, but there are certain aspects, for instance safety of deposits, in the whole hire purchase situation which, from the banking end, we do not feel are quite straight at the moment.

282. As matters now stand you are more directly involved in the public debt and the management of that? ——We are very much interested in the hire purchase system, but, as you know, and I think it is no secret, legislation was proposed in the Queen's speech and subsequently dropped. You will doubtless wish to come back to Treasury and Board of Trade witnesses more on this. I would not wish to prejudge anything they would wish to say. I would only say from the Bank's point of view that we do not regard the Bank's relationship with hire purchase as in quite a satisfactory position.

283. *Chairman*: Does that mean that the Bank has not the same contacts with the people responsible for financing hire purchase as with the older institutions, like the money market and so on?——The whole of this is under some discussion at the moment between the Bank and the Treasury, but at the moment we have not. There is a vast number of hire purchase companies which have sprung up recently, some of which are first class and some of which are, perhaps, a little less. The Bank's view is that this needs a good deal of pulling together, and, legislation having been deferred, we are at the moment seeing, with the Treasury, what can be done to pull it together.

284. *Professor Sayers*: In a recent instruction to the Capital Issues Committee the Treasury has laid it down that the financing of certain types of operation is not a proper business for a clearing bank. Is that position primarily for the Treasury to defend, or is it your responsibility?——Instructions to the C.I.C. are a Treasury responsibility.

285. Do you consider it within the province of the Bank of England to decide, subject to a ruling by the Treasury, what is proper business for a financial institution?——No.

286. There is no specific reference here to the Committee of Treasury. Without probing into the domestic arrangement of the Bank, I wonder if the Governor would like to tell us anything of the functions of the Committee of Treasury, whether he regards that body as being more particularly concerned with general policy than is the Court?——Broadly, I would describe the Committee of Treasury as the Governor's conscience so far as the Court is concerned. From long and ancient practice in the Bank, the Committee of Treasury is the first body with whom any of these things would be discussed by the Governors. I think that from time immemorial the Governors have felt and would feel entitled to go some way in, for example, discussions with the Chancellor of the Exchequer, about changes in policy, if they were certain they had the full support of the Committee of Treasury, before taking the question to the full Court at a later stage. The Committee of Treasury certainly continues to work as it used to work in the old days.

287. *Professor Cairncross*: Are you satisfied with the regulations governing the Scottish and Northern Irish note issue?——*Mr. O'Brien*: Broadly speaking, yes, though possibly less in some Northern Irish banks than Scottish banks.

288. You would not like to see these issues suspended? ——I do not think they give us any trouble.

289. *Chairman*: On paragraph 12, I am afraid I do not quite understand why the profits of the note issue are paid into the Exchange Equalisation Account.——*Mr. Cobbold*: I think your uncertainties are well founded and shared by a number of other people, Mr. Chairman. I think frankly that, as a long term arrangement, it may at some time need looking at. It is a slightly odd arrangement. I think I could say (you would wish to check this with Treasury witnesses) that this is a matter which has been discussed from time to time between the Treasury and the Bank, and we have considered together whether it should be altered, but at the moment the conclusion has been that legislation should not be introduced to alter it.

290. What is at stake on this point? What does it secure or prevent?——*Mr. Cobbold*: It immediately secures that if there is a depreciation in Issue Department securities, that can be made up, so that the value of Issue Department securities is always there, and the Issue Department is not, from a balance sheet point of view, insolvent. I would say that that is what it secures and probably what it was intended to secure.—*Mr. O'Brien*: There is in effect a reserve in the Exchange Equalisation Account which can be drawn on week by week to cover any depreciation and can receive any over-valuation of those securities in weeks when they have gone up.

291. *Chairman*: But if you had a long continued fall you would constantly be withdrawing funds from the Exchange Equalisation Account—I do not say that happens?——Yes, but the amounts that have accrued are so large that they can accommodate most likely falls.

292. *Professor Cairncross*: Where did the profits on the gold re-valuation go? Did they go into this Account? ——*Mr. O'Brien*: Yes. This is developed a little more fully in a later paper, the technical paper on the Exchange Equalisation Account.—*Mr. Cobbold*: It is a question you might want to go into further, and possibly with Treasury witnesses at the first stage, I think. It is a subject which has been in discussion between us from time to time.

293. *Chairman*: I gather it has not caused actually any embarrassment?—*Professor Sayers*: On the contrary, was it not designed to secure the Bank's accountants from embarrassment?——We are quite glad to have an easy means of keeping the Issue Department solvent.

294. *Professor Cairncross*: You say, in paragraph 19, that new private accounts are opened only for special reasons. Have there been any since the war?——*Mr. Cobbold*: Charitable accounts and accounts of public interest of one sort and another; the Lord Mayor's Hungary Appeal and that sort of thing. There are no individual private accounts except staff accounts.—*Mr. O'Brien*: There are also the overseas central banks' accounts.

295. None of the larger firms has become a depositor?——*Mr. Cobbold*: No.

296. *Professor Sayers*: When you are considering what policy should be followed, do you see any positive advantages in any of these groups of people remaining your customers, apart from Her Majesty's Government?——Yes.

297. Would you see advantage in extending this to cover further financial institutions, such as hire purchase finance companies, building societies, and life assurance companies, so that you might have the same advantages in dealing with them?——I think they are in a different category from the banking institutions, so far as relations are concerned. We may come to hire purchase on another paper. There is certainly a case for a bit more cohesion in our relationships with the hire purchase industry. It is conceivable that there might be with the building societies. I do not see nearly the same advantages in their being our customers as in the banks being our customers. It is very important that the banks, overseas and home, should be our customers. I think it is much more suitable with a banking house or a discount house, than, for example, with an insurance company or building society.

298. *Chairman*: What about industrial concerns? Would that give you a special view of what is going on there?——I do not think we could have accounts for them. I think it would only get us into the old business we have tried to get away from, competing with the commercial banks, which we should not wish to do. As a matter of fact we have one or two long-standing industrial customers who have been on our hooks for many years and are still there, but in the case of anybody except banks and organisations normally allied to banks, it would not materially help us for the development of contacts or from the point of view of information. We get contacts through members of the Court, and there are many other forms of contact besides our industrial Directors; we see a great number of commercial people day in and day out.

299. *Lord Harcourt*: Any private accounts on behalf of large firms would tend to be token accounts with the Bank and their main accounts would be with the commercial banks?——Certainly, they could only be token.

300. *Professor Cairncross*: This was not so twenty or thirty years ago with some of the larger firms?——I think it has steadily decreased over the last forty or fifty years.

301. In the late twenties, particularly, the Bank of England was brought into immediate contact with industrial finance because it had customers in industry? One particular contact I thought had had considerable influence on the policy of the Bank, and the views of the then Governor were somewhat affected by the contacts formed?——I suspect that the facts of that particular industry were brought rather more speedily to his notice than if that firm had not been a customer of the Bank.

302. *Sir Reginald Verdon Smith*: In these circumstances are your branches simply a survival of that previous phase, or do they still perform an active, useful purpose?——In our judgment they perform an active and useful purpose. They do a good deal of distribution and collection of notes, which decentralises the Chief Cashier's note issue work to a great extent. They also house the local clearings, that is to say clearings between the various clearing banks operating in the vicinity, so that everything does not come up through London. Our branches help with that to some extent. The Deputy Governor and I find them extremely useful, as giving us a little more insight than we would otherwise have into what is going on. We have regular reports from our Agents in large provincial centres. I quite often go to one of the branches myself and see people with the Agent. Some of our Directors go round the branches. It is a useful way of keeping contact with what is going on, industrially and commercially, and I regard them as extremely useful from that point of view.

303. If they are so useful, is it possible that more of them could be still more useful?——We have at times considered whether we ought to have one in another locality, but up to date we have felt that the country is fairly well covered.

304. On what grounds have you decided not to have a branch at a certain place?——It is the other way round; we have decided what branches not to close. The number has been dropping all the time, but we have kept certain of them open, thinking it was important to keep one open in those localities. That all happened before my time.

305. Over the last thirty or forty years the shift in the industrial population, the siting of firms, and so on, has been very considerable, and yet the Bank has not opened any new branches?——*Mr. Cobbold*: We have opened one at Southampton.—*Mr O'Brien*: There are branches at Southampton, Bristol, Manchester, Liverpool, Newcastle, Birmingham, and Leeds, so that the country is fairly well covered anyway.—*Mr. Cobbold*: And there is the Exchange control office at Glasgow.

306. *Sir John Woods*: You explained to us the relations between the Bank and the Treasury. I was wondering whether the Bank has much contact with other Departments, particularly the Board of Trade which is, I think, quite involved in a good many monetary and credit matters, and whose views may not always be the same as those of the Treasury?——We have a fair amount. On all questions of policy our relations are channelled through the Treasury. On questions of economic information, our economic advisers are in close touch and have full access to the Board of Trade figures.

307. I should have thought that the general policy view of the Board of Trade would have some importance; but no doubt the Treasury are aware of that from their side?——We should regard it as primarily for the Treasury to collect the views of other Departments. I have been in frequent touch with Permanent Secretaries of the Board of Trade over a period, and I generally know what they are thinking about in a lot of these matters.

308. *Chairman*: In paragraph 20, you say:—"The Bank have had no formal control over other banks and no duty of inspection; the possibility that the Bank might refuse to continue to maintain an account for another bank has been historically an effective sanction." That sounds as though, if something happened, that weapon is intact and could either be used or threatened. I do not want particular cases, but in general is that so?——It has certainly not been used in my time. You do not press me to give an individual case, but I can remember one or perhaps two cases when we wondered whether we ought to use the threat in my time. We should be prepared either to threaten to use it or to use it if necessary, and I think it still would have considerable effect. It would be a very serious matter for any bank, particularly for a clearing bank. Historically I could not say without research how often that weapon has been used. Perhaps you would like us to do some research into that. It has certainly not been used in the last 25 years.

309. *Professor Sayers*: Does the same apply to your other customers?——We should regard accepting houses and discount houses as covered by that.

310. Are we to understand that the power of direction, etc., referred to in the penultimate sentence beginning "Since 1946 . . . " is considered as being applicable to any of those institutions?——There is a statutory definition, I think:—" in this Section the expression 'banker' means any such person carrying on a banking undertaking as may be declared by order of the Treasury to be a bank for the purposes of this section."

311. Do you regard that as covering, if you wanted it to cover, an accepting house or a discount house?——Yes, certainly.

312. Would you not like it to cover more people? In that power of direction lies in many senses your sanction. You regard it as covering those classes of institution which are at the hub of the financial system. In the course of time other institutions grow up and also find opportunities for doing financial business, and the weight is bound to shift to some extent—other financial institutions may become important. Would it not be advisable if the Bank Act of 1946 were to be amended so that it should expressly cover a wider range of financial institutions?——I think my answer to that would be—although this is a point I might come back either to confirm or modify slightly*—that I should like it clearly to cover anybody who takes and advertises for deposits. I think that they would probably be brought within the definition, but

* See Qn. 1753.

I am not a legal authority, and I do not know whether the Treasury would be prepared to regard the definition in the Act as extending to anybody who took deposits, or whether the Law Officers would allow them to define anybody who took deposits as a bank for this purpose, if we wanted to use the power in this way.

313. There are, of course, other points of view than purely monetary control. If you were thinking of the safety of the public's deposits—and this is thought of in other countries' legislation—would you argue that there should be some specific power over any organisation that advertises for deposits?——I can only repeat that that mainly covers the hire purchase organisations, and it is a matter which is at the moment under discussion between the Treasury and ourselves, and with other Departments.

314. *Professor Sayers*: It might also cover Building Societies?——Is not that aspect of Building Societies covered by the Registrar of Friendly Societies? By that type of legislation I think almost everything, with the possible exception of hire purchase, is covered by legislation.

315. *Chairman*: I think the question that arises is this: if you are considering the safety of the public, would you be concerned with extending your power as Bank of England over these institutions, or would you look somewhere else?——Primarily somewhere else, so far as anything like building societies, insurance institutions, savings institutions are concerned. I should have thought that they were covered in other directions.

316. Your main answer was that in considering your effectiveness in carrying out monetary policy, you would like to be certain that your power of direction could extend to people who advertised for deposits?——I think I said that we might conceivably wish to have that power in relation to anybody who takes deposits, and that my own view is that the Treasury could define any such company as a bank for that purpose, although that view has not been tested legally.

317. There is one other question I ought to ask you on this paragraph. You have power to request information from bankers; are you satisfied with the amount of information you get on request?——Yes.

318. *Sir Reginald Verdon Smith*: Do you have a satisfactory working arrangement with the commercial banks for communication between you and them as a regular operation? Is that fully systematised?——I am perfectly satisfied with the arrangements.

319. *Chairman*: May we take paper No. 3?* This is as you say, primarily a handbook of background information. Paragraphs 1, 2 and 3 are introductory. Is there anything on paragraph 4?——*Mr. Cobbold*: Might I take the opportunity of going a little further on what Sir Reginald was asking? Would you like a little more about how the machinery of contact works between the Bank and the banking system at that point?—*Chairman*: Yes, please. —*Mr. Cobbold*: I have said to Sir Reginald that we are perfectly satisfied with it. For the record it might be useful to say that so far as the clearing banks are concerned there is a regular quarterly meeting between the Governors and the Chairmen of the clearing banks, with the Governor or Deputy Governor in the chair. The Committee of London Clearing Bankers meet every month by themselves, and under these arrangements once a quarter they meet with the Governor or Deputy Governor, or both. From time to time, if there is anything of sufficient importance to warrant it, I attend one of the other monthly meetings, or on occasion we have a special *ad hoc* meeting with the members of the Committee of London Clearing Bankers, who are the eleven clearing banks. But the main contact is between the Governors and the Chairman and Deputy Chairman of the Clearing Bankers Committee. I could not say exactly how often we meet, but I should think once or twice a week on average. We talk about one subject or another, and there is very close contact indeed. On the whole both parties have found it more convenient to deal with it in that way, through the Chairman of the Committee and the Governor and Deputy Governor, rather than to have the full meeting of the Committee on each occasion. That is the contact at top level. Then there is regular contact between the Chief Cashier and the Chairman and Deputy Chairman of the Chief Executive Officers' Committee, which is the operating committee for the Committee of London Clearing Bankers. There are, of course, a lot of contacts with individual clearing banks on matters affecting them. Very often one of the Chairmen or one of the Chief Officers comes to see one of the Governors or the Chief Cashier either on matters affecting that particular bank, or sometimes on matters of more general interest. On top of that there is day-to-day routine contact all the time in the money market between our Discount Office and the clearing banks' money departments, and on the overseas side between our Exchange Offices and the clearing banks' overseas offices; so there is a continuous link going on there pretty well all the time.

With the accepting houses the arrangements are rather similar; there is an Accepting Houses Committee, though that is not nearly such a closely integrated body as the Committee of London Clearing Bankers, and I think our contacts are more with individual accepting houses than through the Committee. We see the accepting houses very frequently at various levels in the Bank, and we have three directors from the accepting houses.

There is also a very close relationship with the discount houses; I see the Chairman of the Discount Market Association once a week, and of course their contact with the Discount Office of the Bank is daily and often almost hourly. Then again from time to time I would see the Chairman of a particular discount house either if I wanted to see him about something or if he wanted to see me about anything; but the normal contact with the market is (*a*) between the Discount Office and the market and (*b*) the weekly meeting between ourselves and the Chairman and Deputy Chairman of the Committee.

The Scottish banks should also be mentioned, although they are to some extent covered through our contact with the British Banking Association. I should explain that the Chairman of the Committee of London Clearing Bankers is almost invariably President of the British Bankers' Association as well, and the British Bankers' Association to some extent covers the whole field; but we make a practice of keeping a particular relationship with the Committee of Scottish Bank General Managers so as to make sure we have their views, and we are able to explain to the Scottish banks directly on similar lines as we do to the clearing banks.

320. *Professor Cairncross*: Would you regard the Bank of England as being the normal intermediary between Government Departments and all these financial institutions?——Yes.

321. I take it there is some contact between the Government directly and these institutions, that they do on occasions bypass the Bank? They do not always come to you to find out what is happening?——I daresay that is so. Any official or semi-official contact would be through us, but clearly the Chairman of a clearing bank may sit next to a Minister of the Crown at dinner.

322. So that, as you explained earlier, it would be your responsibility to explain your policy to each of these?——Certainly. I think perhaps that I should make one exception to that. If a bank is negotiating with the Export Credits Guarantee Department on a particular export credit, it might very likely want to go and discuss the thing direct with the Board of Trade. I should regard that as outside the general arrangement we were speaking of.

323. Take the case of the restriction of credit, where industry is affected in various ways. The Department likely to be most interested in what is happening is the Board of Trade. How does the Board of Trade learn how industry is being affected? Are they expected to make their own arrangements, to find out from their Regional Controllers, or do you regard it as your job to tell the Board of Trade what is happening?——We regard it as our job to tell the Treasury. Subsequent contact with other Departments we should regard as up to them.

324. Do you regard that as a satisfactory arrangement?——Obviously there are arguments both ways; but our experience has always been that it is more satisfactory to channel through one Government Department, the Treasury being the natural one. On the whole we have found that that avoids an enormous amount of diffusion,

* Memoranda of Evidence Part I No. 3.

contradiction, and so on. I would not say we do not have some contacts with other Departments; we do. There are quite often occasions when the Foreign Office, the Board of Trade, the Commonwealth Relations Office, the Colonial Office and a number of others ask our advice or assistance on particular problems, and we should then give them the information; but we should mention to the Treasury that we were doing so. Our experience is that it is, on balance, a good deal better to keep the single channel than to have a number of different ones.

325. What strikes me is the difficulty of making much progress with an exchange of views if neither party is able to speak directly to the other but there is always some intermediary from the Treasury. You often would not know what questions to put unless you were talking direct to them. I should have thought it would be better for you to have direct contact with the Commonwealth Relations Office or the Colonial Office instead of their being dependent on the Treasury for what they found out?——We have pretty close contact with the Colonial Office and the Commonwealth Relations Office, in official committees and in other ways.

326. *Professor Sayers*: May I ask you to explain to the Committee the relationship between the Bank of England and the Capital Issues Committee?——I am afraid I cannot remember whether it is by statute or only by invitation that we have always suggested one member of the Committee.

327. Would that be a member of your own body?——I must check whether I am right on this, but I think the first member was the then Deputy Governor, Mr. Catterns, who was directly succeeded by Sir Otto Niemeyer, who was an Executive Director of the Bank, and still remains in very close touch with us. I should add that it is common practice for the Capital Issues Committee, where there is any banking question, or any bank is directly involved, to refer to us, among other people, for advice.

328. *Chairman*: May I ask you a question arising out of paragraph 4? You say there that the deposits of the London clearing banks are in the main invested in the United Kingdom in British Government securities, including Treasury Bills. The range of investments in British Government securities and Treasury Bills may be very wide at any moment, and could have very wide variations within it?——Yes, that is so.

329. I would have thought rather, from something we were discussing with Mr. O'Brien and Mr. Hollom this morning, that for your purpose of influencing the money market it would be valuable to know the distribution of the different holdings, what proportion was long and what short?——The Treasury Bill holdings are published separately; so your question would only refer to the British Government stocks.

330. The point would be the proportion of those that are very close to maturity to those that are very distant. The distribution of the holdings, I should have thought, could be very important for the effectiveness of your own policy?——I think there are two questions involved here; one is a historical question, if I may so put it, and the other is an operational question. For the purposes of statistical history it might be useful if some more subdivision of the investments were made. That is a question you would wish to explore with the clearing banks. Operationally it does not worry me, because if I want to know I can ring them up and ask them.

331. That is what I wanted to find out; that kind of information, the actual split-up, is obtainable whenever you want it?——Yes, I can get it if I want it.

332. *Professor Cairncross*: Would not that information be necessary to enable you to predict the reaction of the banking system at a time when you were trying to restrict credit, and to an extent control the clearing banks?——We do not set out to control the policies of the clearing banks in that way.

333. But when you are trying to restrict credit, you ought to know what the reaction of the banking system will be to what you are doing; and that is the object of asking the clearing banks for information about their holdings. If you do not know what they are likely to sell, or could sell in the near future, can you form an accurate judgment of what their reaction would be to a reduction of cash, for instance? If they have the option of selling Treasury Bills or selling short term Government securities and they choose the latter, the result may be different from what you would wish——If the question is: can I foresee exactly what they are going to do, the answer is that I cannot foresee what an individual bank is going to decide to sell.

334. *Professor Sayers*: There are several hundreds of millions of stock maturing every year for the next five years. Have you any idea how much of those hundreds of millions are held by the clearing banks?——*Mr. O'Brien*: We have no formal information from the banks. But we are, after all, the Registrar of these Government stocks, and so far as that goes we know what they hold. That gives us some information, although it is not complete or accurate; but in many cases we have a pretty fair idea. Moreover, the Government Broker is always pretty well aware of any other operator on the market, who it is and what he is doing, so that by one means or another the fact that we do not receive information formally from the clearing banks does not mean that we are devoid of information.—*Mr. Cobbold*: We are, within a pretty close margin, very well informed on that point.

335. *Lord Harcourt*: By indirect rather than direct means?——By indirect means and also by informal information.

336. *Chairman*: I think the positive question we are working round to is this: given that you have these various indirect means of knowing, would it help you in your work of implementing monetary policy if you had a system under which you were currently informed in detail?——I would say that it might be useful for a long-term statistical study of what has happened as a historical matter. In these decisions I have never felt embarrassed operationally by lack of information on that point, because I either have got it by informal means or I know that I can get it.

337. *Professor Cairncross*: Would it not be an advantage to know what is the distribution of the investments held by the clearing banks between those of a maturity of more than five years and those of a maturity of less than five years, which can more or less be turned into money or into credit at will?——I do not think that would give me any operational advantage, because, as I have said, I would either have got the information informally, or if I had not I could get it at any time I wanted it.

338. Do you not feel it might be of some advantage to the public or the Treasury if you were to have it?——*Mr. Mynors*: Thinking only of ourselves, we probably could not get a formal regular return oftener than, say, once a month; and although it might be useful as a check-up after the event, it probably would not tell you more than you know on the day on which it is happening from somebody who comes in to tell you what he is doing, or from somebody else who comes in to tell you what he has heard about what somebody else is doing, which is absolutely operational at the time you get it. If you want to supplement that day-to-day information, as the Governor was saying, you can always ask somebody to tell you more. If you have a formal return it is always behind the times.

339. Is not what you say applicable to every bank asset? I do not see how the force of your arguments applies. It does not discount the value of one day's figures that they will never be the same the day after. In any event, you would not rely on that; you would rely on your contact with the market to tell you what is going on. Nevertheless, surely you would find it useful to have figures. If these short bonds are treated by the Bank of England as equivalent to Treasury Bills for the purpose of discount, would it not be useful to know what the total comes to, what proportion they are to the total investments?——I do not see the parallel with Treasury Bills.

340. I understand you are prepared to re-discount or to give advances against short-term Government stocks with up to five years' life; in other words, you are prepared to treat these on the same footing as Treasury Bills?——These are the holdings of the discount market.

341. I agree, but it is not a very long step from that; if the discount market did not exist it would be the same?——*Mr. O'Brien*: We must emphasise that what is under discussion is not the difference between ignorance and

knowledge; it is the difference between knowledge by means of a formal return and the knowledge which we get already, which we consider to be adequate for our purposes.

342. That may be true operationally, but what about the statistical advantage? The issue is not whether you can get statistics or whether your statistics are correct, but whether it would not be useful for the public to have the periodic statistics which have a very direct bearing on the decisions that are taken. The public have no information whatever about the distribution of the maturity of the investments of the clearing banks. They do not know whether a high proportion is in fact short, and I should have thought they ought to know that.——*Mr. Mynors*: That is a question of what the public should know. We were thinking of it more in terms of our own day-to-day needs.

343. *Professor Cairncross*: What anyone does nowadays depends, in the long run, in this country at any rate, on public opinion. That opinion may filter through in various ways to affect the direction of Government policy and Bank policy. I would not draw so sharp a line of division between those who are in charge of operations and those who are writing about the operations.—*Chairman*: Would you like to comment on that, Mr. Governor?——*Mr. Cobbold*: I do not want to dispute what Professor Cairncross has said. Operationally I stick to my answer: we have either got or can get what we want on this particular subject, and that any monthly, rather belated, return could not probably help us. I am perfectly prepared to look without prejudice at any suggestions for better statistics either on that or on any other point; it might well help. There are quite a lot of points on banking statistics which may arise both in discussion with the clearing banks and in discussion with the Treasury. I should have thought that this is no more than one of a possible series of measures to complete banking statistical information; but I want to make the point that operationally I do not think this worries us.

344. *Professor Cairncross*: We are a little in the dark about the operational significance of the proportion of short-term stocks held by the banks, because we do not know whether it is just over 5 per cent., 10 per cent. or 50 per cent. of their investments; but we were left with the impression this morning that there was a sizeable proportion.—*Professor Sayers*: If I am to talk to anyone in the Treasury about the monetary position, one of the things I want to say is something the Governor has said in answering public statements, that there has been too much liquidity in the banking system. If I am to make that point, I want to be able to point to the elements in the bank statements that show there is excess liquidity. I can point to the cash; I can point to the ratio of what are called liquid assets. I know, and Mr. O'Brien has told us this morning, that there is besides, at any rate in some of the bank statements, under the heading of "Investments", paper that is making the banks much too liquid from the point of view of tight monetary control, but I cannot say how much; these statements do not tell us anything. Professor Cairncross and I are suggesting that, in the present form of bank statements, a line is drawn between Treasury Bills and other Government paper, which does not seem to be warranted by the facts, and that that is not throwing a useful light on the present liquidity of the banks. I doubt whether anybody in the Treasury knows how much it is. That seems to me to be wrong. Would it not be better Mr. Governor, that the Treasury should know just how liquid the banks are?——Are, or could easily be: I think that there is a potential as well as an actual liquidity. It is not an absolute question, it is a question of degree. If I may ask for some clarification on this—you have in mind a split which would show the proportions under two years, and between two and five years, and over five years, or something of that sort?——*Professor Cairncross*: Yes.—*Mr. Mynors*: I should have thought that was a statistical point arising on any possible revision of the monthly banking figures and, as such, worthy of examination. Our earlier answers were purely on the operational side of things.

345. *Professor Cairncross*: We have to go on what our witnesses tell us on this; we have not got the figures. This is not purely statistical, and should not be looked at in that way?—*Chairman*: I think we have put the question to you and perhaps we can come back to it later; we were asking you how it affected you operationally?——*Mr. Cobbold*: Operationally it does not bother us, and we think it is all right from the wider point of view. As the Deputy Governor has said, I think we should regard this as a point very well worth consideration in the general context of banking statistics.

346. What is the meaning of Eastern Exchange Banks in paragraph 6?——That is a technical term. The Hong Kong and Shanghai Bank, the Chartered Bank of India, and a number of other banks operating in the Indian subcontinent and the Far East, are locally called exchange banks because they are the banks that deal with exchange in those parts of the world.

347. *Chairman*: In paragraph 11 you deal with hire purchase finance houses?——*Professor Sayers*: Am I right in assuming that none of the hire purchase finance houses is a member of the British Bankers' Association?——None.

348. Do you mean that they cannot become members of the British Bankers' Association?——*Mr. Mynors*: On the general question of admission to the B.B.A., there was a suggestion that somebody should be admitted last year; they must have written and asked, and there must have been a meeting which considered whether they were fit and proper people to be members, but I do not remember the details.

349. *Professor Cairncross*: If it is not known whether hire purchase finance houses are banks, how could they possibly be accepted?——*Mr. Cobbold*: I think the British Bankers' Association were inclined to admit that they were banks. But I do not know of any case where they have applied for membership; nobody is a member.

350. *Sir John Woods*: I suppose later perhaps we can get some knowledge about the amount of money involved in the acceptance of deposits by hire purchase companies?—*Chairman*: I thought from something we heard you might have some information on this point; have you anything?——*Mr. Cobbold*: Not nearly as much as we should like.

351. On paragraph 15, what are the Special Investment Departments of the Trustee Savings Banks?——*Mr. O'Brien*: The funds deposited in the Ordinary Departments of the Trustee Savings Banks are invested under the control of the Commissioners for the Reduction of the National Debt. The funds in the Special Investment Departments are invested by the Savings Banks themselves.

352. What makes them Special Investment Departments? Why do the National Debt Commissioners gather in one and not the other?——They pay a higher rate of interest in the Special Investment Departments.

353. Does that require a different investment policy?——Yes, and longer notices for withdrawal. So far as the amounts are concerned, I do not think you can put as little as £1 m.

354. I do not think there are any other questions on this part of this paper, so perhaps it might be a good point to break off. We are going to see you again on Friday, July 26th?——*Mr. Cobbold*: Yes, Mr. Chairman.—*Chairman*: Thank you very much.

(Adjourned until Tuesday, 16th July, 1957, at 10.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

SECOND DAY

Tuesday, 16th July, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	SIR REGINALD VERDON SMITH
The Rt. Hon. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	GEORGE WOODCOCK, Esq., C.B.E. (Questions 355 to 495 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	SIR JOHN WOODS, G.C.B., M.V.O.
W. E. JONES, Esq., C.B.E.	MR. R. T. ARMSTRONG, *Secretary*
PROFESSOR R. S. SAYERS, F.B.A.	MR. G. PENRICE, *Statistical Adviser*

L. K. O'BRIEN, ESQ., Chief Cashier, Bank of England, and J. Q. HOLLOM, ESQ., Deputy Chief Cashier, Bank of England, called and examined.

355. *Chairman*: I think that we had put away paragraph 4*. Are there any questions on paragraph 5? *Professor Sayers*: Why is it important to H.M. Government that they should rely on the tender being covered by the discount market?——It is important to H.M. Government that they should draw in enough cash to meet their outgoings during the week.

356. Why is it important?——I think that we should be in a difficulty if we could not obtain the cash required to pay the bills.

357. What is the objection to creating the cash?——It is thought better to withdraw the cash from the market than to create new cash to feed into the market.

358. But you have got to feed in sufficient cash to allow the market to take up the full tender anyway; you would not have to feed in more cash. What is needed is sufficient cash to pay the Government's bills?——In so far as there is not sufficient cash in the market already to take up the tender, the deficiency has to be made good by the Bank in one way or another. Would your argument be that it might just as well be made good by Ways and Means Advances by the Bank as by a system under which the market takes up the whole of the tender?

359. I am asking why it is important to do it one way rather than the other. As far as I can see feeding cash into the market by Ways and Means Advances might in some circumstances have the effect of raising the banks' cash ratios above 8 per cent., but that on the basis of your earlier paper would be a matter of no importance?——No, since the extra cash would simply replace Treasury Bills that would otherwise have been taken out.

360. Would it weaken the Bank's control of the system at all?——Ways and Means Advances have always been regarded as something which is used simply to tide the Exchequer overnight if a mistake has been made in estimating the outturn of payments.

361. But that convention arose when the cash basis was important in itself as a regulator of the total position. Now you explain to us that the regulator is not the cash basis but the total of the liquid assets. That being so, is not this convention restricting the use of Ways and Means Advances outdated?——*Mr. Hollom*: I think that is to take a rather narrow view of the basis for the convention.—*Mr. O'Brien*: To pursue that question very far gets us into rather wider policy fields, whether it is desirable or otherwise for the Government to rely on the direct creation of cash by Bank Ways and Means Advances as against drawing in the money from the market to cover its expenditure.

362. But what is done to the total supply of money depends upon the cash plus Treasury Bills What happens to Ways and Means Advances can influence the distribution between Treasury Bills and cash, but it does not influence the total of cash plus Treasury Bills, which is important now. Is that not quite so?——I think that the main reason why the convention has been perpetuated is to minimise the extent to which the Government draws on the Central Bank to finance its requirements.

363. *Chairman*: Somewhere, either in this paper or in another one, I think the Bank gives us two reasons for preferring the system of always borrowing when it can on Treasury Bills: that it gives the Bank greater control of the money supply, and that to use Ways and Means Advances is to go on in a way that would attract much public attention. Could you enlarge?——I think it would attract public attention if the Government were seen to be borrowing in a large way and more than overnight from the Central Bank on Ways and Means Advances.

364. Is it wrong that public attention should be called to what the Government is doing?——*Mr. O'Brien*: I would not say that.—*Mr. Hollom*: Such borrowing might be held to carry the implication that the Government was unable to borrow from other sources, with a consequent reflection on its credit.

365. *Professor Sayers*: This public reaction depends upon a large part of the public having been brought up on the notion that cash is the basis of the banking system. When the public learns the meaning you put on it last week, will not the public reaction necessarily be different?——*Mr. O'Brien*: I would say so.

366. *Professor Cairncross*: Surely the form in which the debt is contracted affects interest rates. If you were prepared to provide cash rather than assume that someone would take up Treasury Bills, rates of interest would be different?——Yes.

367. *Professor Cairncross*. So your chief anxiety is ultimately centred round the structure of short term interest rates?——Yes. The volume of Treasury Bills offered week by week has an influence which varies from time to time on short terms rates of interest. If that volume were reduced substantially by borrowing from the Bank on Ways and Means Advances that also would have an influence on short term rates.

368. In other words the major material factor is the size of the public debt, but it makes some difference whether it is held in Treasury Bills or cash. If you increase the supply of cash relative to Treasury Bills you will tend to reduce short term rates of interest?——Yes.

369. *Chairman*: The discount houses can only be counted on to cover the weekly needs of borrowing on Treasury Bills because the Bank of England stands at their back?——In the last resort, if they cannot get sufficient cash from other sources to cover the Bills, they know they can come to the Bank to borrow at Bank Rate.

370. *Sir Oliver Franks*: Is it not effectively substituting for a market price operation an administrative monopoly? You decide the price at which Government shall borrow short term from non-governmental sources; you then

* Of Memoranda of Evidence Part I No. 5.

offer a certain amount; then by providing the cash to make it good you persuade the people who have to make the offer always to offer the amount you want. You are substituting determination of price by administrative means for determination of price by "come and go" in the market?——It is influenced in the first place by the level of Bank Rate, and in the second place by the shortness of money in the market, which can be induced by the authorities, and, of course, by a lot of other factors over which the authorities have no control, including the view of the market on the likely trend of interest rates, which may be influenced by factors outside Government control, or only partially within their control.

371. *Mr. Woodcock*: I gather from what you said in reply to Professor Cairncross that the main justification of this convention for the discount houses to take up the Bills was that it set a market rate. It was not, as Sir Oliver says, an administrative decision but a means of testing the market, with the Bank standing behind if necessary to provide the cash. If the Treasury were to go to the Bank of England and borrow on Ways and Means Advances, you would then have to do what Sir Oliver says you do, that is, fix the rate yourself. It would be a direct transaction between you and the Treasury. But as it is the Treasury tests the market and therefore settles the rates in that way?——Yes.

372. *Professor Cairncross*: You have the option of allowing the market to advance to the Government the money it requires in a way that will affect interest rates. If the outcome in the structure of interest rates were not to your liking you would then have to operate in some other form to secure the necessary adjustments. What you in fact do is to let the market take up Bills and, again, if interest rates are not to your liking, you have to make the appropriate adjustments. But in both cases, whether the market operated freely, or whether you were waiting until the tender was covered, what would be in your mind would be the kind of rates of interest that you wished to see established?——Certainly.

373. *Professor Sayers*: Is not the reason for these arrangements, not that the Government must get its cash, because it can do that any way, but that they make a convenient way of getting the kind of structure of short interest rates that the authorities want?——Obviously, the second is a very important reason for the present arrangements. But the first has been held to be an important reason, although I will not deny that the Government's needs could be met in the alternative way you suggest, which would raise a number of policy questions and possible objections about the methods to which the Government was apparently driven to finance itself.

374. If the public knew what was going on it would not make any difference?——That might well be true, but if they do not know it does make a difference.

375. *Professor Cairncross*: Let me put it again to you. You would not want the Government to be able to borrow without limit on Ways and Means Advances; you want to see a bill market of some kind and to see the Government obliged to use Treasury Bills as a method of financing its short term obligations. The convention that exists at present has the effect of limiting Government resort to Ways and Means Advances?——Certainly.

376. But so far as the Government's wishes about short term rates and your own wishes are different, that ultimately sets the basis. If you both see eye to eye it does not really matter?——I should say they do, but the other party would have to confirm or deny that. The intention hitherto has been to make the maximum use of the market to find the funds to meet the Government's needs, and any development of Ways and Means Advances by the Bank would tend to diminish the use of the market. Central banks all over the world try to limit so far as possible their Governments' direct access to them for advances of this character, but in other parts of the world they are not always so successful.

377. *Sir John Woods*: You agree that the technique of going to the market rather than using Ways and Means Advances has an effect on short term interest rates, but my impression is that that has not been the leading consideration from the Bank's view in preferring the use of the market. Am I right in that?——I would not like to put them in order of importance. It has been a very important consideration.

378. At the end of paragraph 6 you say:—

"Nevertheless, the dominant position of the Discount Houses in the tender ensures that the rate at which they tender (which, for the bulk of the tender, is agreed amongst themselves beforehand) . . ."

Mr. Woodcock was putting to you that this really was the old style competitive tender. It seems to me on that language that it is not. Is the price for all Bills a fixed and agreed price among the discount houses week by week?——It is a competitive tender in that there are a large number of prices at which people tender for the Bills, but in fact the most important element of the market, the twelve discount houses, get together each week and decide amongst themselves what they are going to offer for the Bills. To that extent it is something less than a perfectly free market where everybody bids the price he thinks.

379. It approximates to the description Sir Oliver gave, an administrative arrangement as to the amount of Bills and the price which is going to be paid for them?——To some extent. In effect the price at which the discount market tender for their Bills sets the floor to the price at which they are sold each week. The discount market contrive to offer the lowest price which is accepted and as a result only a portion of their tender is accepted, varying with the amounts tendered for at prices above. It depends upon the circumstances; there might be only one price above, or there might be thirty-five prices above. If you have a movement in Bank Rate, nobody knows where he is going to be. There is usually a large difference between various tenders. At the bottom there is always the discount market, the biggest tenderer, and they never get allotment in full.

380. *Lord Harcourt*: In the little bit in brackets you say "which, for the bulk of the tender, is agreed amongst themselves beforehand". Could you explain to us exactly what happens? If they are tendering for, say, £100 million of Bills, do they agree amongst themselves that for £80 million of that they will tender at one price and that there is a free for all for the balance of £20 million?——*Mr. O'Brien*: We know that they meet each Friday and that they talk and decide what they will do; but they will be the best people to tell you what takes place at these meetings. Our understanding is that they meet and that they decide—I think each house having one vote, regardless of its size—on what the price shall be; but each house, I think, nowadays has the right to pay 2d. per cent. more for an agreed proportion of the tender if it feels so inclined.—*Lord Harcourt*: We ought perhaps to keep this question for discussion with them.

381. *Mr. Jones*: The Treasury raises money from the discount market or from lenders on the basis of Bills sold at a discount and redeemed by the Treasury at par at the end of 91 days. Supposing the discount market is not in a position to take the Treasury Bills and there is resort to Ways and Means borrowing, what is the mechanism of the lending? For how long would money be lent on Ways and Means Advances, and what would be the comparative cost?——That supposes conditions which do not now operate. For any extended arrangements Ways and Means Advances would not necessarily be regarded as appropriate, because at the moment the sole purpose of Ways and Means Advances is to carry the Government overnight. They occur comparative rarely, merely when we get the figures wrong. Under the conditions you are supposing Ways and Means Advances would be more of the character of lending on Treasury Bills. It might be done for a longer period; I think it has been. About the rate one cannot say, because we should have to agree with the Treasury; but I would think that the rate of interest on such advances would be very similar to the rate of interest on Treasury Bills.

382. The fact that you were not able to get the money from the market would raise a question of confidence in those circumstances?——Yes, indeed that would enter into it.

383. *Professor Sayers*: Ways and Means Advances cost the Government nothing? The money goes from one pocket into another?——*Mr. Hollom*: No. The Ways and Means Advances by the Banking Department of the

Bank of England are not from one Government pocket to another: not all of the Banking Department's profits find their way to a Government pocket.

384. If your interests in all this were simply to set short rates of interest at whatever level you wanted, would it not be much simpler simply to have Treasury Bills, and other instruments also if necessary, on tap at stated prices, as they have been at various times in the past? What objection could there be to that?——*Mr. O'Brien*: We would fix the rates; it would be our assessment. At the moment it is in part at least the market's assessment. For example, on one occasion when we put Bank Rate to 4½ per cent., the market at the following tender put its rate for Treasury Bills quite close up to Bank Rate. We from our point of view would have preferred a wider margin, to give us more elbow room. We felt it had been overdone, but that was the market's assessment of the position.

385. But you could correct that as you pleased?——*Mr. O'Brien*: It is certainly possible to correct.—*Mr. Hollom*: There are still advantages in having a semi-independent assessment.

386. *Mr. Jones*: Is the discount market earning between 3½ per cent. and 4 per cent. on Treasury Bills as against Bank Rate of 5 per cent.?——*Mr. O'Brien*: That would be their gross earning. Out of that they have to pay for the money they borrow to finance their Treasury Bill holdings.

387. To what extent are the discount houses in a position to make what might be a fair return, say 3½ per cent., having regard to the fact that they have a substantial monopoly in the purchase of Treasury Bills?——I would not say they have a monopoly. They have something much less. The amount of Treasury Bills they get in the tender each week varies a great deal depending on the size of the outside tender and the relative prices that are offered. Some weeks the discount market might get 60 per cent. of its tender accepted at its price; other weeks it might get very much less.

388. *Sir Oliver Franks*: The important thing is the approximate figure over a period of six months or a year. What is it roughly?——*Mr. Hollom*: It would be more true to say the important figure is the size of the outside tender, because the percentage that the discount market gets is the percentage of the amount they apply for, which is variable.

389. Do you not know roughly what the proportion would be—40, 60 or 80 per cent.?——I should say that it is roughly half of the tender throughout the year.

390. That is so from year to year with slight variations?——I would think so.

391. *Mr. Jones*: Would the remaining 50 per cent. then be paid by the banks on behalf of customers and people like that outside the discount market? I have received the impression that the discount houses substantially took up these Treasury Bills?——*Mr. O'Brien*: They reckon to cover the tender, that is, to offer to take up the amount of the tender, and they do take up a very substantial proportion of it over the years, week by week. The outside tender consists of banks, as you say, taking up Bills for customers. The Bank of England, taking up Bills for overseas central banks, is a very big element in the tender.

392. *Chairman*: May we know how the allotment is done?——Everybody comes in on the Friday with their tender forms made out at the price at which they are tendering. Immediately after 1 o'clock they are sorted by the Bank. The highest price is accepted for each day and then we go down the list, each bid being so to speak a subtraction made from the total amount of the Bills offered until we have so much left for allotment at the price tendered by the discount market.

393. *Professor Cairncross*: Do they ever fail to get a Bill allotment?——I have never heard of it. Theirs is the least favourable price which is accepted. Sometimes when the discount market is very anxious to get the Bills it will pay more for them.

394. *Sir Oliver Franks*: Must it be the least favourable which is accepted? Are there never any over when they have been satisfied?——The outside tender may sometimes be at a higher price and that we always accept. Or the discount market may move their price up, and the outside tender will be left below and none of it be accepted. On these occasions the discount market get a very high proportion of the Bills. That varies from week to week; it depends what the discount market want to do. (When they come to you, they will be able to explain this more fully than I can, and I must explain it subject to what they have to say later.) In some cases they may be influenced by external events, by the movement of the exchanges, and will feel they must pay less for the Bills, that is to say, put the rate up. Other weeks they may feel they must have the Bills, and they bid for them accordingly. That determines whether the outside tenderers get in or not.

395. *Mr. Woodcock*: Are there any unofficial arrangements for exchanging information about tender prices?——Generally speaking some outside tenderers have a pretty good idea; others do not; and in consequence very frequently they make offers substantially but unnecessarily more favourable.

396. Would you describe the state of the discount houses' knowledge of the outside tenderers?——*Mr. Hollom*: It is not very easy to explain because the outside tenders are not a readily identifiable body. They may get some impression of what a particular tenderer may do, but it may be very slight and not covering any substantial amount of Bills.

397. Do you keep it to yourself when you go into tendering?——Yes.

398. *Sir Reginald Verdon Smith*: I find it very difficult to judge how far you regard competition in this matter as important. Are you really interested in competition rather than having all the Bills taken up?——*Mr. O'Brien*: We regard competition as important. We regard it, subject to having all Bills taken up, as important that the market should be as free as possible and that the rate should reflect the market view.

399. *Mr. Jones*: In one day's purchase to what extent could the rates accepted vary between the highest and lowest tender? What effect would that have on the borrowing rate?——When there is a movement in Bank Rate, it is very common for there to be a wide range of prices. I can remember one instance when we had 36 different prices.

400. What would be the difference between the highest and lowest in those circumstances?——It could be 2s. per cent. It is quite frequent for the range of prices accepted to vary by 1s. per cent.

401. *Chairman*: On the occasions when the discount houses go to the Bank of England for accommodation to enable them to take up their Bills, would it be fair to say that the Bank of England provides them with the money?——Yes.

402. Does that have an effect on rates?——*Mr. O'Brien*: It has an effect upon the market. If the discount market is borrowing heavily from the Bank the discount market do not like it because it is at a high rate and for a longer period than they would normally borrow at such high rates.—*Sir Oliver Franks*: That depends on whether the Bank of England chooses to make the money available at the penal rate or to adopt a neutral position and make money available to the market at the ordinary rate in order to keep the market in balance.—*Mr. Hollom*: The fact that the market may borrow from the Bank, so that the Bank in effect provides some of the money with which the Government's issue of Treasury Bills is taken up, does not carry the implication that the money would not have otherwise been put up by the market because of the market's reluctance, but the implication that our policy was to make the supply of money in the market sufficiently short to compel recourse to the Bank.

403. *Chairman*: It really means that the Bank of England remains in control of the short term rate?——*Mr. O'Brien*: Yes.

404. *Sir Oliver Franks*: And the element of competition is, first of all, between the unified tender of the discount market and the outside tenderers. That element of competition is increased to the extent that the discount houses themselves, in making their unified tender, have certain

room for manoeuvre in the price. All that degree of competition takes place within a fixed administrative framework laid down by the Bank. Is it, so to speak, a little garden of competition with high walls of administrative determination?——That is broadly true, but I think the degree of competition is perhaps a little greater than would be gathered from that description.

405. *Professor Cairncross*: The discount market presumably operates even if they are not successful in bidding for Bills. Do they operate by the sale or purchase of Government stocks?——Yes.

406. These will have other effects on interest rates? ——Yes. For example, at the beginning of this year when the amount of Treasury Bills was subsiding, as it normally does in the first quarter of the year, the fall was accentuated by the fact that the authorities were selling large quantities of stock. For that reason the Government did not need to finance itself on Treasury Bills. Therefore the amount of Treasury Bills issued was small. In addition the banks, foreseeing a decline in the Bank Rate, were more anxious to have Treasury Bills. The demand for Treasury Bills was stepped up. Consequently the discount market were finding it extremely difficult to get Bills. One of the consequences of that was that they invested more of their funds in short bonds than they would have done in other circumstances.

407. *Professor Sayers*: So the discount market was tending to replace its holdings of Treasury Bills by holdings of short bonds?——*Mr. Hollom*: Yes. One should not assume that the failure of the discount market to obtain the Treasury Bills it wants in the tender automatically gives it a supply of spare money which it tends to employ in the short bond market. Someone else has presumably taken up the Bills, so that there may be less money to lend to the discount market and the supply of funds would correspondingly more or less be cut down.

408. If the Government's accounting position is tending to reduce the total of liquid assets in the banking system, there will be no addition to the spare funds in the discount market. It has been suggested by the Chief Cashier that in the first month or so of this year the discount houses were taking up more short bonds because they were being left short of Treasury Bills.—*Sir Oliver Franks*: In the early months of this year the Government's accounting position was such that the number of Treasury Bills and the liquid assets in the banking system declined. At the same time the discount houses took up quite a large number of short term bonds. If you put those two facts together there must be some explanation of the second fact, which is not the one, or not wholly the one, which the Chief Cashier suggests?——*Mr. Hollom*: Yes, I think it must be so. One of the factors may well have been the increased appetite of the banks for Bills as against call money, which would provide the discount houses with more cash.

409. *Professor Sayers*: Surely, if the Government has reduced the volume of liquid assets available, the preference of the banks as between Treasury Bills and call money is not putting more money at the disposal of the discount houses, with which they can buy bonds?——*Mr. Hollom*: I think you can separate the two factors, leaving aside the fall in the volume of Bills and the effects of the fall. If you take them out of account you have a position in which at the outset the banks hold a given amount of assets in the form of Treasury Bills and over and above that an amount in one form or another which is then swept away by the process of the drawing in of revenue. If within that part of their assets which is not affected by the revenue they prefer Bills as against call money, the tendency surely would be for them to buy Bills from the discount houses and reduce their call money.—*Mr. O'Brien*: The banks' liquid assets, apart from cash and notes, consist largely of call money in the discount market and Treasury Bills. The call money allows the discount market to carry Treasury Bills which the banks would carry themselves in a different system. In so far as the banks pull in the Bills to themselves the discount houses have to carry something else.

410. Not if the banks are doing switching from call money to Treasury Bills? Then the amount of call money in the market is reduced?——The amount of call money in the market is reduced, but the banks have to pay for the Treasury Bills.

411. *Professor Cairncross*: The question is, where did the resources of the discount market come from, if they did not come from call money? We still have to explain whether they use their own capital or get funds from elsewhere.—*Chairman*: What were the additional resources which came into the discount houses?——The banks do not get their Treasury Bills for nothing. They have to pay for them.

412. The banks are not tendering?——No. They get their Bills almost entirely from the discount market. We will gladly think about that a bit more.*

413. *Professor Sayers*: All my questions were directed to establishing the fact that the action of the discount houses in buying short bonds cannot be explained by the reduction in the Treasury Bills available. They have other motives?——They have other motives, yes, but I will not accept that it can be fully explained in terms of other motives.

414. *Sir Oliver Franks*. You say in paragraph 5:

"Because of the importance of the Discount Market to the Clearing Banks . . ."

This is something which is regularly said, but it is not a belief which I encounter in my daily life. I want to assume for the purposes of the question I am going to put that the discount market is a useful and convenient form of institutional life. As far as I can ascertain from what is said in the ordinary way within the commercial banks, we do not mind very much whether there is this or another way of employing liquid resources that can be turned into currency on demand. This way suits us; there is another way that would suit us; but what does the difference come to? In the same way the banks hold Treasury Bills with only a few weeks to run. I am told by those older in the business than I that that is because "they" do not want us to buy them early. "They" want them kept for the discount market. Perhaps this sentence is not really stating an argument for the discount market on behalf of the clearing banks, but really only stating what the facts are in the situation?——We cannot speak for the clearing banks; they will have to speak for themselves. If they deny this then we do not fully understand the situation. The fact is that the discount market has survived. That may not be entirely due to the fact that the clearing banks like it so much. It may be because the Bank of England like it also. We believe it to be the most highly flexible mechanism for looking after the needs for short term money that there is in the world. I cannot say more than that. The clearing banks may not think so much of it as we do or they may think well of it for different reasons.

415. *Mr. Woodcock*: But surely it does not matter to them, does it? It would be all the same to the clearing banks to rediscount themselves?——They could rediscount, but I think one of the main purposes of the discount market is that it is a highly special organisation which matches up shortages and surpluses and reduces the need for intervention to a minimum.

416. But the clearing banks ought on paper to be quite as happy to rediscount themselves?——That would be so if they had no call money with the discount market at all, if they in fact took up all the Treasury Bills on the tender. Whether or not they would agree to cover the tender, and whether or not it would be a desirable arrangement, is doubtful; but, assuming they had taken up the Treasury Bills on the tender, they could convert them into cash at the Bank of England. The Bills could not be converted into cash in the market so easily, because it would be more difficult to sell Treasury Bills in the market if there was no mechanism which dealt with such a commodity. If one assumes that one has assassinated the discount market, there would be nothing between the authorities, trying to get their requirements from the market, and the banks, who would be the major element, as indeed they are now. The discount market stands there to introduce a fluid marketability in these particular media.

417. *Professor Sayers*: As the system runs now, the discount market's work in adjusting the cash position of the clearing banks consists in a certain amount of walking around in the market and talking to people, and a considerable amount of telephoning. It has always seemed to me that there would be no inherent difficulty in doing it all by telephoning directly between the banks

* See Appendix to Minutes of Evidence.

and not from banks to discount houses and discount houses to banks. Is that a fair description of the position?——It is a fair description of the present position, but it is a matter of opinion whether the alternative you suggest would be as efficient as the present system. I would doubt it myself.

418. Why does it matter that there should be intermediaries there?——If it were done between the banks you would tend to have people on the periphery trying to sort out their overs and shorts, whereas with the discount market in the middle the business is centralised. Where there is overall shortage or surplus in the market in the morning I do not think it would become so quickly apparent during the day if the banks were doing it round the circle. It is not just a question of the banks, it is all people who have money to lend.

419. Then is the work of the discount market here primarily not for the convenience of the clearing banks but for the mopping up of cash surpluses in the outside banks and institutions?——It is difficult to put things in the order of merit. Certainly, from the authorities' point of view, to have an organisation which quickly demonstrates whether money is over or short very much facilitates credit control and management.

420. Surely a quick piece of telephoning round the clearing banks would establish the fact very much more quickly than under the present system?——*Mr. O'Brien*: It would not at the present time, but if you had no discount market, then it would.—*Mr. Woodcock*: If we had not a market functioning normally, we should have to devise a different system; I think we should devise one which operated pretty satisfactorily.

421. *Sir Oliver Franks*: The effect of the answers to the questions which Professor Sayers was asking earlier was to give a picture of the discount market within the general framework of administration and control by the Bank of England, with a degree of competition within that framework. The control of the price of short term money was one of the important things with which the Bank of England was concerned. Now let us suppose that the Bank Rate is fixed at whatever it may be for the time being; what are first the types of consideration, the sorts of motive, which influence the Bank of England in looking at the rates of short term money one way or another, and who are the types of persons or institutions affected?—*Chairman*: The second half of the question is purely factual, is it not: within what ranges do the changes in short term rates make their effect?——*Mr. O'Brien*: The eddies from the stone thrown into the pond go right out to the periphery. I think that on the whole the Governor would prefer to deal with that question in its larger sense.—*Sir Oliver Franks*: That is why I was trying to put it in a form in which we could get a descriptive explanation without having to introduce the policy issues which lie behind.——*Mr. O'Brien*: I am prepared to go cautiously as far as I can to help; this steps outside my sphere very considerably. If we decide to influence short term rates in one direction or another, given a particular level of Bank Rate, the first rate which is affected is the Treasury Bill rate. Supposing we wanted to make short term rates higher, we should keep money short in the market consistently, and as a result the discount market would be compelled to borrow from us quite heavily and quite often. This would have an effect upon the overall cost of the money which they are borrowing to finance their book of Treasury Bills and short bonds. They would feel for that reason alone that they must put up the rate for the Treasury Bills they buy, in order to retain their profit margin. They would be influenced by the obvious wishes of the authorities to move in that direction. The influence on the Treasury Bill rate would spread into the short bond market, because the short bond also is largely held on borrowed money. That would tend to increase the yields on short bonds. If that movement persisted the conditions in the short bond market would tend to spill over into the medium-term market, and even into the long-term market after a period. So the effect can be very wide indeed.

422. *Chairman*: Given that conditions in the short bond market flow from the Treasury Bill market, why should they spread over a period of time into the long term rate of interest?——Largely because that would reflect the views of what the future held. If we were making rates very tight at the short end that would presumably mean we felt that a squeezing or tightening of rates was a necessary corrective to the situation which was developing, and people buying and selling medium and long term securities would be influenced by those things.

423. *Sir Oliver Franks*: I can see that, if the other type of consideration that you mention is taken into account, the authorities must be taking a certain view of the whole situation, the whole economy, and therefore the markets behave differently in relation to their holdings on medium or long term bonds. But that is a psychological argument about states of mind and inferences from them. When we come simply to the working of the price mechanism, apart from people's states of mind, if the Bank of England successfully levers up the rate for short term money, who is to behave differently because that has happened?——The discount market in the first instance. They are important people when it comes to a change of behaviour under that kind of influence, because they are large holders of and traders in the securities whose rates of interest are being altered.

424. In the circle that goes round the Bank of England, the discount houses, the clearing banks, call money and so on, the partners in the quadrille all step a little differently because of the action the Bank has taken. Who then has to behave differently because they have changed the step?——*Mr. Hollom*: Amongst those immediately affected are those who advance money on commercial bills.—*Sir Oliver Franks*: That of course is a very small fraction of the whole?—*Mr. Hollom*: Yes. If the movement is carried far enough the banks themselves may alter their lending rates. It does not often happen without a change in the Bank Rate, but it does happen.

425. Leaving aside the broader considerations about people making judgments about the state of mind of the authorities and therefore behaving differently, I am still not clear whether minor changes in the rate of money, within a given Bank Rate, which obviously affect the people immediately in the ring, necessarily have any effect outside the little ring. For example, what about the sterling balances in London? Do they begin earning a little less? Is that important? Is there anything which is very important?——*Mr. O'Brien*. The actions of these people who are directly affected may be important. For instance, the discount market's actions on short bonds will affect general dealings on the Stock Exchange. All those bonds are affected by a change in price. The price may be affected by different attitudes of the authorities, and still more by psychological reactions as to what a particular attitude is felt to connote for the future. That does, of course, alter what we have to pay on overseas holdings of bonds and sterling balances in this country. It has in the past, but perhaps less now, altered the attitude of people abroad, whether to put sterling here or not.

426. *Professor Cairncross*: Do international transactions financed in London escape without any repercussions when rates go up?——I did not say it was possible to escape without any repercussions.

427. Do you think that any more business is attracted to London in that way, or that more money is attracted to London from foreign centres?——That does happen; I think it is less important than it used to be.

428. But you have no conception of the odds involved here?——No.

429. If rates in London doubled, for instance, and did not move elsewhere, would that not have a considerable effect on transactions?——It would also depend on the forward exchange rates; it would increase the cost of covering your exchange, as people invariably do now.

430. At one time there was a considerable response to the movement of rates at other European centres; do you believe that there is not much movement of money into London or out of London, or any movement of business into London or out of London, in response to changes of interest rates?——There have been occasions when we have seen a considerable movement into London under that kind of influence. At other times when we might have expected the same thing to happen it has been notably absent. There is no constantly true answer to that question.

431. Would account be taken of the impact of high rates on the balance of payments?——I think we are bound to nowadays.

432. *Professor Sayers*: May I put this point in a different form? Suppose that what was fixed every Thursday morning was not just the re-discount rate but also the rate at which Treasury Bills would be available, and the rate at which the discount houses borrowed all their call money from the clearing banks; and then further suppose they were altered when the Bank Rate was altered, so that the process of fixing the Bank Rate was the process of fixing a steering rate for the other rates; would this matter to anyone in the market, particularly anyone on the fringes of the market? I am thinking purely of the effect of the rate structure on people in the market. I think that is the point.——*Sir Oliver Franks*: I am wondering how these small movements in the short term money market, within a given Bank Rate, if you abstract the psychological arguments, affect the wider ranges of people who have to deal in money, short, medium and long term. If it turned out that nobody was affected, then we would have a series of operations which went round, as it were, in an admiring circle of its own perfections but which was not of great importance apart from that?——Variations in market rates within a given level of Bank Rate express themselves in the first instance in a change in the Treasury Bill rate, which affects immediately the discount market, on the one hand, as the lender, and the Government on the other hand, as the borrower, increasing or decreasing the cost of its borrowing. This cost is in part transferable overseas in so far as foreign central banks and others abroad hold Treasury Bills. In affecting the lender, it affects the rates at which he can borrow money in order to lend, and therefore it affects the people from whom he borrows, the clearing banks, the subsidiary banks and any other lender who may lend money at sight or short term to the discount market. So the effects on that side spread out in a pretty extensive way, but diminishing as you get further and further away. As they spread out, it shows on the other side in that the cost to the Government is reflected in many Governmental activities and to some degree in the balance of payments. The Treasury Bill rate having altered, the short bond rate is likely to alter. If the movement is upward, it is likely that the money which the discount houses need to borrow in order to finance their books of short bonds will become more expensive, and therefore they will be prepared to deal in such bonds at lower prices. This will affect the short bond market generally, so that all dealers in such securities will feel it, and the Government might feel it if they were selling such bonds from their portfolios; or, if they wished to issue bonds of that character, it would affect the cost of their borrowing.

433. *Professor Cairncross*: It has been suggested that it might be possible to hold Bank Rate where it is and allow short rates to fall in relation to Bank Rate and to maintain a fairly wide spread. Then the Bank Rate would continue to determine the banks' lending rates and other important rates in the community. Are you contemplating that proposal in making your answer?——No. Mine was a purely technical description. What happens in a situation where, as you say, one rate is made the basis for bank advances and another for short term money loans, seems an entirely separate question, and I do not think I would be prepared to give an answer on it at the moment.

434. Are you thinking of an alteration in rates within the order of perhaps one-quarter per cent.?——No, I was saying that, whatever takes place in short term rates under a given level of Bank Rate, this is a description of the eddies which result from it.

435. The size of a variation might make a material difference. Given a variation of half of one per cent., could not the effects of this differ markedly from the effects of variations of the kind which you had in mind?——I would not think so.

436. *Professor Sayers*: Would it not mean that more people would be drawn into the eddy or that the effect on people in the eddy would be heavier?—*Professor Cairncross*: If the short term rate altered by as much as one per cent., even with a fixed Bank Rate, that would have consequences on medium rates and ultimately on longer rates, and would have quite different consequences for a different set of people. You would be varying the price of liquidity. The question is, how much does liquidity matter? There might be large numbers of people who might be prepared to put their funds into the bill market, if rates there were relatively high in relation to rates prevailing in other markets. Has there been a noticeable tendency to put funds into the short market by people who, in the past, may not have thought much about it?——I think there probably is. There has been a tendency for people to put funds into Treasury Bills; but that of course was to gain the greater interest on Treasury Bills, as against the interest on bank deposits, thus preserving their liquidity but getting more out of it.

437. But surely a movement from bank deposits is none the less a move towards something slightly less liquid?——Slightly less liquid, but in practice a Bill can be sold readily.

438. So can a deposit?——No, a bank needs seven days' notice before you draw your money, except under penalty.

439. From a current account?——There is no comparison there; there is no interest on current account.

440. That is a comparison I was rather pressing on you. Would you not think that some large companies have substantial funds which they hold on current account and which they would put into Treasury Bills?——I would not like to distinguish between current account and deposit account; perhaps the bankers could do that. Certainly the attraction of the Treasury Bill at present, with its high rate, has meant that a lot of large commercial and industrial firms have gone into Bills.

441. We are dealing with a money supply of £6,000 million, or more if we add in currency; a loss from this total of the order of £100 million or £200 million may seem small; but might it not be perceptible in relation to the consequences you want to see follow, in relation to capital expenditure, for instance, or the balance of payments, or in relation to bank liquidity? Do you think that a loss of £100 million to £200 million is conceivable if short term rates move up by 1 per cent.?——I suppose it is conceivable. I could not say more than that.

442. If we take the movement under which some of the larger companies have been buying Bills, do you think that these purchases have been of the order of £100 million to £200 million?——*Mr. O'Brien*: Perhaps £100 million; that is possible.—*Professor Sayers*: Has the Bank even approximate estimates as to the number of Bills held by the clearing banks, the discount houses, outside banks, etc., and industrial and commercial holders?——*Mr. O'Brien*: You asked last week for the figures of the distribution of Treasury Bills. I am not in a position to come back to you at this stage, but I hope we shall have some information soon*.

443. Would you agree that, if short term rates rise even by one half of one per cent., that will have a damping effect on the values of bonds or securities and that there will be a tendency for the values of all bonds, all the way up the list right to long term, to decline, or certainly not to rise?——Yes, I would accept that.

444. Have you any idea of the mechanism by which this happens? Is it just the effect of opinion, or are there people dealing in both ends of the market?——There must be arbitrage, of course.

445. There certainly is arbitrage. Do you see anything of it?——Yes, I think we do, though not on a massive scale.

446. But if rates differed seriously, then it might become large?——It might.

447. *Mr. Jones*: What is the shortest maturity date of a Government Bond?——The shortest at the moment is one that will mature on 14th November next, the 2½ per cent. Serial Funding Stock. From time to time, of course, it varies, but nowadays we have always got some maturing in each year; we have maturities right up to 1962.

448. *Mr. Jones*: But what is the length of the life of the bond itself—the shortest period of a bond?—*Chairman*: In other words, after the Treasury Bill, what is the next shortest period of life?——There is no constant period: it depends. We would not normally issue a Government security of less than one year. The shortest that I can remember is one of a trio of Government securities which we issued when we funded a substantial proportion of the floating debt in November 1951. They were funded into Serial Funding Stocks, which were

* See Appendix to Minutes of Evidence, note to Qn. 2248, and Memoranda of Evidence Part I Appendix 2.

Stock Exchange securities. One of these matured one year after the date of issue; and then there was another one maturing after two years; and another one after three.

449. *Mr. Jones*: To what extent does the discount market purchase gilt-edged in the stock market?——It is a very substantial holder of short bonds up to five years, but not beyond.

450. And is it purchasing all the time in the stock market?——Purchasing, selling, dealing.

451. As regards this question of the cost of borrowing you told us some time ago that the tender prices for Treasury Bills could vary to the extent of 2s. per cent.? Now suppose that you had a situation where you had one block of Treasury Bills and the following quarter another block; over a period of four quarters you could have a situation, could you not, where the cost of operating at the highest rate would be two-fifths of one per cent. higher than the lowest rate?——I do not quite follow you.

452. It costs 2s. more to borrow the money at the highest accepted tender rate and you do it four times a year, because you pay that 2s. in respect of a quarter's borrowing, so that, if you were maturing and issuing on the same basis, it would cost you over the period of a year 8s. more. That is a fairly substantial extra burden for borrowing?——Yes, if that were the position; but it is not likely to be because I do not think there is likely to be a range of sales at 2s. on the tender prices: that is merely what has happened in the past. It varies each week, and the people who tender at the higher price do not cover the whole tender. We might only sell £1,000,000 or £500,000 or £100,000 at the highest rate.

453. *Lord Harcourt*: Have you in fact any means at the Bank of England whereby you can tell what Bills are held outside the market at any given moment? The tender record will not show you, because the application will come through a bank, and equally, when Bills come for payment on maturity, they will come through a clearing bank?——*Mr. O'Brien*: That is so. Whether we could find out for you, I am not yet sure; you asked last week for figures of the distribution of Treasury Bills, and we are working on that. But the present answer is that we do not know.—*Mr. Hollom*: We could ask particular persons what they do.

454. *Chairman*: I think we have pretty well covered paragraph 6. Paragraph 7?——*Mr. Jones*: I wonder if Mr. O'Brien could elaborate on the long sentence at the end of paragraph 7, beginning "The Bank operate almost daily in the Market . . . ". I would like to know what happens in this operation in the market to "smooth out shortages and surpluses of funds between one day and another, which arise mainly out of the uneven incidence of payments by and to H.M. Government". You say you also operate to create conditions of continuing ease or shortness of money at times when it is desired to influence short-term rates in a particular direction. This is the operation of Bank and Exchequer policy?—*Chairman*: Is there any other purpose in all this except to influence the short-term rate?——We might say that the primary purpose, leaving policy aside, is a purely immediate one of smoothing out the ebb and flow of money between the market and the Exchequer—a mere question of tidiness. Perhaps I can describe what takes place in the Bank, leaving aside the question of policy for the time being, and just taking the mechanics. The Exchequer, every week of its life, has receipts and disbursements. Its main receipt is revenue, which flows in throughout the year but mainly in the first quarter of the calendar year. On the other side it has disbursements week by week, such as maturing Treasury Bills which it has to pay off; interest on Government stocks at all times; from time to time it has to repay stocks at maturity; it has to pay money out under the Health Service and for education grants at periodic intervals. It now makes a monthly payment to the nationalised industries for their requirements, and also the ebb and flow of exchange reserves have their counterpart in receipts and disbursements from the Exchequer. In collaboration with the Treasury, we keep a very close watch on these transactions and arrive at a position where we decide that, assuming the amount of Bills to be offered in the period ahead at the tender is going to be the same as the Bills maturing, then the Exchequer has a net requirement, in that particular week, or a net surplus, of so much. We try to look forward over a period, which usually happens to be about seven weeks, because that is as far ahead as we can look with any reasonable certainty. The further ahead we look the more imponderables there are. On the basis of this looking into the future, we decide each week how many Bills we must advise the Treasury they should offer at the tender to meet their requirements. We offer those Bills for the tender to be taken up in the week after next, and on the following Friday when we are opening the tenders which have been made in respect of the next week, we can then decide whether to allot the Bills which have been applied for in full or not. Events may have taken place which may have altered our estimates of the money required. We may have offered £240 million last week; this week we will cut that down and allot only £220 million. Then that theoretically should cover the Exchequer's requirements absolutely in the following week so that they should come out at the end with nothing unbalanced and with the market undisturbed. Even so, during the week you might have a Health payment of £25 million on one day, which would make the market very full of cash that day, and there might be revenue coming in the following day, which would make them very short; so within each week there will still be tightnesses and surpluses arising. We try as we go along to ease these out; the method of easing shortages is by buying Treasury Bills in the discount market and from the banks, which puts cash back into the market and restores the cash which they may have lost, for example, as a result of paying revenue to the Exchequer. So, purely as a matter of mechanics, we can go a long way in evening out surpluses and shortages. Occasionally we even them out by selling Bills. That is more rare because usually we can see a surplus some way ahead and deal with it in other ways.

Outside that question of pure mechanics is the question of policy: do we want the market to be short of cash? That will influence our decision about the number of Treasury Bills which we recommend the Treasury to offer at the tender. If we want the market to be short then we take good care that the Treasury borrows, if anything, more than it requires in that particular week. As a result the market will be short, because it will be paying the money into the Exchequer. If we do not choose to relieve that shortage by the painless method of buying Treasury Bills at market rates, then the market has to go into the Discount Office and borrow at Bank Rate.

455. *Chairman*: Why does it matter to the Bank that these displacements should occur from day to day except in its influence upon the short-term rate?——If our policy was to be neutral, it would not be possible to maintain a neutral policy without smoothing them out, because the shortages would make themselves felt. On a day when there were large shortages the market would have to borrow quite heavily from the Bank, and that would tend to drive up the short-term rates, which we might not want.

456. But, apart from your interest in the short-term rates, does it matter whether there are surpluses one day and shortages the next day?——Yes, because, leaving aside any question of monetary policy, this is a market for money, and its reputation throughout the world depends upon it being an efficient market, a market in which people who want to realise an asset quickly to meet funds can do so without any trouble. I think that if we disregarded the ebb and flow of cash and let the market stew in its own juice, it would lessen its efficiency to meet all the hazards of a market.

457. *Chairman*: And therefore when your interest in it did arise you might find less balances?——For example, take an overseas bank with large sterling assets partly required to meet large sterling payments in respect of its international trade. If an overseas central bank can employ those assets at interest, except for a relatively small cash balance, and yet at the same time always have them at their disposal at a moment's notice to make any payment which they are called upon to make, its regard for sterling will be very much increased. This, I may say, is one of our prides; that people who hold sterling can use it in that way at a moment's notice. In certain other markets it is not so easy. I think that if we left the market to its own devices, it would become less efficient

458. *Professor Sayers*: But only if the discount houses were unable to pay off their call money on demand. There is no question of leaving them in the position where they could not pay off their call money; they could always go to the Bank if need be. How would their efficiency as places at which money could be lent for short terms be affected by the market's having to go formally to the Bank's front door much more frequently and on a much bigger scale?——*Mr. O'Brien*: I think the mere matter of frequency would lessen our own efficiency.—*Mr. Hollom*: The sort of people we are considering do not ordinarily lend money direct to the discount houses but invest it in Treasury Bills which they would need to sell to the discount houses. The difficulty of selling to the discount houses or anyone else in the market on days when there was an acute shortage of funds would tend to lead to very volatile rates as between one day and the next. If a holder of Treasury Bills is liable, when he wants to realise them, to suffer a considerable penalty because rates are highly volatile—quite fortuitously—between one day and the next, the attraction of Treasury Bills is obviously liable to be reduced.

459. But are you right in saying that rates would become highly volatile? If the market was very frequently indeed in this position, the market rate would surely tend never to fall much below Bank Rate?——*Mr. O'Brien*: I do not think it would necessarily follow, because there might be just as many days when the market was swimming in money.—*Mr. Hollom*: If you assume that in a week which, over the week as a whole, is perfectly even, there is a great shortage of money on Monday and an equal surplus on Tuesday.—*Professor Sayers*: But why assume that?—*Mr. O'Brien*: Because, in those circumstances, assuming that we were going to do nothing to even out the ebb and flow but would allow the discount market this facility of borrowing in the Discount Office, if there was a shortage on Monday, they would borrow so many millions for 7 days at 5 per cent.; then if, quite apart from the money which has been put on to the market by us on Monday, there was a surplus of £50,000,000 on Tuesday, the market would be swimming in unlendable cash, and we would do nothing about it.

460. It depends in fact on your rule about 7 days?——*Mr. Hollom*: Even if it was less—only overnight—it would have almost the same result, assuming that Monday was tight and Tuesday was comfortable.

461. No, because you would be in a position to virtually prevent there ever being a glut of money. That would mean that the market would come in on an enormous scale?——*Mr. O'Brien*: How could we prevent a glut? Supposing it was not 7-day money but merely overnight, and supposing we had lent £30 millions on Monday which was repaid on Tuesday, it would mean in effect that Tuesday's shortage would be transferred to the following day, but then the surplus the following day might be £60 millions.

462. No. If you are assuming that you have already created a cash basis that makes it necessary for the market to borrow only £30 million on Monday, I suggest that you could have limited the cash in such a way that the market had £90 million on Monday?——Not so long as the banks want to keep their 8 per cent., because the assumption is that in one way or another they would have achieved it the night before.

463. They would have achieved it by the market borrowing £90 million on Monday?——No. Suppose that at the end of the week, on Saturday, all books are closed; the market in one way or another has found the cash it requires, and it has found that cash principally in order to enable the banks to keep their 8 per cent. In order to keep the 8 per cent. they have drawn cash from the market which has had to find it elsewhere. So now we start on Monday morning clean and bright and in good order with 8 per cent. for the banks. Then, if there is a shortage it might be made good by borrowing money from the Bank of England, the purpose again being to restore the banks' 8 per cent. Next day that money is repaid to the Bank of England, which, to that extent, produces a shortage; but if the surplus occurring in the ordinary way on that particular day is even greater, you have still got money which is unlendable.

464. *Professor Sayers*: There must surely be figures at which you create the minimum cash balance, and then everything that is required on any day over that is borrowed from the Bank of England, provided you are prepared to lend overnight?—*Professor Cairncross*: It was suggested that, if you did not operate in the way you do, it might be possible to reach the position where the market rate and Bank Rate were identical; there would then be changes of the rate which you might not want. You prefer to keep the changes as a last resort, and if there are changes you want them to be in conformity with some plan of your own rather than in some undefined way. If there is not some mechanism by which undesired rates can be avoided, you would not have an efficient market?——Yes. I should need to think rather more about Professor Sayers's plan before accepting that it could be done.

465. *Professor Sayers*: I was not putting it forward seriously as a necessary improvement; I was merely wanting to bring out the reasons for holding to the present system?——*Mr. Hollom*: It is perhaps worth pointing out, in case it is not already sufficiently obvious, that if desired we do, in fact, lend overnight by buying the following day's Bills.

466. *Lord Harcourt*: But that is at the Bill rate and not Bank Rate?——*Mr. O'Brien*: Yes.

467. *Professor Sayers*: The 7-day minimum is maintained purely because it strengthens your hand in the market?——It adds to the penalty, so that the penalty is effective even when market rates are relatively close to Bank Rate. The 7-day period can be extended, if loans are rather large, to 8, 9 or 10 days, on the basis that we do not reckon to lend to the market on one day more than we think they can reasonably be expected to repay on maturity. So we phase it so that those who get there last get the 9-day money, and their faces are redder than those who come first.

468. *Lord Harcourt*: On any day will there be a proportion of 7-day, 8-day and 9-day money?——Only if the borrowings from the Bank are very heavy. In the normal case it would always be 7-day money. But if the market comes into the Bank to borrow at the half-year or at the end of the year, when quite possibly the whole market comes in and borrows very substantial amounts, then it is quite possible that some of the money would be 7-day and some of it would be 8-day and the other 9-day, and so on.

469. *Professor Sayers*: And is it the people at the back of the queue who get the 9-day money?——*Mr. Hollom*: Not necessarily. If the indications are that heavy borrowing is going to take place and that it would be desirable to spread some of it over 8 or 9 days, we should not lend to a particular house a disproportionate amount of 7-day money in relation to its size and what we know to be the volume of its business, and so on; otherwise the tendency would be for a particular house to come in first and borrow all that it thought it could want, to put it in an advantageous position as against its competitors. —*Mr. O'Brien*: But it could happen that the last comer would get less advantageous money.—*Mr. Hollom*: It could happen, but in general we try to put all comers on a relatively level basis.

470. *Lord Harcourt*: When you are lending as a last resort, is the amount which you will lend unlimited? Is it related in any way to the capital of the discount house or to the extent to which you think they should be helped?——*Mr. O'Brien*: It is related to the security that they provide, but it is unlimited.

471. *Mr. Woodcock*: But the price has varied very little?——When we restored monetary policy in 1951, we had a special Treasury Bill Rate to begin with, which used to be below Bank Rate, and the discount market could borrow on Treasury Bills at that lower rate. But after a while that rate, which was an innovation, was abolished and now we always lend at Bank Rate. That does not mean to say that the rate could not be varied if we wished.

472. As you said last week, the Bank Rate is a minimum; you reserve the right to charge more?——Exactly so.

473. *Chairman*: Paragraph 8? Paragraph 9?—*Professor Sayers*: At the bottom of the page it is stated that the discount market "is nevertheless of real importance and a source of valuable earnings of foreign ex-

change". Has any estimate been made of the amount of its earnings of foreign exchange?——*Mr. O'Brien*: I do not think we can give any information on that.—*Mr. Hollom*: Estimates are made from time to time hy one of the discount houses of the volume of bills, divided, I think, hetween those drawn in this country and those drawn abroad. It might give you some kind of approach.

474. *Chairman*: What lies behind these two qualifying adjectives "real" and "valuable"?——*Mr. O'Brien*: I have nothing more than our knowledge that their business in bills is still substantial, although they are relatively less now than they used to be, and that quite a number of them are for foreign account. I do not think there is anything more precise than that.

475. *Professor Cairncross*: Is it also your contention that this is related to the existence of the discount market, or would you not associate this at all?——*Mr. O'Brien*: Yes, I would. In our opinion the discount market is a part of the London money market which contributes to its efficiency, and that efficiency is an inducement to people overseas to hold sterling and to use sterling.—*Professor Cairncross*: And it is for that reason that you get accumulations of short-term balances of sterling on foreign account?

476. *Professor Sayers*: The last sentence of sub-paragraph 1 states that a body of brokers of some kind would emerge to carry out the sort of function now undertaken by the discount market. Admitting that, it surely does not follow that the brokers would need to he anything like as numerous as the present members of the discount market to handle dealings between principals for commercial bills?——I do not think it necessarily follows that there need be as many as twelve for that purpose; hut there again I think the discount market could probahly make their own case better than I could on that.

477. *Mr. Woodcock*: It seems to me that this sentence in sub-paragraph (ii) about the hrokers is begging the question. This assumption that the banks could not create the equivalent of a discount market for themselves could not he true?——If they did create the equivalent of a discount market, it would probably look exactly like it by the time they had finished.

478. *Sir Oliver Franks*: I think Mr. Woodcock had in mind as the alternative that they had facilities for discounting with the Central Bank direct?—*Mr. Woodcock*: A little bit more than that. This is a distinction between structure and function. Are these qualities implicit in the structure?——I am not sure what different mechanisms the clearing banks themselves would create if they wanted to have a position in which their liquid assets, apart from their balances and till money, were held other than in Treasury Bills and commercial hills, plus their small loans to the Stock Exchange and so on. If they wanted to hold them in some different form, I cannot myself think of a different mechanism.

479. But surely the capital of the discount houses is very small; they are only using other people's money. Other people could use that money, and on the face of it it could be used just as effectively as in the discount market. Is there something in the structure of the discount market that gives it its special quality?——*Mr. Hollom*: One thing in the present situation which gives it a special quality is that it has access to re-discount facilities.

480. The hanks could have that facility?——Yes.

481. Why could not the hanks use the money in the same way? Why, for example, do you say they would prohably also feel it necessary to maintain larger balances in cash? The discount market does not maintain the halances in cash.——*Mr. O'Brien*: If the banks had re-discount facilities at the Bank of England and if their liquid assets, instead of heing held partly in call money and partly in Treasury Bills, were wholly in Treasury Bills, apart from cash, they could always turn those Treasury Bills into cash. Assuming that was readily done they would need no more cash than they need at present.—*Mr. Hollom*: But instead of meeting a cash shortage hy withdrawing money which they had already placed on the market, they would have to go and borrow at whatever penalty rate was applied. That is a rather different hasis from recalling at need funds which you have placed out as a cushion against that need.

482. But they would be under exactly the same pressure as the discount market is now?——But not as they are now.

483. But no heavier than the discount houses are now? If you think of the market as comprising the hanks, as the people who pay the money to the discount market, and the discount market borrowing from the Bank, there is no great pressure?——*Mr. Hollom*: The position overall would be unchanged, and the pressures would be the same, but it does not follow that they would have the same effect.—*Mr. O'Brien*: The banks would have more reluctance to borrow from the Central Bank at a penalty rate, and they might as a result be more reluctant to take up all the Treasury Bills on offer. They might prefer to keep a higger margin of cash in order to shield themselves against the need to call on the Central Bank for cash.

484. That seems to he implying that there is something in the mere structure; what is it, I wonder?——I think it is something residing in the cushion which exists hetween the banks and the Central Bank.

485. *Professor Sayers*: But if the clearing hanks in fact decided that they did not like to borrow quite as frequently as the discount houses might have to borrow, would they not hold a cash ratio that was frequently, in fact almost normally, ahove the 8 per cent., and correspondingly less in Treasury Bills? The hanks would get a little less from the Government. It would be uneconomic for the banks in the sense that their earning assets would be less, but surely the Bank of England would have just as much control as it has now. Or is there some difference?——But would it be economic for the Government? If the Banks held fewer Treasury Bills than the Government wanted to have taken up, the Government would have to find the money elsewhere.

486. It would be because the banks were holding more cash. The cash is that part of the National Debt on which the Government does not pay interest. Treasury Bills are a part on which it does have to pay interest. Surely a switch from Treasury Bills to cash is to the advantage of the Government?——*Mr. O'Brien*: On the supposition that the halance of the Government's requirements would be lent to it hy the Bank of England.—*Professor Sayers*: Yes, on the supposition that the cash needs are provided.

487. *Professor Cairncross*: Should we not look at this from the point of view of the clearing hanks as well as from that of the Central Bank? From their point of view, if each acquired one of these discount houses, do you suppose they would then keep the discount houses in existence as separate institutions, or would they merely amalgamate them with their other assets?——It is not for me to answer that question.

488. *Professor Sayers*: While from your point of view, you must have some central means by which you can adjust the pressure on short rates, as it arises; and you fear that if it was abolished you would no longer be ahle to adjust the pressures?——This is a quite different line of argument.

489. *Chairman*: This sub-paragraph is based upon the view that something uneconomic would he involved in the hanks having no discount market to turn to. What is the meaning of "uneconomic" in that context?——We had in mind here that the banks might be reluctant to borrow from the Central Bank, a reluctance which other banks in other countries show, and would as a result keep more than their 8 per cent. in cash, which would reduce their assets.

490. *Professor Sayers*: But if they have money on call it is earning a lower rate than if it was in Treasury Bills bought directly?——Yes; if they had it in Treasury Bills givng the full rate, rather than some in Treasury Bills and some at call money, that would temper the loss a little.

491. *Mr. Woodcock*: If the structure is sound in both cases it ought to equal itself out. What they lose by holding more in cash they would gain by huying Treasury Bills, by cutting out the intermediate stage of call money, which is earning them something less?——Another effect would, I suppose, be that the banks would be called upon to bring Treasury Bills to the Bank to be discounted

more frequently than under the present system, when their first step is to take call money back. When you discount a Treasury Bill you lose on the transaction.

492. But if the clearing banks would lose, so does the discount market; they cannot lose permanently, or they would not remain in existence?——*Mr. O'Brien*: I only meant that they would lose a margin, to set against your point that they would gain a margin. The loss of holding more in cash would be compensated to some extent, but perhaps not exactly.—*Mr. Woodcock*: They ought surely to be exactly compensated, unless there is some special merit in the structure of the discount market.

493. *Professor Sayers*: May I just repeat the Chairman's question: what does the word "uneconomic" mean?——Uneconomic from the clearing bank's point of view.

494. *Chairman*: Less profitable employment of its total assets?——Yes.

495. Mr. O'Brien, as you have to come back again to see us this afternoon, I expect you would like to break off now?——Thank you very much.

(*Adjourned until* 2.30 *p.m.*)

MR. L. K. O'BRIEN and MR. J. Q. HOLLOM further examined.

496. *Chairman*: Are there any more questions on paragraph 9 of paper 57?—*Sir Oliver Franks*: I infer from the last sentence of this paragraph that, when the situation described here does not exist, the Bank of England expects to be so placed that when it seeks to influence the volume of money and the level of interest rates it secures reactions on the part of the banks. I assume that, when "the banks" are referred to, they include, perhaps particularly include, the clearing banks. It is clear to me that the operations of day to day management of the money market, not only those which you describe as tidying up the flow of money, but also those which stem from policy, do not themselves constitute major changes of policy, as, for example, changes of Bank Rate do. It is, I think, part of the received doctrine, that operations by the authorities in the short-term money market have effects, and perhaps major effects, in the banking system as a whole, and in the medium and long-term markets and so forth. It is not clear to me that in the last three years that has been true. When it has been said that money is plentiful or tight, that money is cheap or dear (which always refers, I think, to the short-term money market), I have not been able to detect that what we in the clearing banks have decided to do has been modified by these occurrences. If because of largely seasonal influences, for example the run down of deposits because of the run down of Treasury Bills at the beginning of the year, we found ourselves short of liquid investments, there was never any difficulty about that: we had lots to sell. In a way we were insulated, whether rightly or wrongly, from immediate effects or longer effects of these changes in the money market. That would lead one to the rather simple-minded statement that these operations, however necessary and important in themselves, do not carry with them the consequences in relation to the banking system or the general economy which I think received doctrine assumes that they carry with them. That is a very important consideration from our point of view, and I wonder whether you would be willing from your experience in operating the short-term market to comment on the situation, even if you do not want to address yourself to the straight issue of policy?——*Mr. O'Brien*: I think that it is not quite fair to infer from the final sentence of this paragraph that, because we say that larger cash balances would slow their reactions, we think they are necessarily fast enough now. As to whether there are any actual physical reactions from the clearing banks to pressure applied by us in the money market, immediately I should say nil. We would hope however that the action which we took in the money market to apply sustained pressure there would come to the notice of the clearing banks and indicate to them clearly which way we thought we were moving and what we would expect of them. Only if we are successful in applying pressure and carrying it right through so that it brings in the end a decline in bank liquidity to a point where the liquidity ratio is in danger and only if thereafter they are not in a position to repair their liquidity, can we say we have real control of what the banks do even if they do not want to do it. But we would hope that, having shown our intention and what we think needs to be done, we would find them rowing in the same direction as ourselves.

497. That is a different and entirely legitimate point, that when you give a signal other institutions in the City conform or move in that direction. But that, whatever may be the motive which prompts it, is quite different from being compelled by the exigencies of the market situation to take different decisions and to behave differently from what you would otherwise have done. It was on that narrower point that really I was putting my question. Perhaps you answer it by saying that in these last three years it has not been the case that what has been done in immediate market operations in the money market has necessitated a change of attitude on the part of the clearing banks; or is that putting too much into your answer?——I think it is putting a little too much. I do not think that it has produced an immediate change in attitude but I think its cumulative effect has produced a change in attitude.

498. *Chairman*: But there must be observable effects, looking back over the history since 1951, which correspond or do not correspond to your own decisions about what to do with the supply of money in the short-term money market. Would your paper on the history since 1951 deal with this?——I think it would only deal with that in a broad way, Mr. Chairman. It would not take up the point, which Sir Oliver raised, whether there are necessary technical reactions to what we do.

499. They must be observable if there are?——Yes.

500. *Sir Oliver Franks*: Putting it the other way on, could it be said that, of all the different kinds of measures which have been taken, the two which have taken bold and bitten are the restrictions of hire purchase, and the direct requests to the banks to limit advances? Now if that view were right, it would also be the case that changes in the attitude of the clearing banks in regard to their earning assets or restrictions upon them through changes in their liquidity did not arise from operations in the short-term money market; otherwise these other measures would not be necessary. It might be true that the banks did in fact behave differently and decide differently on the ground that they realised that the authorities were taking a different line; that is the other point. I am on the point whether market operations carry direct consequences which force banks to act in a certain way, because on the theory of the text books that is what ought to happen, and I am inclined to think that over the last three years it is like the dog that did not bark in the night-time; it has not happened, and that is the remarkable thing?——In the first half of 1955 we were successful for six months in keeping bank liquidity right down to the minimum of 30 per cent.; indeed banks only contrived to keep it at 30 per cent. by escaping out from under, by realising investments on a large scale while advances were mounting on a large scale. In fact we were frustrated. We got as near as we have in the last two years to making the normal technical processes do their work, and just as we got to the point where we thought they would bite, the banks realised investments instead of reducing advances, a very natural reaction in the circumstances.

501. That seems to me to be a point of importance?——*Mr. O'Brien*: Vital.—*Mr. Hollom*: But to take that view of the situation is surely implicitly to dismiss a substantial realisation of securities as an absence of reaction. The banks did in fact react by selling securities and to the extent that they did it as a whole that created, looked at in isolation, a fall in deposits, which, if you like, did no more than offset increases in deposits. But to say that they did not react is surely to put a wrong impression.—*Mr. O'Brien*: Too strong an impression certainly. It was not the reaction that we would have liked best, but it was much better than nothing.—*Mr. Hollom*: They were prevented from the simple increase in advances to which their inclination would presumably have turned.

502. Let me admit at once that in the first half of 1955 the banks sold investments on quite a large scale and that that in a sense was a reaction to the attitude of the

monetary market. Whether or not it was a direct reaction to what was being done on the short-term money market let us not argue.——*Mr. O'Brien*: I think that it was primarily a reaction to those technical measures. I do not believe that at that time the banks had quite got around to realising what the overall monetary policy was.

503. It would be true, would it not, that the authorities were interested in reducing the ability of the banks to advance money?——Yes.

504. But that did not have to be, because we could and did sell investments instead?——*Mr. O'Brien*: We were also interested in preventing any expansion in the total money supply.—*Mr. Hollom*: That is surely the reason for wishing to prevent an increase in advances.

505. Yes, but that was followed at the end of June by the Chancellor of the Exchequer's request relayed by the Governor. Obviously something that had been expected to happen in the first half of the year had not happened; and therefore a much clearer blunt instrument was employed, which was really a direct control as opposed to a so-called monetary discipline. Is it not so, that the sort of effect which the action that the authorities took was designed to have did not happen, because the banks were so "chock-a-block" with investments and so grossly underlent by all normal standards—meaning by normal 1900 to 1939—that they could go on selling at little or no loss for a very long time?——*Mr. O'Brien*: I would not disagree with that at all.

506. That is all very important when one is trying to evaluate the quality and effectiveness of different aspects of monetary policy or the quality of different monetary weapons in this situation. I think the Committee will feel that your experience on this is very valuable; certainly from my experience it is often felt that all this is going on but the banks do not have to worry?——We have been worrying all the time. We entirely agree with you that the weapons which we have at our disposal have been insufficient in the prevailing circumstances to do the job traditionally assigned to them.

507. *Professor Sayers*: I think that from this sentence we can bring out the way in which the authorities' weapons have been inadequate. The basis of it is that anything that puts the banks in a position of being able to vary their cash reserve slows their reactions. In fact that is too narrow a view, because at present they base their operations on liquid assets that extend far beyond the cash; that in fact extend beyond the Treasury Bills, because they have so much under the heading of investments that is sufficiently close to Treasury Bills. So no matter what has been done in the money market their reactions have been slow because they have been able to reinforce one liquid asset by another. Their total liquid assets have in fact been far beyond 30 or 35 per cent., and the weakness of the authorities has been their inability to reduce this corpus of liquid assets that consists of cash plus Treasury Bills plus near-maturity investments. The banks have been able to finance expanding advances by running down that total. If they could be prevented from running down that total, or if that total could be substantially reduced by some operation of the authorities, the reactions of the banks would not be slow. Is it not that sort of change that is needed to quicken reactions?——I entirely agree. I think that, quite naturally, some of these sentences are being made hooks on which to hang rather wider questions. In this particular sentence we meant that, if the banks have a cushion of cash which is substantially greater than the minimum that they feel they require, then that cash can fluctuate a great deal without any shortage appearing in the market. If no shortage appears in the market then our attempts to tighten rates by shortage in the market are frustrated. There is no more to it than that.

508. I am suggesting that the relevant cushion is the cushion of casbable liquid assets, which already exists?——If we are going to decide on the size and importance of cushions yours is the big one and this is the smaller one.

509. Is not this an unimportant one?——*Mr. Hollom*: If we have already got a big cushion any addition to it is surely important.

510. *Chairman*: Do you think that your instruments are becoming over this period more effective than they were when you began to operate them, in the sense that, though they have failed to produce certain immediate results, these failures cannot be repeated indefinitely?——*Mr. O'Brien*: No, I would think that we were just barely holding our own.

511. *Professor Cairncross*: Is not the important ratio from the point of view of total credit creation not the 30 per cent. liquidity ratio, but the ratio of advances to deposits? Do not the banks regard this as the material ratio, all investment as pseudo liquid? If things had been allowed to work themselves out without the intervention which took place in the middle of 1955, deposits would have grown until ultimately you had a ratio of deposits to advances which the banks took to be straining their liquidity?——If the banks had progressed down that path without regard to what the authorities were obviously trying to do by technical means (even if those technical means were incapable of achieving it) at least they would be putting up a flag which everyone could see. It might not be seen very clearly at the beginning, but it would be seen more and more clearly as time went on. I agree that it would have been technically possible.

512. I asked because it is important to know how far the element of direct control of advances applied to the banks at the present would require to be directly maintained.—*Sir Oliver Franks*: This second thing to which you refer is not a legitimate instrument, but control on the "old boy" basis. It is really another form of direct control, however gentle in its application, and is quite different from the technical effects of technical operations which simply change the ground rules of the game, leaving those concerned with freedom of decision given the change of ground rules. This other method, whether on the "old-boy" basis or by straight request from the Chancellor of the Exchequer, does not do that; it takes their freedom away and says: "Do so-and-so"?——From the point of view of the authorities there is no doubt that, if it is possible for them to establish a situation to which the banks must conform willy-nilly, that is by far the most satisfactory. I think it is also the most satisfactory from the banks' point of view.

513. *Sir John Woods*: How far do you think the banks would be held back from selling investments by losses on sales?——The fact that such a large proportion of their investments are very short indeed very much reduces possible losses on sales, so I should not think they would be held back a great deal.

514. Can we have some idea of the proportions in which the various maturities are held?——You remember that question was raised with the Governor last Thursday; he felt we knew enough for our purposes but did not pretend that we had complete information about the composition of the investment portfolios of the clearing banks. It would, I think, be a question to address to the holders of the securities.

515. *Mr. Jones*: If the Government borrowed money direct from the banks at the same rate as the discount market borrows it from the banks would there not be a substantial saving to the Treasury?——If that were possible, there would be a saving. Of course the discount market borrow money at a variety of rates. They get a certain amount of money from the banks at the present time at $3\frac{1}{2}$ per cent. A lot of their other money they have to pay more than that for, depending upon the conditions prevailing on particular days. Nowadays, during the credit squeeze, we keep money pretty short nearly every day, and quite a substantial proportion of their money costs them more than that, so that the average rate at which they borrow would be something higher than $3\frac{1}{2}$ per cent., possibly at times substantially higher. As against that at the present time the Government is borrowing on Treasury Bills at £3 17s. per cent.

516. That is $3\frac{7}{8}$ per cent. as against $3\frac{1}{2}$ per cent.?——$3\frac{1}{2}$ to $3\frac{3}{4}$ per cent. If it were possible for the Government to borrow at that lower rate it would obviously be cheaper.

517. According to the argument in this paper, if you abolished this monetary mechanism, there would have to be greater liquidity about the resources of the banks. Suppose that the cash resources had to be raised from 8 per cent. to 9 or 10 per cent.; if they were in a position to secure what they need at between $3\frac{1}{4}$ and $3\frac{1}{2}$ per cent. would not that be adequate remuneration of any loss that

they sustained in consequence of not being able to use the margin between 8 and 10 per cent.?——That is a question of arithmetic; I could not say across the table whether it would or would not. It would obviously go at least part of the way towards compensating them for having to carry, if they did have to carry, a larger proportion of their assets in cash.

518. Has it ever been worked out in detail what the effect would be of removing the discount market, and allowing direct servicing of these Treasury Bills by the banks? Or is your assumption based upon general smooth running experience?——I think the latter; I should not think it has ever been worked out in any great detail. If the banks, to compensate themselves for carrying larger cash resources, were to put their rate up to 3½ per cent., then the Government would gain nothing.

519. If the disappearance of the middle man was to benefit the Government and the nation, there would have to be a reduction in the borrowing rate to the Government itself?——I should doubt whether by removing the middle man the rate at which the Government borrow would necessarily *pro tanto* be reduced.—*Mr. Hollom*: It would not, unless the Government borrowed on the same terms as the middle man, which in general provide for repayment not at 91 days but the following morning if demanded.

520. But if the market is borrowing on call at 3½ per cent., say—let us stick to that figure for the sake of examining this position—and lending at 3¾ per cent., is there not a substantial margin within which the banks and the Government could both be served at a greater lending rate so far as the bank is concerned, and a lesser borrowing rate so far as the Government is concerned? ——*Mr. O'Brien*: Obviously if there is a market there exists a possibility that it might be cut. I could not contest that, although I would still express the personal view that it would be unlikely over the year that the Government would be able to borrow much cheaper by dealing direct with the banks instead of the discount market. I believe the Government would probably borrow at much the same rate, while the banks would lose a facility in exchange perhaps for getting a little more.

521. In saying that the banks would require a greater liquidity of assets, you are saying in effect that the deposits of the banks would not earn so much as they are doing now. Might they not be earning more?——A small proportion of them might be earning more and making up to some extent for the losses which they would occasion by the change of system. If they had a larger proportion of cash earning nothing it might be that instead of the rest of their liquid assets being partly in call money, at say, 3¼ per cent. and the rest in Treasury Bills at 3¾ per cent., the whole lot might be at 3¾ per cent.

522. 10 per cent. earning nothing because it is cash in reserve and the remaining 20 per cent. earning 3¾ per cent.?——Yes.

523. *Professor Cairncross*: There are periods when the rates have not been of the order they are now: the arithmetic done today may not give the same result as the arithmetic done, say, ten years ago?——Yes.

524. *Chairman*: Paragraph 10. I think we have discussed the content of paragraph 11. "Uneconomic" there means more costly to the burden of the national debt?——Yes, in that the Exchequer would have to keep a cushion of cash at the Bank of England against emergencies, virtually unused, which they do not keep at the moment; and they would have to borrow in order to acquire it.

525. *Professor Sayers*: That costs nothing?——*Mr. O'Brien*: If it is being borrowed on Treasury Bills from the market it costs something.—*Mr. Hollom*: If it is raised by taxation it could equally well be used to reduce market interest-bearing debt, and so also costs money.—*Mr. O'Brien*: Any funds left doing nothing are wasteful.

526. All you would have to do would be to issue extra Treasury Bills to the Banking Department of the Bank of England and put the corresponding sum on the other side on the Public Deposits?——There would be interest to the Bank of England on those Bills.

527. Taking the Bank of England and the Government as one from the point of view of cost, there is no cost? ——It would be a cost to the Government, in that the interest which they would pay on those Treasury Bills would accrue to the Banking Departments, and not to H.M.G. except so far as payments are made to H.M.G. out of the Bank's profits.

528. I am considering the Banking Department as owned by H.M.G.?——So it is.

529. *Professor Cairncross*: The Government have a residuary interest in those profits which go to reserves? ——A residuary interest, yes.

530. *Chairman*: Paragraph 12?—*Sir Oliver Franks*: I think that the discussion which we had on the last sentence of paragraph 9 is really relevant to the last sentence of this paragraph, in the sense that anything said here about how far reactions are at present achieved by operating the discount market, or how far alternative methods might be effective if the discount market were not there, wants modification in the light of our previous discussion, in so far as what you said led to any modification. We are dealing with the same area of thought?——Yes, indeed.

531. *Chairman*: Paragraph 13?—*Professor Sayers*: Here we come to the function of the discount market in relation to short-dated Government stocks. There is no general account in this paper on that. I wonder if Mr. O'Brien would tell us what he considers the role of the discount houses to be in the market in short bonds?——They are large holders of short bonds, and quite active dealers. They largely supplement the jobbing facilities in the Stock Exchange in those bonds, in which it is particularly important to have an active market, because they are near-liquid assets, and if they cannot be regarded as such it is bad for Government borrowing generally.

532. Are we not in danger of arguing in a circle here? The bonds become more liquid partly because the discount houses are dealers in them?——They do; and the desire for liquidity grows as the bonds become shorter.

533. But the extent to which other institutions use these bonds is dependent partly on the liquidity that the discount market has given to them; if that liquidity were not there, institutions that depend particularly on the liquidity of these bonds would not buy them so much? ——Certainly.

534. In which case the Government would have to raise its money in other ways?——We must remember that these short bonds have become short. They have not all started life by being short. If you issue a security which matures in fifty years one day it is going to be a short bond.

535. I am trying to find out how it is important that they should have this additional liquidity given to them. They are becoming shorter; they are becoming more attractive to some people in that way and less attractive to others. Why should the authorities, by encouraging the discount market to hold them and to deal in them, want to give the bonds this added liquidity?——One of our objects in life is to reduce the amount of the floating debt. We have not reduced it as much as we would like, and if we can persuade people that they might as well, or better, hold short bonds or near-liquid assets rather than Treasury Bills that gives us an opportunity at least of putting off our problems for a while. Admittedly, if the banks hold short bonds rather than Treasury Bills there is not a great deal of difference; but if large commercial and industrial houses keep their liquid funds in short bonds rather than Treasury Bills, it may only be a short step in the right direction, but it is a step. They will not do that, if they find that once they have got their money in that kind of security they cannot get it out again when they want to.

536. That function of the discount market then depends upon the willingness of the discount houses to act as jobbers, absorbing bonds when the other institutions than the public are unloading and *vice versa*. Do you believe that the discount houses in fact operate in that way?——That is part of their operations, yes. Some houses operate much more freely in that way than others. They have not all got a similar policy.

537. *Chairman*: Do they accept anything like an obligation such as the jobber is supposed to do?——No

formal obligation, but I think important members of that market are always ready to deal, and accept a less formal obligation.

538. *Professor Sayers*: Does not this function imply a certain passivity on their part, that they should buy when the public wants to sell and vice versa?——If you are thinking of their buying short bonds it would, but it would not be true to say that they are passive, and fill only that role.

539. But does not the liquidity they impart to short bonds depend on this passivity?——Yes, to some extent: I would say it is marginal.

540. Did not the discount houses taken together absorb something like £200 million of short bonds during a period of a couple of months or so recently?——Yes.

541. Were they passive in absorbing those, were they buying bonds because the public were selling short bonds on that scale?——Not entirely, I would say. I should say they had their views about the likely trend of Bank Rate, as other people did.

542. If the discount market take a position—never mind whether they burn their fingers or not—they are not seriously adding to the liquidity of the bonds, are they? They are acting in a way contrary. May I go back again to the historical event? In those weeks, that was about last Christmas, a number of people were taking the view that gilt-edged prices were going to rise. If the discount houses were acting merely as jobbers in this market one would have expected to see their portfolios of these short bonds run down rather than up during that period. In fact they ran up to the extent of £200 million. Do you watch the position of the discount houses in short bonds, and ascertain whether they are acting in this passive way or whether they are taking a view?——We watch their position, but we do not lay on them the obligation to act as jobbers in the bonds.

543. But if they do not act as jobbers what is the use of having them in that market, from the point of view of H.M.G.?——One has to consider who would hold the bonds if they did not; the banks presumably, by and large. It is, again, a piece of mechanism, which gives a degree of flexibility which we do not believe would exist if, instead of lending the money to the discount houses to hold these Treasury Bills and short bonds, the banks were to hold both types of security themselves in larger measure.

544. Having the bonds held by the banks is not the only way of dealing with the situation. The money could be obtained in different ways; from the public if the Government offered terms, or it could be provided by the creation of more cash?——But if there were a demand by the public for these bonds outside the banks and the discount market, and there is of course a fluctuating demand, the banks could not satisfy the demand. At present they can get what they want; the market is there, the securities are there.

545. What does the discount market add to this market?——It adds a degree of liquidity to these bonds which would not exist if they were all in bank portfolios and banks would not deal.

546. Only in an important way if the discount houses act as jobbers?——*Mr. Hollom*: You are perhaps basing your comparison between discount houses and jobbers unduly on a rising market, where there is a demand on the discount houses for short bonds, or rather a general demand for short bonds which you might expect to be centred on the discount houses acting in their capacity as jobbers.

547. If you take the falling market in the years before that, when short bonds were rather less popular, were the discount houses tending to absorb short bonds?——I would think so, though I have not checked the facts. The point I was seeking to make was that in a rising market there is no particular reason to expect their books to fall, as on the jobber's analogy you would argue that they should, because there is almost always a seller in the form of the Departments, so there is no reason why the jobbers' book should fall. It can be kept stable or even, if his funds allow, be increased.

548. In this case did it not rise by £200 million?——*Mr. O'Brien*: It rose by some figure of that order, yes; on a rising market, with the authorities selling securities.

549. In fact were not the authorities' sales of securities roughly matched by the addition to the portfolios of the discount houses?——In broad figures, yes. I think we sold rather more than that.

550. *Chairman*: What sections of the public, if you exclude people such as the discount houses who are interested in short-term money, would be likely investors in bonds which are near the end of their life?——There are many large industrial and commercial companies nowadays with enormous resources which they need to keep pretty liquid who have in recent years been attracted by the Treasury Bill as an alternative to bank deposits. That is based on the fact that the Treasury Bill is a completely liquid investment. Such companies have also been attracted into short bonds by the high yield, and, as long as liquidity is adequate, they go into them. It is very important from our point of view to preserve their faith in the liquidity of those securities; otherwise they will abandon them and go back into Treasury Bills.

551. Does an, as it were, instantaneous market for those bonds matter?——I suppose any company is basing its programme over a number of years. Does liquidity in between matter very much?——If I were in a position of being responsible for the investment on behalf of a company of funds which were certain to be wanted over a period which was more or less clearly established, I would prefer to know that, if I made a mistake, I could get out without difficulty. An investment manager in that position would want to invest the money in order to get the maximum return on it. It might even be borrowed money and he would have a double incentive to get the maximum return, because he would have had to pay interest and would want to get some of it back. That, I think, is quite often the case; you have to raise money when you can and spend it in accordance with your programme. But, when looking at the maximum return available to him within his programme, he would have to balance any loss of liquidity which might go with the maximum return and any greater liquidity which might accompany a more modest return. It would be a matter of judgment which way to jump. If we want such people to go into bonds rather than Treasury Bills it is in our interest to show that bonds have a high measure of liquidity as well.

552. *Professor Sayers*: If the banks had fairly flexible deposit rates, would they not provide for these industrial and commercial customers as well?——I think they could.

553. *Chairman*: Paragraph 14? In paragraph 15 you say ". . . the extent to which the Discount Houses in fact place securities and find funds outside the banking system should not be under-estimated." I find that a little vague. If it should not be under-estimated, what is it? —*Professor Sayers*: May we have figures?——I think there are two ways of asking for that kind of information; direct from the houses themselves, which presumably you could not do until a later date, or by asking us to get it for you. I do not know which you prefer, Mr. Chairman.

554. *Chairman*: I imagine that we shall be able to put our questions to them direct and get our answers, but what you are telling us here is something upon which your own views about their importance and their value are based; so you must have some view?——Yes. I think our views are not precise, merely that we know from our day to day experience that it is substantial though fluctuating.

555. *Chairman*: Paragraph 16?——*Professor Sayers*: The first sentence is difficult to follow: "Finally, it is worth pointing out that it is at least possible that the disruption of the existing tender system would tend to produce a lesser degree of stability in short-term interest rates generally." That really brings us back to the discussion this morning on the value or otherwise of smoothing out. Would the extent of instability in short-term interest rates that might be added by the disruption of the existing tender system be damaging to anyone outside the money market? ——*Mr. O'Brien*: No. It might have undue effects in a wider field, even abroad. No practical damage, I should say, probably.—*Mr. Hollom*: If by money market in that context you mean all those who hold or might wish to hold Treasury Bills, yes. That is a fairly wide field.

556. Would instability in the short-term interest rates have any disadvantage from the narrow Exchequer point of view?——It need not. They might borrow more expensively at one time and more cheaply at another, and the average might be no higher than the present more stable pattern.

557. *Professor Cairncross*: Do you feel that any instability tends to make the average rate higher?——*Mr. O'Brien*: That would be my feeling.

558. *Professor Sayers*: Do the limits referred to in the penultimate sentence relate to the capital of the discount houses? You expect them to keep their book in reasonable relation to their capital resources?——Certainly.

559. *Chairman*: Paragraph 17 is a summing up of all that has gone before.—*Lord Harcourt*: In the summing up you say, ". . . it seems improbable that alternative mechanisms could be devised which would work as smoothly and efficiently." Up to five or six years ago Canada had no money market at all, and the Canadian banks were forced by and large to employ their funds in the New York market. They then decided that they would like to set up a money market, and I believe they sent a small team from Canada to study our discount market?——They did.

560. Having studied our discount market my impression is that they rather studiously avoided copying it. I wonder if you could (1) tell us in what way or why they did not copy it and (2) give us a very short picture of how the Canadian money market works at this moment?——I could not do that today, but I could put myself in a position to do it. All I can say today is that, having met the team when they were over here, I think that their original belief that the discount market was a useless encumbrance was later modified, and that they have in Canada attempted to do something not, obviously, on precisely the same lines, because the market is a different entity, but to imitate the sort of machinery we have, giving it a greater flexibility.

561. *Chairman*: Could you in due course give us something on what they have done and what their major departure from our system is?——Certainly. It may take a little time to do it. I should want to make sure that the Canadians agreed with our description of what they do.*

562. *Chairman*: That brings us to the end of that very interesting paper. Then we have Paper No. 6—The Issue of Legal Tender.† Are there any questions on paragraph 1? Paragraphs 2, 3, 4, 5, 6, 7, 8, 9, 10?—*Mr. Jones*: As I understand it the Issue Department is responsible for the fiduciary issue on the basis of reserves and holdings that are placed against the fiduciary issue. In what respect can it be profit making?——The Issue Department issues notes against resources, which, in days gone by, were largely gold and foreign exchange and are now almost entirely Government securities. Those Government securities all earn interest and the amount of the note issue now being so large the interest earned on that portfolio of securities is also very large. The charge against that interest is broadly the cost of producing the notes—printing, designing, distribution, and so forth—so that the net profit is very substantial.

563. *Professor Sayers*: Could we say that it is a matter of complete indifference to H.M.G.? Any discount allowed on the Issue Department's holding of Treasury Bills comes back as part of the Issue Department's earnings, and the costs of the note issue have to be incurred anyway?——The interest on the securities of the note come out of one pocket and go into another.

564. *Lord Harcourt*: The securities in the Issue Department could in fact be a non-interest bearing note from the Treasury?——They could be.

565. *Professor Sayers*: Would not the nation then know what the note issue costs?——They could know.

566. *Chairman*: On paragraph 11, would you tell me what the process of purchase of Treasury Bills is; when the sterling in the account is lent back to the Exchequer does the Account purchase Bills in the market?——No, from the Departments.

567. *Sir Oliver Franks*: Is not this a deliberately inexact way of putting it: the Departments are like so many pockets which the Bank of England have, and it always puts a certain amount of everything which it is disposing of, whether it be Treasury Bills or Government Stocks, sometimes from choice and sometimes from necessity, into each of these pockets; the result is that, if it has at any time to produce Bills or bonds, there is always a pocket into which it can reach to produce them?——That is broadly so. The Exchange Equalisation Account would buy tap Treasury Bills and the money surplus to requirements would flow back to the Exchequer.

568. Tap Treasury Bills are held by the Departments?——Yes.

569. *Professor Sayers*: So far as this operation is concerned, all that is required is the writing out of a Treasury Bill whenever the Exchange Equalisation Account buys foreign exchange?——Yes.

570. *Chairman*: For this purpose a Treasury Bill is just an I.O.U.?——Yes. In effect all that the Account holds is its foreign currency assets and pieces of paper which give it the right to call for cash sterling when it needs it.

571. *Mr. Jones*: What is meant by a tap Treasury Bill?——It is available on demand, with a life, normally, of 91 days. It is like the securities which were issued by the Government during the war to people who wanted to put their money to help the war effort. They were available on tap. You could go to the Loans Office of the Bank of England and say: "I want 3 per cent. stock", and it was available, as against the normal issue which you cannot get if you do not apply on the day when the lists are opened. Afterwards you can only buy it in the market.

572. *Chairman*: Do these tap Treasury Bills just go to and fro between the Exchange Equalisation Account and the Departments?——Yes; it is a piece of book-keeping.

573. *Sir Reginald Verdon Smith*: In relation to that, what is the precise meaning of the first few words:—"The Account was equipped by the Exchequer with a capital sum in sterling which, so far as it was not used at any time to acquire and carry holdings of gold or exchange . . ."?——The Account has not unlimited rights to draw cash from the Exchequer to buy foreign exchange.

574. Was it capitalised?——*Mr. O'Brien*: Yes, it was capitalised by the Exchequer.—*Mr. Hollom*: The Exchequer in fact placed a sum at its disposal. Such as was not immediately required was borrowed back.

575. Has that capitalisation always remained the same?——No; there are pretty constant changes.

576. Is there any significance in fixing a figure of capital?——*Mr. O'Brien*: I see no great significance. If we were in a position where we decided that we were acquiring too much gold and foreign exchange reserves and we really could not afford to buy, and there was not much useful purpose served in so doing, presumably a complete upper limit would be set on the capital. But of course we are far from that position.

577. *Professor Cairncross*: There is no statutory ceiling?——No.

578. *Mr. Jones*: Do we anchor our currency now to the Exchange Equalisation Account as against formerly anchoring it to the level of gold in the vaults of the Bank?——Not in that sense at all.

579. Is there no relationship then between the anchoring to gold on the basis of the former gold standard and the use of the Exchange Equalisation Account?——There is a connection, but not that connection.

580. *Professor Cairncross*: From the point of view of bookkeeping is there any reason why any gold whatever, even the token amount, should be held in the Issue Department rather than in the Exchange Equalisation Account?——From the point of view of bookkeeping I should say not.

581. This is simply a prolonging of the old legislation into the present day?——It may be a sentimental survival—perhaps a very small bridge some people may have hoped to re-cross.

582. *Lord Harcourt*: Was the original amount in the Exchange Equalisation Account established by Parliament?——*Mr. O'Brien*: Yes.—*Mr. Hollom*: At £150 million.

* See Appendix to Minutes of Evidence.
† Memoranda of Evidence Part I No. 6.

583. *Professor Cairncross*: But the subsequent increases have not been statutorily fixed, like the increases in the fiduciary issue?——*Mr. O'Brien*: No. The sterling capital was quite recently reduced.

584. *Chairman*: Does "capital" in this connection mean the Account's total borrowing powers from the Exchequer?——Yes.

585. *Chairman*: Paragraph 12? Paragraph 13?

586. *Sir John Woods*: I am a little puzzled to find Ways and Means Advances between the Exchange Equalisation Account and the Departments. I was under the impression from what you said earlier that the Exchange Equalisation Account's assets consisted almost entirely of tap Bills or of other Government stock?——This is a technicality which perhaps did not need to be mentioned and slightly fogs the issue. If the Exchange Equalisation Account were, for example, to sell its Bills to the Issue Department, the Issue Department would have to get the cash from the Exchequer. It would get the cash from the Exchequer by getting part of its Ways and Means Advances repaid.

587. *Sir Oliver Franks*: It is really a matter of how you do the bookkeeping?——Precisely.

588. *Mr. Jones*: Paragraph 12 appears to deal with the buying and selling of gold. I wonder whether you could describe more simply the function of the Ways and Means machinery in this particular connection. Who authorises these Ways and Means Advances in the purchase and selling of gold, particularly in the purchase of gold?——I do not think there is any need to relate Ways and Means particularly to gold. Government Departments with surplus funds do not keep those funds in their own separate accounts. They are all turned in to the Exchequer in order to reduce the amount of idle money lying about.

589. Would that include the National Insurance Funds?——It would. Their surplus funds could be lent on Treasury Bills or Ways and Means Advances. All cash which comes into the Government orbit and is not required for immediate disposal tends to be centralised into the Exchequer on Ways and Means Advances.

590. *Professor Cairncross*: In the first line of paragraph 12 does "foreign exchange" in practice mean dollars, or does the account deal in other foreign currencies as well?——It deals in very many foreign currencies.

591. *Professor Cairncross*: All convertible, or some inconvertible?——Some inconvertible.

592. No statement has ever been issued on the functioning of the Exchange Equalisation Account. Is there any reason why, 25 years afterwards, something should not now be said about the early transactions?——I would rather, Mr. Chairman, that this question were addressed to the Governor. We are merely doing it as agents. It is a Treasury account.*

593. *Chairman*: Paragraphs 13, 14, 15, 16, 17, 18?——*Sir Oliver Franks*: I have a question on the first sentence of paragraph 18. This is, of course, a statement of fact. I wonder whether it is also a very important statement of policy. If this is taken simply to mean what it says, it says that as money is required in the community so it is dished out. There is therefore no control over the actual supply of money in the strict sense?——The supply of bank notes is not the only, nor nowadays the only important, supply of money.

594. I am speaking of the £2,000 million note issue, and not the £6,000 million bank deposits. There is no control at all over the legal tender currency?——On the banks' demanding the notes, we supply them. It is passive.

595. I suppose, in the history of theory, that could be a very surprising statement. There have been times when the volume of the currency was supposed to be the key to the whole business?——Yes; it would have been a surprising statement, I imagine, fifty years ago.

596. Would it be the view of the Bank of England that everything is now entirely reversed, and that, far from the amount of currency being considered a key to the whole situation, it is of no importance? The Bank of England stands passive to supply the demands of whoever wants currency; is that correct?——I think that question is so important with relation to your deliberations that it ought to be addressed to the Governors rather than to me.† My function is to explain what we are trying to say here.

597. Are we to take this first sentence here as being a strict statement of fact and note that it carries an implication of policy with it?——Yes, I think that is fair.

598. *Professor Sayers*: I have one question that relates to all the paragraphs explaining the current position. Could it not all be enormously simplified for the better understanding of the public?——We are back to the unification of the Issue Department and Banking Department?

599. *Professor Sayers*: That is one of the points involved, but it is only one.—*Chairman*: Could you suggest one or two simplifications?—*Professor Sayers*: That the Bank cease to have a fixed fiduciary issue, a pseudo-fixed fiduciary issue; at any rate that that be debated, which would raise the whole question of sentence 1, paragraph 18. The question of what notes are legal tender where could be simplified; the arrangements for the profits could be simplified?——They could be made different, but that would not necessarily simplify them. I think we would maintain that present arrangements are very simple in that respect.

600. May I suggest that that is because it has not been considered the duty of the Bank of England to explain it all to the public. If you had that duty, would you hasten to simplify it?——I should doubt it.

601. *Professor Cairncross*: You take no responsibility for the activities of the Mint; therefore presumably you do not think it incumbent on yourselves to issue any statement about coin circulation?——At one time we used to act as intermediaries between the Royal Mint and the banks as distributors of coin throughout the country. We no longer occupy that rôle. The Mint deals direct with the banks, and we merely hold in the Bank a reserve of metal currency against emergencies, for use from time to time to help with any problems which may arise in meeting needs.

602. Do you know what the coin circulation is?——We must know. I have not got it at my fingertips.‡

603. *Mr. Jones*: The coin circulation you keep in the Issue Department is not gold?——There is some gold.

604. But according to the Bank statement it is not a very large holding?——Very small. Gold coin and bullion last week were £360,000. The coin other than gold coin in the cover for the fiduciary issue is about £3 million, and we have about £2½ million in the Banking Department; so our total reserve of token coin is £5½ million.

605. *Sir Oliver Franks*: For roughly how long has the Issue Department's rôle been a passive one?——*Mr. O'Brien*: I think one would say since 1914.—*Professor Cairncross*: I would say longer.

606. *Sir Oliver Franks*: This is obviously a long discarded weapon, but is it not perhaps the sharpest of them all? There may be very good reasons for its having been "long discarded"; but if you said: "There is a certain amount of currency in this country and for the next three years it is not going to be increased by one iota", and if, for the sake of argument, a particular trade secured a wage increase, which meant that the pay packets of the people in that trade would be increased week by week, then out of an amount of currency which was static they would be taking a rather larger share. Therefore for the rest of the population there would be less currency, so that some people could not receive so much currency for the work that they did. That seems to me, in its simplest and crudest form, to be a direct and sharp control over the direct use of money, as in the use of currency to pay wages. One of the points we have to note is that, if the authorities have been completely passive in relation to the amount of currency used since say, 1914, then they have not used an instrument which perhaps should never be used, but which would produce a direct and savage reaction?——This would certainly be a sharp weapon and one which would cut in many unexpected and unwelcome directions. In considering whether it should be used or not, one should decide on what the function of the bank note is. Is it the essential thing, or is it merely a convenient method of passing the essential

* See Qns. 2850 and 3223.

† See Qns. 1759 to 1761.

‡ See Appendix to Minutes of Evidence.

thing from one to another? Would you do no more than remove from people something of convenience, and so upset them very greatly without in fact making any difference to the underlying situation? I think that probably that would be the effect.

607. Should one then go on to argue in exactly the same way about the other form of money—deposits?——No, I do not think so. If you reduce the number of bank notes, presumably a lot of people would begin by paying with cheques what they would normally use a bank note for. We should be paying bus fares with cheques.

608. *Professor Cairncross*: You would agree that we could drop shillings or half-crowns for a time and survive?——It would be of considerable inconvenience, I should say.

609. *Professor Sayers*: Is it not surprising, when you get this argument against the Bank's assuming an active position, that at the same time you cling to the forms of 1844 and 1928 in your few public statements?——No, I do not think so. I do not think that is very relevant to Sir Oliver's point.

610. *Sir Oliver Franks*: Over the last eight years the amount of currency has increased about 50 per cent. That is a very large increase, and obviously it is an element in the total picture which we all have to take into consideration. But, far from control of the quantity of currency being something which is a matter of policy among the authorities, this is saying that it is totally passive.—*Sir John Woods*: You would say, Mr. O'Brien, that currency circulation is really of no more than functional importance, and what you are after is the total amount of the means of payment?——That is precisely what I do say.

611. *Professor Cairncross*: Would you agree that you might include Treasury Bills in means of payment?——So far as the Exchequer is concerned, I suppose you would.

612. From the point of view of the liquidity of the entire system, is there very much difference between Treasury Bills and bank notes?——There is some difference, I think.

613. It is a little arbitrary?——Yes.

614. *Lord Harcourt*: If you restricted the circulation of bank notes, surely the first effect would be that, rather than have inconvenience in their daily life, people would resort to things like travellers' cheques which would circulate as substitutes for bank notes, merely passing from hand to hand? Instead of being presented to a bank, they would merely circulate amongst private individuals?——And presumably you would get back to the previously existing position where lots of banks issued their own private notes.

615. *Chairman*: Are they allowed to do that today?——No. It would have to be something like a traveller's cheque.

616. *Chairman*: Shall we begin on Paper 10?*——*Professor Cairncross*: In paragraph 2 you draw a comparison with the pre-war position and choose the years 1935-1938. Had you chosen the years 1925-1928, would the comparison have looked so extreme? Are you not taking a period here that is as long way after the first world war, and indeed after the main problem of tackling the floating debt had been handled and after the big conversion operation in 1932?——The purpose of this comparison is to try to show what the banks would normally aim at as compared with the present time. We felt, I think, that those years were for that purpose as good a set as any.

617. *Mr. Jones*: The National Debt before the war would be substantially less than the National Debt after the war; was not the floating debt higher after the war, even expressed as a percentage, and substantially greater in amount?——Yes.

618. *Professor Cairncross*: But the short term floating debt may have been about as high a proportion of the total debt of the Government in a period some years after the first world war as it has been following the second world war.—*Chairman*: Your point is more concerned with the difference this second war has brought about in this situation now, as compared with what it was before that war?——*Mr. O'Brien*: Yes, but we could produce the other figures if the Committee would like to have them.—*Professor Cairncross*: I should be interested to see the figures for 1925-1928, for the purposes of comparison.*

619. *Chairman*: In paragraph 4 you are saying that all these nationalisation operations did two things: first of all they turned what had previously been fixed interest stocks into what were gilt edged in the sense that they were Government guaranteed fixed interest stocks, and also to some extent, though I am uncertain to what extent, they turned what had previously been equities into fixed interest gilt edged. But I do not find in this any idea as to what difference it made, turning equity shares into fixed interest stocks. To some extent that seems to me more important than the mere fact that certain fixed interest stock obligations of local authorities, independent companies, or whatever they were, were turned into Government supported fixed interest stocks?——We could try to quantify that.†

620. *Professor Cairncross*: It would appear, although the figures available are not clear enough, that the range of industries we are discussing had much heavier investment programmes in the post-war than in the pre-war period. So, quite apart from how they were financed, there was a much heavier capital issue to be met. Have you any forward programme for these potential borrowers or not? It would be of importance to us to see this. I take it you have something from the Treasury on the prospect for the next five or ten years?——We have no such programme, but I feel sure the Treasury and Government departments concerned will have ideas as to what will be required.

621. Have you any idea what proportion of their normal capital expenditure these industries, public utilities particularly, financed out of their own money in pre-war years?——No.

622. Before the war it was common for them to try to cover some part of the capital expenditure out of their own profits, but this is much less true now?——Yes, much less true.

623. To that extent it has meant that the effect on the market has been threefold; the burden on the gilt-edged market has been increased, by transfer from the equity market; there has been a total capital commitment heavier than before the war; and expenditure has been financed to a much greater extent by borrowing rather than from gross profits?——Yes.

624. *Professor Sayers*: What is implied, in the second half of the third sentence in paragraph 5:—"and had to be supported where necessary by the use of Departmental funds"? That means, I take it, that the stocks were in fact underwritten by the Departments?——In the same way as a straight Government issue is underwritten by the Departments.

625. They take what the public will not have?——Yes.

626. *Mr. Jones*: Does that mean that the National Insurance Fund, the Post Office Savings Bank Fund and organisations like that would be the underwriters?——No, they would normally only take what they required for their investment portfolios. In fact it is the Issue Department which stands behind such issues of stock.

627. *Chairman*: There is a distinction between what can be expected or required by way of support from a fund like the National Insurance Fund, and what can be expected or required of other Departments?——There is a very great distinction. "The Departments", for this purpose, normally means the Issue Department. It is a convenient vagueness which we use, or have used in the past; but the funds, such as the Post Office and the Trustee Savings Banks Funds and the National Insurance Fund, have their own investment policy which they follow like any other fund in accordance with their liabilities. They take up such quantities of these stocks, when they come on offer, as they require. They do not take them up willy-nilly, as the Issue Department does, if the public will not take them.

628. *Mr. Jones*: There is the greatest possible independence of these organisations from the Treasury?——We are in close touch with the National Debt Office which, as you know, looks after the investment policy of these funds; but the position is that they have their independence and are under no obligation at all to underwrite

* Memoranda of Evidence Part I No. 10.

* *Note by witness.*—On the average of the years 1925–28 the floating debt amounted to 11 per cent. of the total National Debt (again excluding external debt).

† See Appendix to Minutes of Evidence.

an issue, that is to say, to take up what the public does not want, or any part thereof.

629. *Sir John Woods*: Do not the National Debt Commissioners administering the National Insurance Funds and so on rightly claim complete independence?——*Mr. O'Brien*: From time to time they take part or all of issues which are made. Some of the smaller nationalised industry stocks have been taken entirely by the National Debt Office on behalf of these various funds, but they have done that in the light of their own policy.—*Lord Harcourt*: Because it suited them to do that?

630. *Chairman*: And they remain equally free in their subsequent decisions, whether to sell what they have taken up? There again their investment policy is independent?——*Mr. O'Brien*: Yes; but, because we have to manage the market, it is done in close collaboration with us, and where they can properly meet our wishes and fulfil their own, they do so.—*Mr. Jones*: There is a very close liaison then in this activity.

631. *Sir John Woods*: Where it suits their investment policy they would operate very largely not only in relation to new stocks? Where there is a big Government maturity coming would they be available to buy the maturing stock in advance?——Yes; supposing those funds have quantities of stock maturing in the next month or two we can normally rely on them to convert, if it suits them.

632. *Professor Sayers*: When you say these issues had to be "supported where necessary", do you mean that, if that support had not been forthcoming, the public would not have taken up the bonds at any price?——Not at the price at which they were offered.

633. *Chairman*: These issues arise because there is a demand for capital from these industries. Would it not be reasonable to say that these resources should be obtained at the market price, that the issues should be priced at a figure at which the public will absorb the whole issue?——I think the answer to that is that there is no such figure. I believe it to be a fallacy that merely by adjusting your price you can get the market to take any quantity of a security you like to offer on a particular day. Perhaps I may describe the procedure, which is now past history. Bank advances to a particular nationalised industry have reached a pretty high level and it is felt that they ought to be funded. The nationalised industry issues a stock, normally a stock of relatively long life, 20 or 25 years, and that stock based on Government guarantee is issued at a rate which is considered appropriate for such a stock in the light of prevailing conditions in the market, depending upon the existing rate for comparable stocks on the gilt edged list. The lists are opened on a particular day and the public subscribe for what it wants. It is not usual for the public to subscribe for anything like the full amount of one of these stocks where the amount is large—and we have had issues of £150 million to £200 million. In so far as the public do not take it up on the day of issue, the stock is taken into the Departments. In fact they convert Ways and Means Advances to the Exchequer, or Treasury Bills they hold, into the stock. The stock is then held there and as opportunity offers the stock is sold to the market at the rate prevailing on the day of sale. That may result in that stock eventually being sold at prices lower than the price of issue, or higher, depending on the state and appetite of the market. That is how they are disposed of.

634. *Professor Sayers*: But how serious a point this is depends upon the time which the public Departments take to peddle this stock. If the clearing banks want to sell large blocks of securities, they can only sell them over a matter of weeks. We have seen over the past few years how they have gone in a few weeks. Do the Departments sell at that sort of rate, even at the expense of pushing down the price?——I do not think anybody could sell large quantities of securities in the gilt edged market at any time merely by putting his price down. What the market will buy depends basically on market expectations of the future.

635. If you operate on the basis that you will keep the price up as high as you can, but you have continually more and more of these things to peddle out, is not the tendency for market prices to be continually sagging, and your sales to be very slow? Do you ever consider the alternative of putting the price floor down with a bang and then sticking at that?——I think we have put the price floor down from time to time considerably, but it is no good putting the price floor down with a bang and therefore making your borrowing market more expensive, unless you are pretty sure of having the effect of increasing the market's appetite. If you push the price floor down, then tomorrow it will be even lower and they will not nibble. In effect you can really only sell in quantity on a rising market. You cannot sell on a falling market.

636. When you say "in quantity", how much do you mean a month?——Say, £10 million a week; that is a purely arbitrary figure.

637. *Sir Reginald Verdon Smith*: Of any one stock?——No, it would be a mixed bundle of stocks; anything in the bag for which there is a demand.

638. *Chairman*: When these issues are made and Departmental funds are employed in underwriting, how much of that operation is public knowledge?——In the past, as little as possible. The result of the issue has been so arranged that the public has no definite knowledge that the Departments have intervened and certainly no knowledge of the degree of their intervention. From the point of view of market management, there is not much point in telling the market which you hope will eventually take the whole of the stock that you yourself have taken, say, three-quarters of it and are ready to push it out at a moment's notice.

639. *Chairman*: I think we will come back to this next time we have a chance of seeing you. Thank you very much; I am very much obliged to you.——Thank you, Mr. Chairman.

(Adjourned until Friday, 26th July, 1957, at 10.30 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRD DAY

Friday, 26th July, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (Questions 748 to 802 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

L. K. O'BRIEN, ESQ., Chief Cashier, Bank of England, called and examined.

640. *Chairman*: We have only your paper 10 to finish, Mr. O'Brien. I have a note that questions had arisen about paragraph 5, at the words:—

"... the issues directly involved the Government's credit and had to be supported where necessary by the use of Departmental funds".

You had been asked how much of an operation of support of that kind was public knowledge and you said:—

"In the past, as little as possible ... From the point of view of market management there is not much point in telling the market which you eventually hope will take the whole of the stock ... etc."

There are one or two things I want to ask you arising out of that. I saw it stated the other day that when an issue is made and all or part of it is taken up in this way by Departmental funds, there is a statement made that it has been fully subscribed. Is that current practice?——It is the practice and, of course, it is true. It does not say who has subscribed, it merely says "fully subscribed", the Departments on occasion being an important subscriber, but still a subscriber.

641. I do not suppose this has happened in recent years, but supposing there was an issue which had been fully taken up by outside subscription; is no distinction made in the announcement between the two?——None whatever.

642. *Professor Sayers*: That practice of making a statement of that kind is of long standing and it is now pretty well recognised, is it not, in the market that the truth of this statement is of a very limited kind? That being so, is there any point in going on with the practice?——I believe there is. It is true that a number of commentators in the press assume that a portion of the issue has been taken up by the Departments and they even try to guess how much. More often than not their guesses are very wide of the mark and for that reason alone, from my point of view, I still consider it worth while to make the statement in its present form. It all bears on my answer, part of which the Chairman read out just now, that if the market knows precisely how much of the stock you still have to offer it is in a very much better position. In other words, we are in a very much worse position as sellers and they are in a much better position as buyers.

643. But is there not a third course, namely, to refrain from saying that it is fully subscribed, which is a questionable statement, but not to say just how much is taken up outside?——I do not see any advantage in that and I think I would question that it is a questionable statement.

644. Does not the advantage of that third course lie in the fact that the Government would refrain from making a statement to which the word "truth" can be applied only by an extraordinary stretch of the term?——I would not say it was an extraordinary stretch of the term.

645. *Sir John Woods*: It is only part of the truth, is it not?——It is only part of the truth, yes. One could say that the public have taken up so much of the stock and certain Departments, not forgetting that some of the Departments have a considerable measure of independence about what they do and do not take up, had taken up the rest.

646. *Chairman*: Towards the end of our last meeting we had rather distinguished between Departments who had an independent investment policy and those who in one form or another are really under control, like the Issue Department.——I think at a later stage the Governor himself might want to comment on this,* but I would say that the Issue Department certainly has independence in its investment policy.

647. *Professor Sayers*: Independence of whom?——It is a responsibility of the Bank.

648. *Chairman*: I do not want to press on you the major policy which this involves. My questions are directed to find out primarily what happens and your answer is given from the point of view of market management?——Yes.

649. *Lord Harcourt*: This is the only case, is it not, where the market does not know what is left with the underwriters?——Yes, because there are no underwriters.

650. One underwriter?——If you like to describe the Issue Department as an underwriter; but Government stocks are not formally underwritten.

651. *Sir John Woods*: You said that if, instead of your saying the issue was fully subscribed, the market were told how much Departments had, you would be in a worse position as a seller and they would be in a better position as a buyer. Could you expand that a little? On the face of it, that means you would be in a worse position in fixing the price; but you fix the price before this announcement is made?——Yes, we fix the price of issue, but the price in practice at which we sell the stock that remains with the Department after the date of issue is the going rate.

652. You mean that you would be at a disadvantage in the Departments afterwards, supposing the stuff accumulated?——Yes, we always have to dispose of it at the current rate.

653. You are talking of after the issue?——Yes.

654. *Chairman*: Let us envisage that over a period of six months after the issue of a stock Departmental holdings are sold at whatever is regarded as the favourable rate to take and not necessarily at the issue price at all. If they are sold below the issue price does it not mean that in effect the Government is borrowing, but at a less favourable rate than at the rate of issue?——Yes, and conversely if the rates have improved.

* See Qns. 1762 to 1809 and 1841 to 1898.

655. Yes; if circumstances, whether brought about or not, give you a good market, then no doubt the holdings are sold on a good market, and the rate of borrowing would appear to be more favourable.——If it is known precisely what the Departments have to sell you have, for all intents and purposes, a stock on tap. It would not be the first time that we have had a stock on tap but in ordinary times there are considerable disadvantages in selling from the tap.

656. *Professor Sayers*: But are not the operations of the Government Broker such that there are always in fact stocks on tap?——There are always stocks on tap, but the amount of each stock on tap is not known.

657. Does that mean sometimes the tap of a particular stock runs dry?——Certainly, that is a very important feature of market management.

658. *Professor Cairncross*: You have been speaking of stock left with the Departments; but might not some of the Departments put in a firm bid?——They do.

659. There are three possible customers for the stock, the public, the Departments which put in a firm bid, and the residue; and when you say, therefore, that 100 per cent. is always subscribed for, it is three proportions you keep dark, not just two?——Yes.

660. Would the firm bid normally be a substantial proportion of the total issue?——It would depend. As I was saying last time the National Debt Office, which manages the National Insurance Funds, and the Post Office Savings Bank and Trustee Savings Banks Funds, has an independent investment policy suited to the needs of those funds, and if any stock offered by Her Majesty's Government happened to suit those funds in a small or large way they would tend to subscribe accordingly as firm investors.

661. *Chairman*: So one should think roughly of firm bids as coming from those funds or Departments that may be said to be operating an independent investment policy?——Yes. I do want to emphasise again that there is an independence in the Issue Department as well even though it is used for this function.

662. *Professor Sayers*: There is not absolute independence in these funds but the degree of independence varies?——I think it is important not to underrate the basic independence of any Department. The National Debt Office funds, for instance: I think no one would seek to influence what they do in pursuit of their trust. It has been a convenience for the Issue Department to do things which possibly the National Debt Office would not do, but that does not mean to say that the Issue Department's proper independence would not assert itself if the occasion demanded.

663. But is not the National Debt Office the Chancellor of the Exchequer and the Governor's joint responsibility?——Yes, but they have different hats on when they are considering those affairs.

664. And split minds also?——I think they achieve a remarkable degree of separation.

665. *Professor Cairncross*: Would the National Debt Office be prepared to sell some of its investments in order to subscribe to a new issue, or is it simply a matter of investing liquid funds?——If it suited it to do so on grounds of investment policy, it might sell to subscribe to a new issue. I must make the point here that I am talking about somebody else's affairs; I think you must put that to the Comptroller General, who is the man responsible.

666. Would you or the Treasury put pressure in any way on the National Debt Office, or any independent or semi-independent Department, if left with a lot of stock, to get that stock taken up firmly?——I am not quite sure that I understand the question. The National Debt Office, so far as I am aware, would not be left with any stock.

667. No, but the Issue Department would be?——In relation to the Issue Department I have never been aware of any pressure, although there is naturally an interest that they should agree to do so.

668. *Chairman*: What is the accounting operation with regard to the Issue Department? If they have to find funds to take up the stock which they are going to take, where do the funds come from? Do they borrow on Treasury Bills?——A large part of the assets of the Issue Department is held in Treasury Bills and Ways and Means Advances to the Exchequer. When a new issue by H.M. Government is about to be made the Department can put itself in the position of being able to subscribe if need be.

669. By selling its Treasury Bills on the market?——By allowing its Treasury Bills to run off and accumulating cash which it puts in Ways and Means Advances which are recallable at a moment's notice.

670. *Professor Sayers*: In fact, it is very simple?——Very.

671. The Issue Department simply has to change one bit of paper, with "Treasury Bill" written on it, into another bit of paper on which is written, say, "Treasury 3½ per cent. 1977 Stock"?——Exactly.

672. *Professor Cairncross*: From your point of view what is involved is the distribution of maturities? If an issue flops you have more short and less long than you want to have?——It depends on the issue. If it is a long-term issue I should think more longer and less shorter.

673. If it fails, the Issue Department then has to borrow short in order to fill the issue?——If the Government issues a long-term stock which the public and the other Departments do not take up, then the Issue Department will take it up, and it will pay for it with the proceeds of Treasury Bills and Ways and Means Advances. So its short maturities are reduced and the long maturities in its portfolio are increased.—*Professor Cairncross*: If I put it in terms of the Government it is the other way round.

674. *Sir John Woods*: I would like to go back for a moment to the independence of the National Debt Office, as I think it is a very important point. I have a recollection that two or three years ago the then Comptroller General of the National Debt Office gave evidence before the Public Accounts Committee. In that evidence he stressed this point very strongly. I wonder if it would be worth while if the Committee were provided with that statement, because the Comptroller General is the operative official?——I think the Committee would find it most useful to read his evidence.* It was, of course, Mr. Norman Young in those days.

675. *Mr. Jones*: To the extent that the Issue Department finds money to subscribe to the issue of bonds, what effect would that have on the fiduciary issue?——None at all directly.

676. Would it have any effect indirectly? Would it have any effect upon the number of notes in circulation?——None at all. It is merely changing the nature of the portfolio which backs the fiduciary issue without increasing its size at all.

677. *Chairman*: What happens when a stock which has been taken at the issue price by the Issue Department is later sold in the market under that price? What is the accounting result? Does it reduce the year's profits of the Issue Department?——Yes. The assets of the Issue Department are valued week by week on the basis of current market prices.

678. It is regarded as trading stock, in fact?——Yes.

679. *Professor Sayers*: You stressed just now the importance of not underestimating the independence of the Issue Department; yet, at the same time, if I understand correctly it may well be the Issue Department which has to provide the support that is necessary. How do you reconcile the independence and the necessity?——On this point I must speak subject to what the Governor may wish to say on it.† It is a subject very close to his heart. I would say that we have a statutory responsibility for the Issue Department of the Bank and for the assets which are the cover for the fiduciary note issue. Their disposition and their management is the Bank's affair. Of course, almost all of the assets are Government securities of one sort or another, securities of all maturities from short to long. It may well be consonant with one's responsibility to manage that portfolio properly from the point of view of the fiduciary note issue to take into it large amounts of new securities which might be offered against a reduction in other securities in the portfolio, because if you take in one, subject to the fiduciary issue being unchanged you must lose an equal portion of something else. I think we would say that we would find such an operation consonant with our prime responsibilities

* See Minutes of Evidence of Committee of Public Accounts (Session 1951–52) for 19th June, 1952 (pp. 503–514).

† See Qns. 1762 to 1809 and 1841 to 1898.

in the Issue Department, provided that the large blocks of stock which we might take in from time to time were readily marketable. We might find it less consonant if we took in a block of stock which it was impossible to market for years.

680. But why does it matter whether the stock held in the Issue Department is marketable or not?——*Mr. O'Brien*: I think the theory is that the stocks in the Department are the backing for the note issue and therefore should have an adequate degree of liquidity.—*Professor Sayers*: That theory is applicable to one small issue among a large number, but it is not applicable at all to a monopoly issuer issuing the legal tender of the country.

681. *Professor Cairncross*: Has the Issue Department any power to refuse a demand by the Government to borrow, or would the demand be on Ways and Means Advances only, and not affect the Issue Department? If the central Government is running a deficit and wants finance, has the Bank power to refuse facilities to the Government?——It would not borrow from the Issue Department.

682. It would borrow on Ways and Means Advances?——Yes, from the Banking Department. There again, that is a question which I think the Governor would want to answer rather than me.*

683. *Chairman*: Do you think this is a fair statement, that as a result of this system, when the Government is borrowing by the issue of bonds of this kind, so far as the bonds are taken up by the Departments and sold later, it is not really borrowing at the issue price, but from time to time as you go along at prices which the Departments realise for the sales which take place?——Yes.

684. So it is a sort of current and continuous funding at variable rates?——Yes. The process is twofold. Any maturing stocks, which in theory should be paid off at the redemption price on the day of maturity, are in fact gathered in, as the maturity gets nearer, at the price ruling in the market on the day; so that when actual redemption takes place the disturbance in the market is relatively small. On the other side, as new stocks are issued as much as possible is sold on the day of issue, but in so far as the remainder is taken into the Departments it is sold off later at the rate of the day. So the whole process is going on incessantly.

685. *Professor Sayers*: As the Government is borrowing such big figures is it not to the advantage of the Government as borrower to make the process, both of redeeming and of issuing, reasonably continuous?——It is, yes

686. *Lord Harcourt*: When the Government makes an issue, you advertise in the national Press that you are issuing, say, £300 million of such and such a security. If the position ever arose where that security was not taken up firmly by either the public or the independent investing departments, and if, as you say, the Issue Department chose to exert a form of independence and decided not to subscribe for the balance, then you would be forced, would you not, to announce that Her Majesty's Government's issue of £300 million would in fact only be, say, £280 million?——I assume that would be the result, unless somebody thought of anything better.

687. *Chairman*: Are there any more questions on paragraph 5? We will then turn to the local authorities. From 1945 to 1952 they were largely, as a body, not allowed to make stock issues. What was the policy behind that? Why could they not go to the mortgage market?——I think that this is primarily a question for the Treasury to answer.

688. *Professor Cairncross*: You speak in paragraph 6 of being unable to reduce the heavy stock maturities facing the Government for a number of years ahead. I take it that the average maturity of the outstanding debt is changing all the time. Is there a particularly large proportion of near maturities at the moment? Are you trying to push back the average maturity?——There is a large weight of maturities over the next few years. Up to 1962 there is not less than £650 million maturing in one or more stocks in every calendar year. That is higher than the general average of maturities. Thereafter there are some years completely blank.

* See Qns. 1810 and 1811.

689. Is not this a position that may recur? You may push back the near maturities a little further, and when you come to look at things in two or three years' time you may find the same situation prolonging itself?——If we have to find every year not less than £650 million quite clearly we shall have come into the same sort of trouble, but we would hope to spread the maturities more evenly each year as we go along.

690. Have you not been faced with this situation throughout the post-war period?——We have indeed.

691. Is there any reason to suppose you will not have it for the next ten years?——It may take ten years to get it reorganised, I think. I may say that the Macmillan Committee when they were sitting found the Government faced with precisely the same post-war problem; not of the same order perhaps, but the heavy rate of maturities was one of the great difficulties of operating the system successfully.

692. Is there the possibility that you could so conduct operations that you would reduce short-term and increase long-term debt at the same time?——Yes, we are constantly trying to do it.

693. Do you have any measure of success in doing it?——There were two maturities on 15th June last which together came to some £400 million. No conversion offer was made in respect of them at all, although there was a small issue of 4½ per cent. Conversion Stock, which may be said to have been made to provide funds for the repayment of the balance of those two stocks still in the bands of the public. To that extent we added only £100 million in 1962 and completely wiped out the £400 million stock which otherwise we might have had to re-fund, as in earlier post-war years, for one, two or three years. That was a successful operation of that kind.

694. But in general this is dependent on a substantial Budget surplus?——Not only that. The principal reason why we were able to do it on this occasion was because we made such heavy sales of stock in the first two and a half months of this year.

695. *Chairman*: Can you say quite shortly why in general it is desirable that you should be able to borrow long rather than short?——From the point of view of monetary control, when we are trying to get a grip on bank liquidity. If each year, in addition to financing the Government's current requirements, we have also got to find £650 million to refund stocks which are maturing it is so much more difficult to reduce the floating debt and, therefore, to squeeze bank liquidity.

696. Should one set against that the fact that the tendency will be, if you turn short into long, that you will be borrowing at rather heavier interest rates?——Yes.

697. And these will be rigid during the period of that borrowing, as opposed to your taking advantage each three months of the current rate of the short-term market?——Yes. That is one of the penalties of trying to apply a tight monetary policy.

698. *Lord Harcourt*: May I go back for one moment to paragraph 5? We have examined in great detail the method by which Her Majesty's Government issue stock, and how, although that stock is not underwritten, its subscription is virtually assured. Can you tell us how other countries manage this question?——I have not sufficient information on what other countries do.

699. I do not know, for instance, what happens in the United States. I do not know, when they do these enormous conversion operations, whether they have any comparable arrangement. I think it would be interesting to know, perhaps, how one or two other major financial centres deal with the same sort of problem, just as a comparison?——*Mr. O'Brien*: I really do not know, but I could find out if the Committee would like to know.—*Chairman*: Yes, we should like to know, I think.—*Mr. O'Brien*: I will do so.†

700. *Sir Reginald Verdon Smith*: In paragraph 7, you say:—

"Borrowing from the Board was done at rates which reflected the credit of the Government itself (having regard to the length of the borrowing) and not that of the Authority concerned."

As a matter of practice is the credit of the authority concerned something which is liable to vary in ordinary cir-

† See Memoranda of Evidence Part I No. 16.

cumstances very sharply from that of the Government; and, secondly, do the circumstances of different authorities vary between themselves very greatly?——The credit of local authorities is, of course, different from the credit of Her Majesty's Government; they cannot borrow quite so cheaply. The differential between the rates at which they can borrow is, I should say, fairly constant. No doubt it has varied in the past, but not in recent years, although there have been some curious manifestations at the present time.

701. I appreciate that the question of policy is one for the Treasury, but I was interested in the factual background. What could have been said to have been gained by providing Government credit rather than leaving it to the credit of each individual authority during these years?——The Government lent to these authorities at the same rate at which the Government could borrow the money required for the purpose from the market. That was at the time when the Government were lending all the money that the authorities required, and it made the operation cheaper. Here again, the Treasury may say I am encroaching upon their wicket. When it was desired to push the authorities out into the market to borrow money on their own initiative they obviously had to borrow in the market at the rates the market would lend to them individually. The rates vary a little as between one authority and another; some are more popular, some are larger, which tends to increase their standing, although not uniformly so. That encouragement had to be backed up by a refusal to lend to them through Governmental channels at any cheaper rate; otherwise the local authorities would have continued to favour borrowing from the Government. That has since been reinforced by an absolute refusal to lend to them from Government channels at any rate, if they could not show that they were not able to get the money at the current rate in the market. Getting them off Government finance has been done by progressive steps.

702. *Professor Sayers*: Confining ourselves to market behaviour, the differentiation between yields on local authority stocks and on Government stocks is a recognised market fact, but that may change. It is particularly liable to change if it has no rational basis. Has it a rational basis? Why should the yields on local government stocks be higher than on Government stocks?——Nobody would expect to be able to borrow in the market at a rate cheaper than the Government.

703. No, but why not as cheaply?——The local authorities are not the Government. They may be very close to it and I think the narrowness of the differential between the two stocks illustrates that the general market view is that there is not a lot of difference between a local authority and H.M. Government.

704. *Professor Cairncross*: Is not the chief difference the size of the issue?——That is a difference; that is one of the reasons why current yields on existing local authorities' stocks are actually lower than current yields on Government stocks. The fact is that there are virtually no deals at present and, therefore, the yields are not a true illustration.

705. The net effect is to push the local authorities into a narrower market than they were previously in? They are borrowing from people who are less willing to set their money go into a less liquid form?——It is a less liquid form; most investors would take up small portions of local authorities' stocks and would not go in deep into any one stock, but would go in, in a big way, for gilt-edged stock because it has maximum marketability. That has an influence on yields.

706. *Mr. Woodcock*: One of Sir Reginald's questions was whether there was much variation between the authorities. Mostly you have been talking about the distinction between the local authorities and the Government, but you said there was some variation in the credit of the authorities. I would have thought that was a question of timing. I would not have thought there was any difference in the credit of authorities as such but one might, of course, have the disadvantage of having to go in at the wrong time?——Broadly speaking, I am sure you are quite right, but the market has a long memory, and there are very subtle shades of feeling about these things. Particular names appeal to the market more than other names and that is reflected in a very narrow way in the terms when it comes to giving credit. But I would not question your broad generalisation at all.

707. *Lord Harcourt*: Local authorities tend to be regarded to a certain extent by the market as trading entities, to the extent that a city council with a very good financial record would tend to borrow more cheaply than a small council where the financial control probably had not been very astute or able, which would have to pay more. Does the market in fact look at the general financial record of the authority concerned?——I think they do, yes.

708. *Professor Sayers*: Has the financial record of any authority included any default or delay on payment of interest or maturity?——*Mr. O'Brien*: I believe so in the past, but not in the recent past. *Professor Sayers*: In this century?——*Mr. O'Brien*: I would say, yes.

709. *Mr. Woodcock*: How far back would you go?——I should have to make sure I had got my facts right before giving anything to the Committee on that. I shall be very happy to give it if you so require it.*

710. *Chairman*: There were several widespread forgeries within the memory of the City in the issue of these stocks, and that may have left a shadow behind perhaps?——*Mr. O'Brien*: Would you like me to get some information on that?——*Chairman*: Yes, please.*.

711. *Mr. Jones*: I wonder whether I could ask Mr. O'Brien a question arising out of the figures in paragraph 8? These give a picture of the net issues to the Public Works Loan Board that were taken up by the local authorities. I suppose that in all these instances this money has been made available for long-term projects, housing, schools, roads and the rest. Are there any figures that would show what the income into the Public Works Loan Board has been as against these issues, by way of interest and capital repayment?——I feel sure there must be such figures. I expect the Treasury could obtain them, but we have not got them available.

712. To what extent were the issues of credit by the Public Works Loan Board made on long periods of loan?——There again, that information is not at my disposal, but I believe it is available.

713. *Chairman*: The figures in the left-hand column are the net issues?——*Mr. O'Brien*: Yes, which one assumes includes any income to the Public Works Loan Board; but you would like details of what they did get, Mr. Jones, would you?——*Mr. Jones*: Yes.——*Mr. O'Brien*: I have not got the gross figures available to me.

714. *Chairman*: We see from the figures that in the period of rising interest rates—1952 to 1955—when the local authorities turned to the mortgage market, they were raising comparatively large sums in spite of the high rate of interest?——Yes.

715. *Sir John Woods*: On the other hand, their total borrowings have gone down considerably since 1953-54?——*Chairman*: In 1952-53 they were about £500 million, the same in the next year and £478 million in 1954-55. We have not got 1955-56?——Yes.

716. *Professor Cairncross*: If the money received by the local authorities on mortgage came from exactly the same people who would otherwise have bought gilt-edged, the sole purpose of this manoeuvre would be to raise the rate of interest to the local authorities; but presumably it was intended to force the local authorities on to a different set of lenders. How successful do you think it was in that direction? Do the people who lend to the local authorities in this way constitute a different set of people from those who would otherwise have bought gilt-edged?——To some extent I think that is true.

717. *Professor Sayers*: Why are people lending to the local authorities who would not have lent to the Government on identical or better terms for the Government?——I should say a lot of people lending small amounts to local authorities would have a variety of local authority stocks in a portfolio for the sake of the yield differential. They might have a large portion of their investments in gilt-edged and would like to get the extra 5s. or 6s. per cent. on a small portion of it.

718. *Mr. Woodcock*: I think Professor Sayers said if they were on the same terms?——But they are not. That is a hypothetical question.

719. *Professor Sayers*: I was supposing that for money raised on mortgage the lender was getting a higher rate

* See Appendix to Minutes of Evidence.

of interest than from Government stocks. Would that be right?——That is so. Mortgage rates at the moment are six per cent. and over.

720. *Professor Cairncross*: Would you think that is one reason why the rise in bank deposits has been more contained in the last two or three years? People have withdrawn money on deposit and put it on loan with the local authorities where they would otherwise have left it in the banks?——I would say there has been a general tendency for people to draw money from deposit and put it into investments offering more attractive yields. Some, of course, have gone into hire purchase companies offering much more, but some may feel at greater risk. That process is going on all the time, of people looking for the maximum yield with the minimum risk attached to it.

721. *Sir Reginald Verdon Smith*: Is the Public Works Loan Board a statutory body or a branch of the Treasury?——It is a statutory body which works in collaboration with the Treasury.

722. Does the Bank have any responsibility?——No responsibility whatever and no very real knowledge of how they set about their business.

723. *Chairman*: But they are provided with funds for their work by the Treasury, which borrows for them?——Yes.

724. *Sir Reginald Verdon Smith*: This would he general borrowing by Bills?——To the extent that the Public Works Loan Board makes issues to the local authorities the Exchequer is called upon to provide the necessary funds, which it does in the normal way, borrowing in the first instance on Treasury Bills.

725. *Mr. Woodcock*: If borrowing by local authorities was exclusively from the Public Works Loan Board, would there be a greater degree of Government control over the total amount of borrowing, leaving price on one side?——I do not think that is for me to answer, but I would say, looking at the years since the war, that it is open to question.

726. *Mr. Woodcock*: Yes, but as a matter of machinery?—*Professor Sayers*: There is other control on local authorities' borrowing?——Government departments have to give sanctions for the works for which the money is required, even now, despite the fact that they borrow on the market. I do not know whether there is any greater degree of control merely because the money is provided through Government channels.

727. *Mr. Woodcock*: Surely the decision to borrow money for certain purposes is related to the social desirability of the purpose in question rather than the financial circumstances. As I understand it, for example, the decision whether they should borrow for house purchase is largely a question of the housing situation, is it not?——I understand local authorities have to get loan sanctions, and cannot borrow money until they have sanctions from the various Government Departments concerned sufficient to cover them for that amount of borrowing.

728. I should have thought the control was rather different in one case than the other?——I do not know; that is rather outside my field.

729. *Sir John Woods*: Would a local authority going into the market, or trying to go without loan sanction, have to get over the hurdle of the Capital Issues Committee?——Local authorities do not normally go to the Capital Issues Committee.

730. *Lord Harcourt*: As long as they have loan sanction?——That is my understanding. As I say, I am not so concerned with that side of the picture.

731. Am I right in thinking that the Public Works Loan Board did borrow in the market itself?——*Mr. O'Brien*: I rather believe it did some time ago.—*Lord Harcourt*: I think it did borrow at one time under its old name.—*Mr. O'Brien*: The Local Loans Issues, yes.

732. *Mr. Jones*: Would not the local authorities obtain sanction to raise money on loan in respect of those projects that were capital projects and in respect of which the Treasury itself or the various departments of the Government were making a contribution?——Without wishing to be unhelpful on that I must repeat that this is rather outside my field. I am concerned with how we raise the money. I think it would be for the Treasury to answer that question.

733. *Professor Sayers*: In your own field would you say that the wider the variety of bonds issued to the public, even if some of the issues are very small, the more money can be raised?——I believe that to be so.

734. That may be an important lesson for central Government borrowing policy?——Yes.

735. Could not more money be attracted on long-term by making a greater variety of bond issues by the central Government?——If you wanted that I think they would have to be more frequent, because we do have a certain amount of variety nowadays. In the last few years we have issued stocks all the way down the line; for example, 1962; 1969; 1968/1973; 1979/1981; 1999/2004; so that there has been variety in that sense.

736. *Lord Harcourt*: Since the local authorities have been obliged to rely on market borrowing and have not been able to get ready access to the Public Works Loan Board, have they not gone out of their way to try and attract the small saver?——They have indeed.

737. In a way which the Government bond market never really could?——*Mr. O'Brien*: No; with over-the-counter mortgages you mean?——*Lord Harcourt*: Yes. You see local papers plastered with advertisements that sums of £5 and upwards are acceptable on mortgage.—*Mr. Woodcock*: I think that is for current expenditure, running costs, rather than capital expenditure. —*Mr. Jones*: On maintenance account rather than on capital account. But it does seem to me to be true that it is possible to have these investments on short periods. As a matter of fact, there are arrangements made, I believe, for them being redeemed at very short periods—a few months.

738. *Chairman*: I suppose these mortgages are all at call at six months?——Not all.

739. Do some authorities make them for longer periods? I did not know mortgages were tied up in that way?——Some are. They are not all six months.

740. *Lord Harcourt*: Is not a great deal of the so-called mortgage borrowing by local authorities at the moment really more akin to the acceptance of deposits?——Almost like deposits, yes.

741. Although it is advertised as a mortgage it is in fact a deposit with the local authority redeemable at call or very short notice probably?——I should think so. They vary, of course, according to the terms offered.

742. *Chairman*: Is there anything on paragraph 10? Then paragraph 11—the nationalised industries? It says in that paragraph:—

"Instead they draw advances from the Exchequer each month to cover expected capital expenditure".

What rate of interest are they charged?——They are charged the rate of interest applicable to Government borrowing for the period agreed. This again is something on which the Treasury would be able to help you. The Exchequer lending rates are established for various periods and according to the period for which the nationalised industry will borrow from the Exchequer. It is a matter of agreement between them and the Treasury, as I understand it, what rate would apply. They are really borrowing on Government terms through this mechanism.

743. *Chairman*: We ought to pursue that with the Treasury. Paragraph 12?—*Lord Harcourt*: You say:—

". . . nor is it limited in the choice of the term of the borrowing to stock issues which match the financial structure of a particular nationalised industry".

By that do you mean that the Government is free to issue a stock of any maturity which suits its own debt structure rather than the financial structure of the nationalised industry in question?——It has to suit two things, first, what the market will take; and if the market will take something which suits the Government's debt structure so much the better. It is not always so, I am afraid.

744. *Professor Cairncross*: But the nationalised industry is debited with the actual rate, not with the rate that might have to be paid on a debt adapted to the debt structure of its other borrowings?——The borrowings of the nationalised industries from the Exchequer are not

related directly to particular Government borrowings at all. A theoretical rate is established and kept under review which would be applied to their borrowings.

745. Is this theoretical rate the same for all nationalised industries?——Yes.

746. *Sir John Woods*: Irrespective of period?——*Mr. O'Brien*: No.—*Professor Cairncross*: Loans are made for different periods?—*Mr. O'Brien*: There again, you are on Treasury ground.

747. *Lord Harcourt*: Does it follow from this statement which you have just explained that in future we need not expect a Transport stock or Electricity stock and in fact they will all be Treasury stocks?——The changes were made in the 1956 Budget for two years as an experiment. Those two years will have elapsed by April, 1958, and presumably it is now under review or will shortly come under review whether these arrangements should be continued or not in the light of experience. If they are continued, you will not get any more of these particular stocks until we come to the happy day when the nationalised industries are able to borrow on their own credit.

Chairman: I think paragraph 13 includes the same points we were discussing earlier—the departmental funds. I think that brings us to the end of your three papers, Mr. O'Brien, and we are very much obliged to you.

C. F. COBBOLD, ESQ., Governor, H. C. B. MYNORS, ESQ., Deputy Governor, and M. H. PARSONS, ESQ., an Executive Director, of the Bank of England, called and examined.

748. *Chairman*: I hope, Mr. Cobbold, I did not create any misunderstanding when you left us last time. I do not think we had altogether finished the third paper. I think we can take it up on Paragraph 17 where my note shows we broke off.——*Mr. Cobbold*: May I come back to one or two other things first?—*Chairman*: Yes, please do?—*Mr. Cobbold*: The first thing was the question of the Macmillan Committee's recommendation about the form of the Bank Return. You asked me about it, and I said it had not been under consideration during my period of office but we would look up the earlier records. The Deputy Governor has been kind enough to look into this. So far as we can discover the position is this:—In reply to a Parliamentary Question on the 10th September, 1931 the Financial Secretary to the Treasury said:—

"The recommendations regarding the regulation of the note issue would, of course, require legislation. The Committee do not represent this as urgent, and I do not think that, in the present conjuncture of events, it would be desirable to propose an alteration in the law".

Nothing further bearing on the point has been found in the Bank's records. We have made enquiries from the Treasury and it is understood that Treasury records relating to the Macmillan Committee were among those which suffered serious war damage.

Perhaps it is fair to say that the Macmillan Committee's recommendation followed upon recommendations regarding the relation between the gold reserve and the note issue, and the method of determining the profits of the note issue. The abandonment of the gold standard and subsequent events made fundamental changes in the circumstances to which these recommendations were related. The new arrangements for the Exchange Equalisation Account and so forth were experimental: and it is hardly surprising that no room was found in the legislative programme for these particular changes.

With regard to the form of the Bank Return, it is of course as it stands a matter of history: but it is difficult to believe that anyone who is interested in such things cannot quickly learn to find his way about it. The form is statutory, and to change it would require legislation. In fact the Return is not only published, as the Act requires, in the London Gazette, but the Bank also issue every Thursday a form of the Return which gives more detail than the Act demands. If the Committee think it would be of public advantage for somewhat more detail to be given in this latter edition of the Return the Bank would be ready to consider this with sympathy but with caution. The statutory Return would still have to appear in the London Gazette.

If, on the other hand, the Committee had in mind not primarily the presentation of the Bank's figures but rather the separation into Departments which results in the existing presentation, it must be said that this would raise a much more serious issue. The assets of the two Departments are managed on different principles: their profits, although all within the public sphere, are ascertained and disposed of in different ways and amalgamation would raise general questions of the constitutional position of the Bank. In the Bank's view, the existing position (as it has stood since 1946) does not impede their power to execute their public functions and meets with general public approval. The Bank would see great disadvantage in bringing again under discussion, so soon after they have been settled by Parliament in the Bank Act of 1946, the constitution of the Bank and the management of the profits and inner reserves of the Banking Department.

749. Thank you. I was really seeking your view as to whether there was any advantage in adopting the Macmillan recommendation?——We have considered that very fully and I have consulted my colleagues, and we all feel pretty strongly that we should see strong disadvantages to it, although, as I said, if the Committee feel that advantage could be gained by some extension and amplification of the edition of the Bank Return we publish, other than the statutory one, we should be ready to consider it.

750. I think we shall have to explore any questions on the statement as it stands. I think there was another matter you wanted to speak about?——Yes. I wanted to talk about the question which was raised of making our policies better known to the public. I think I dealt with two aspects of it, that is, the explanation to the other sections of the financial market and also to central banks, and so on, overseas. When we got to the question of explanation to the public I said at the time that that was a subject which raised a number of difficulties and while I was ready to speak freely to the Committee I should like a little notice of anything which was for publication. We have considered that matter a little more, Mr. Chairman. I can now say a good deal about which I should be happy to regard as almost all for publication if I might just have the arrangement which I foreshadowed in my opening statement, that if there was a sentence or two here and there that I felt on reflection against the public interest I might ask you to consider whether that could be excluded from the published record.—*Chairman*: I think we should like to discuss this among ourselves before I reply on that; would you be good enough to withdraw for a short time?

(*The witnesses accordingly withdrew*)

After the Committee had discussed the matter in private session, the witnesses were recalled and the Chairman made a statement to the following effect as indicating the Committee's attitude towards statements or answers by witnesses.

(1) Witnesses should realise that a full record of evidence is intended to be made public at the time of the publication of the Committee's Report. If a witness objects to answering any particular question on the ground that its eventual publication would be undesirable, he should make an objection to that effect without answering the question. Normally, he will be invited to state the grounds of his objection. If he relies on such circumstances as the fact that publication would disclose matters confidential as between banker and customer or would be inimical to the public interest he will not be pressed further for an answer.

(2) As a general rule the Committee do not wish to take cognisance of material submitted to them, either orally or in writing, unless they can treat it as available for publication as part of the record of evidence.

(3) Witnesses will be allowed to see the printed record in proof. As a general rule requests for excisions or corrections will not be entertained, unless the excision or correction is needed to put right something that is inaccurate or misleading or is clearly required in the general public interest.

751. *Chairman*: You will see that our general approach is that we do not want to receive from witnesses information that they are not prepared to have published later, but that will not exclude a power to ask for alteration of something which is thought to be what a witness did not intend to say, something that needs correction. I shall operate this with a reluctance to give weight to anything that does not seem really to call for important consideration. Would you guide yourself on that line?——*Mr. Cobbold*: That is quite acceptable.

752. Then I think we had reached the second point you were going to amplify?——I think it would be relevant, and perhaps useful to the Committee, before I start talking about our policy on this very difficult question, if I gave a short statement of background on some of the things that we do and on some of the things that we try to do, which I think are very relevant to this particular aspect:

(1) The Bank are the bankers to H.M. Government. They hold the Exchequer accounts, manage the National Debt and the issue of currency and, as agents for H.M. Treasury, the Exchange Equalisation Account and exchange control

(2) In this capacity they are H.M. Government's advisers on banking, foreign exchange and general market matters. They are regularly consulted over a wide range of financial subjects affecting Her Majesty's Government.

(3) They are also bankers to the main commercial banks and houses in the U.K. They have close and intimate relations with these banks and houses, as would be normal between any banker and customer.

(4) They are also bankers to many overseas central banks. Here again there is a close relationship of banker to customer, in many cases covering a regular and intimate exchange of views and information. The closest relations in this field are with the central banks of Commonwealth countries, the Federal Reserve System of the U.S.A. and the major European central banks.

(5) The Bank is thus a focus of operations and information in various fields. Much of the individual operations and information is secret as between banker and customer; but general knowledge of what is going on often enables the Bank, without disclosing matters affecting particular customers, to give advice and assistance to each category of principal customers.

(6) The Bank must be in and of the market place, but at the same time closely in the counsels of Government. They must be ready to expound, and often interpret, the thinking and policies of Government on financial matters to the financial community, and vice versa.

(7) It is essential that the Bank should, in the current management of its affairs, be sufficiently independent, both of Government and of commercial interests, to form an objective view and to give unbiassed advice. As a previous Governor put it, the Bank should be ready to advise the Government, even to the point of nagging—recognising that in the last resort policy must be decided by the Government of the day.

(8) It is no less essential that the bank should enjoy the confidence, as an impartial and national institution, of the Government of the day, of Parliament, and of the general public at home and abroad.

753. Are there any questions anyone would like to ask arising out of that?——May I come up to the policy considerations which derive from that statement? This, as I have indicated, Mr. Chairman, we regard as a very difficult subject which is continually before our notice and to which we give a great deal of thought. It is, of course, always an easy criticism that the Bank are obscurantist and do not wish to give figures, and all that. I would like to make it quite plain to the Committee that our present policy is not dictated by blind adherence to tradition on this subject. The tradition is possibly not formed without very good reason, but our present policy on this is for considered reasons and the prime consideration is that of the best service that in the Bank's judgment we can give to the public.

There are, of course, many arguments both ways. I think I would summarise them briefly as follows: the pros for a more forthcoming attitude are: (1) educating the public and facilitating informed comment; (2) seeking public support and approval for monetary action; (3) removing the idea that high finance is a sinister mystery. The main cons I would see as follows: (1) the final responsibility—I did mention this point the other day—for economic policy lies with the Government, and Government are increasingly collecting and publishing statistical information, an exercise in which we help wherever we can. In fact we work very closely on monetary and financial statistics and provide a great number of the statistics which go to form part of the general Government publications on the subject. We do largely see, if we published too much of our own, certain dangers both of duplication and of possible contradiction. (2) We regard it as vitally important, and this is perhaps the most important point of all, that the Bank should have and retain the confidence of the Government of the day. The main relationship, as I have already said, is that of banker and customer. If that relationship is to be maintained Her Majesty's Government must be able to consult and the Bank must be able to advise on terms of strictest banking secrecy. That is an absolutely essential point which we always have in mind in any public utterance that we might consider making. More broadly we regard it as absolutely vital in the national interest that the Bank should keep entirely out of political issues.

This is not a matter which we can look at as if it were starting from today. There is a long history in all this. We are bound to take account of the history in the 1930's of the public view of monetary action. I think I should convey my meaning not improperly if I used the words "bankers' ramp" about which we heard a good deal at those times. Since then we have had the nationalisation of the Bank. The present Court have, I think, seen it as one of their prime objectives to create conditions and so to manage their affairs that the Bank could and would settle down as a national institution, accepted as such by the country as a whole, but retaining sufficient independence of thought to do its job properly.

The next point I would like to make is that it is of some doubt whether it would really clarify the issues for the public if the Bank were continually making statements with a different slant from similar statements made by Government to the public. Further, it would quite certainly make Bank relations with Government intolerable if discussion and argument were conducted by the Bank and the Treasury in public instead of between themselves. We believe there is very much to be said for the policy we generally adopt of hammering out any differences of policy or view and by and large leaving it to the Government to explain the decisions finally taken.

Lastly, I would give a good deal of weight to the evident conflict between giving information and operational efficiency. Very often, I think, in our case it is no more appropriate that we should publicise our exact dispositions and intentions than that an army in the field should be expected to do so. It is indeed quite clear, to take a specific instance, that if you say in a loud voice that you are holders of large blocks of a particular stock and also intend to be heavy sellers of the same, it is not likely to make the operations any easier.

I would say, therefore, that this is not at all an absolute question. There is a continuous need to set off one lot of arguments against another. The arguments on the one hand fall mainly under two heads; the importance of securing public understanding and support and the very proper desire to have the fullest information possible. On the other hand, they also fall under two main heads: first the non-political status of the Bank, the Bank's relations with Parliament and Government and with the public; and secondly operational efficiency.

On balance the Bank's present policy is in fact to be rather more forthcoming than it was, I would judge, in the old days. As the Committee are aware it has been my practice to make speeches from time to time—not a great many, perhaps two a year—saying a good deal about the Bank's view on current policy developments. We have, I think, much closer relations with the Press than used to be the case in the early thirties. Moreover we have on occasions made some reference, in my speeches, or by informal information given to the Press, to changes in monetary policy, changes in the Bank Rate, and so on.

Our view is that it is very much better that we should be able to choose our own time when it would be useful and helpful to the public to say something rather than be

forced by some regular monthly or weekly arrangement to say something, or indeed perhaps to say very little, in frequent, regular statements.

The Bank are, as I have said, always thinking about this. I think it is quite possible that we may be able to make further progress in the direction in which I claim we have already made considerable progress for the last few years, but I think it should be done gradually, and I think it should at all costs avoid the Bank's taking positions which are or which could reasonably be alleged to be political positions.

Our general view on statistical material is that it should be left to be published mainly by the Government, but that the Bank are always ready to help whenever they can.

One more specific point only. We have given a great deal of thought, of course, to the Annual Report. It has, I would admit, in comparison with some Continental and other central bank reports been something of a barren document because of policy considerations which I have already detailed. We have introduced rather more policy matter in the last year or so, but not very much. We have given a great deal of consideration to amplifying the Report.

I think I might particularly mention that we have given particular thought to the possibility of including—in fact I think we might have included in this year's Annual Report —something on the lines of Paper 9, the history of certain aspects of monetary policy. Obviously, when the decision was taken to form this Committee we did not think it would be wise to pursue the idea of publishing that in this year's Annual Report. We should have done it in a slightly different form, but that particular paper was, so to speak, commissioned some months before your committee was set up and we had it in mind to consider the possible publication of that. We should indeed as of now have it in our mind that something of that sort might appear in further Annual Reports. There again, there is an operational consideration; if we were to publish that sort of information and that sort of story, there would have to be a considerable gap between the date that the story went up to and the date of publication. I think those are the main views.

754. I am much obliged. It will be easier of course to digest it when we see it in the record. I have no doubt it raises a number of questions which we will want to come back to later. By giving full effect to what you said about the relationship of banker and customer between the Bank and the Government, that would exclude in your view any overt criticism from the Bank of Government actions as affecting monetary policy or the monetary system?——*Mr. Cobbold*: I think I would there rely on the record of speeches that I have made.—*Chairman*: Those that you give us in the appendix?—*Mr. Cobbold*: Yes.

755. *Mr. Woodcock*: I am not quite sure about the relevance of what I think was your second "con", where you spoke of this accusation of a "bankers' ramp". As I understand the accusation, it concerned the advice which the Bank was suspected to have given to the Government, but that was not part of the question about information? ——Our feeling is that it is so essential that the Bank in its present guise should be accepted as a national institution without party political views. That seems to us to be an extremely important consideration.

756. Yes, but of course you have those views; you are bound to have views about political action. The question that I thought gave rise to this was the question of publication of information?——The publication of views and information, was it not? We were talking about not solely statistical information, I think. I think we were talking about—in fact the question the Chairman asked was—whether we should ever feel it proper to make overt criticism of the Government.

757. I think your second "con" really relates to the Bank's relations with its customers rather than the publication of what goes on?——I would have thought it had an awfully important bearing on the general acceptance of the Bank by the general public as a national institution.

758. *Sir John Woods*: On that particular point are you not really saying that you want to keep quiet in order to avoid being accused of taking part in political views? Actually you have to give economic advice which obviously has political implications. That cannot be avoided. Is it the case that the "bankers' ramp" accusation arose from any publication of anything by the Bank? Was it not an inference as to the Bank's advice generally, not any publication?——I was merely saying that the historical facts of that period were one of the things that we had to take into account in forming our present policy on these matters.

759. The facts of that period have led the Bank to that particular feeling and reinforced your feeling that to the extent you can you should keep out of any party political view?——I think that is so.

760. *Professor Sayers*: Is it not a historical fact that the talk about the "bankers' ramp" could only have arisen as it did because the public was ignorant of the part that was being played by the Bank of England at that time?——It may well be.

761. *Professor Cairncross*: May I put another point arising out of this to you? I see you have to balance considerations on both sides, and I can see that other agencies of Government, nationalised industries, are in exactly the same position. Now each of them may come to the same conclusion as you. Let me put it to you that, if all the nationalised industries were to refrain from making their views public, for fear they might give the impression of criticising the Government, the public would then be in a very awkward position?——I did not go as far as you suggested in your opening phrase. I think this is a point we watch extremely carefully. We try as far as possible to keep out of party political issues. I should not feel myself debarred—the Bank would not—from making overt criticism of the Government if they thought that on a balance of considerations proper. I think you would find there were some notes of criticism in some of my speeches. I do not regard this as an absolute question. As I say it is a question of degree and balance of arguments on each particular occasion. I can perfectly well see the possibility of a situation when on behalf of the Court or myself personally I should wish to make a very overt comment. It is obviously conceivable that any of the Court, including the Governors, would wish to take actions of resignation and make speeches on those occasions. There are a great variety of different possibilities. I am saying that there is a balance of consideration here all the time, and what we are trying to do is to balance this step against the other step. We may not have got it right yet and I do not regard this question as at all static. In fact, I would claim that over the past three years we have said a good deal more than we did in the three preceding years. I am referring to the time in which I have been Governor myself.

762. *Chairman*: To come back to Professor Cairncross's question, you do not equate your position with that of a leading Civil Servant?——Not at all. I am a servant of the Bank Court.

763. *Professor Cairncross*: The question I would put to you is this: while any large industry owned by the State might reasonably come to the conclusion that it should err on the side of caution, if each of them came to the same conclusion the public might then be denied an insight into the real issues which were at stake within large sectors of the economy and between them and the central Government.——I could not give an answer affecting the Coal Board or any other nationalised industry. I doubt whether I could add usefully on that point to what I have already said.

764. I will take a specific case. One of the indications you gave was towards the issue of a larger Annual Report. You thought perhaps more might go into it in the future, but you were, I think, a little afraid that statements and views might necessarily go into any larger document in which there would be a slant different from the slant which was given in the Economic Survey. Is this in fact a sufficient deterrent?——If I did say that I did not quite mean to say it. I did say that very frequent statements with different slants were more likely to confuse than to assist the public. But I do not think I should see objection to the Bank's Annual Report giving a different slant from that given by the Economic Survey.

765. In that case you are resting your position partly on the frequency and partly on the seriousness of the difference?——Yes.

766. *Mr. Woodcock*: The fact that you advise the Government on issues which, whatever your motives, are

political issues, does bear on the question of the extent to which you ought to be in a position to advise the Government, since nobody knows what that advice is? ——Surely the Government has to be responsible for where they take their advice.

767. I was speaking of your position in relation to publicity. You say, I think rightly, that whatever you say must take into account the fact that you are the Government's banker and also that you have the right, or the duty, to advise them on these things. But surely it works the other way too, that, so far as you are restricted—or restrict yourself—in making public what you do, that is a fact to be taken into account in considering the Bank's position?——I am sorry, but I have not exactly got your point, Mr. Woodcock.

768. Let me come back to this "bankers' ramp". It was, as Sir John said, an assumption held by many people in this country that the policy followed by the Government in the thirties was the result of the influence of the Bank, and further that it was the result of advice given by the Bank from the bankers' point of view?——That was an assumption which was certainly never admitted.

769. That may be, but if you are not going to publish the advice (I do not say you should) that raises the question as to the extent—let me put it bluntly—to which you should be allowed to give advice?——I do not think that is a question I can answer. That has been settled by Parliament, has it not?

770. The question of policy has not been entirely settled by Parliament?——I think you and I are taking approximately the same view about publicity.

771. *Professor Cairncross*: I think you suggested that you are now producing a good deal more in the way of statements and information from the Bank of England than has been done in the past. I do not think you put it as generally as that, but you were suggesting that you had been rather freer in giving a lead as to the opinion held in the Bank. There is one particular way in which in the thirties you issued information which you do not use now: that is the Statistical Summary. This was an important and pioneering document. I can see that you may feel that Government publications adequately replace it, but have you thought of resuming the publication of a document of that kind?——*Mr. Cobbold*: That was the basis of the decision, that it would be duplication; in fact we largely handed over the information to the Government.—*Mr. Mynors*: That was certainly a consideration in our minds when we gave up the Statistical Summary. We had thought of it in the first place as an attempt to develop something in a field where something was needed and lacking. After the war the Government came out with the Statistical Digest. We wanted to make up our minds whether we should continue to operate in parallel with the Digest, not quite knowing at that stage on what scale the Digest would prove to be. We decided that, since that made a widely available source for those figures, it suited us if the Government wished to do it. Rather than run on in parallel with a paper which contained much of the same figures (which were Government figures in the first instance, that we had to get from the Government in advance of publication) it was better to hand over, which we did with goodwill. We have not really considered much in detail since then producing another Statistical Summary, because the real excuse for it would be that the Digest was a bit indigestible.—*Mr. Cobbold*: I think if there was any feeling in the Committee that resuscitation in any form of our own Digest would be helpful and would not be purely duplicating, the Bank would be always extremely ready to consider that.

772. *Chairman*: I think we shall come back to these policy questions later, particularly this difficult question of setting operational efficiency on one side against other considerations on the other, but I think at the moment we are rather seeking to inform ourselves.—*Sir Oliver Franks*: I find myself in broad agreement with the considerations pro and con which affect all these questions of public relations. I agree it is a question of balance. I think there has been progress in giving more information in the last few years, but the difficult question remains, whether the rate of progress is fast enough, or alternatively whether a policy which involves the taking of slightly more risk and giving a little more information might not buy very large dividends. I would like to discuss later on what the circle of people and institutions is in this country, which one would want to have some notion of what the Bank of England thinks and does. I think that the circle of institutions which at present has any notion is extremely narrow. It is a question whether that is a good or bad thing. Secondly, there are occasions—and I can think of two of them—when the Bank has said that a particular change was made "for technical reasons." I think one was a decision about transferable sterling, when a degree of support was given to that which was not given before; and another was a recent change in the Bank rate when again "technical reasons" was the phrase used in connection with it. On both occasions it may well have been the case that the primary considerations which led to the decisions were technical reasons, and I am not raising that at all; but I think that if one goes outside a very narrow circle, that explanation is greeted with complete incredulity, which is undesirable. It is assumed that this phrase is used because, whatever the reasons may have been, the Bank does not want to state them. It is on occasions like that that it seems to me—and it is a question of balance—that it is a very difficult question to know what and how much to say; but it is on occasions like that that it seems to me that, if the Bank is trying to make itself intelligible to a rather wider circle than, say, 50 years ago, important issues arise. I do not want to go into that now, but on the policy issues raised by the Governor's statement that is the sort of question that I would like to pursue further.—*Mr. Cobbold*: I should be happy to do so. I am, as I think I have indicated, in sympathy with that line of thought. Taking the two specific cases you have mentioned I would only claim that on the latter of the two I made quite a long speech at Coventry, of which I sent at least the chairmen of the clearing banks a copy.—*Sir Oliver Franks*: I do not want to get into any discussion now. I think it had better come later. There is a sense in which subsequent statements never catch up; that is a law of journalism.

773. *Professor Sayers*: May I put one rather narrow question and then another wider question later on? First, an example of weighing operating efficiency against the desirability of giving as much information as much as possible. I should like to hear what Mr. Governor has to say about the history of the publicity question in relation to the Exchange Equalisation Account. For some years after the Account was established the figures of its holding of gold and dollars, etc., were secret. There was no publication at all, I believe, for some years. Then there was some degree of publication—I think perhaps it was quarterly, some time after the event. Now we have for some time settled for a monthly publication which comes pretty quickly after the event. I wonder whether Mr. Governor has views on whether that experience of change in publicity can help us in this matter of how far publicity should be pushed generally, weighing operational efficiency against the desirability of giving as much information as possible? Another question of the same calibre I might add is in relation to the Bank's holdings of stocks. Mr. Governor said that it would obviously be undesirable to say that the Bank had huge holdings of such and such stock, and that they were going to sell it as quickly as possible. But if the policy of the authorities is already known to be that of funding the debt, selling long term securities, as rapidly as is reasonably possible, is there any added danger in publicising official holdings of particular groups of stocks? On a broader issue I should like to hear Mr. Governor's views on whether the position of the Bank in giving advice to the Government on broad questions of monetary policy might not be strengthened by its taking a more public lead, giving more public information, making more public comment, so that it had a greater body of outside opinion behind it in giving advice to the Government? That is one of the wider issues and I acknowledge on this the force of all the Governor has said in pros and cons. It is a very difficult question. I do not know if Mr. Governor would like to comment now at all?——*Mr. Cobbold*: If I can take your last point first and give you a quick comment on that, that has certainly been one of the considerations weighing very definitely on occasions when I have made speeches of a slightly different slant. On your second and more detailed point, I would say that it does add to the difficulties if

you publicise the amount of stock that you hold. I do not say that difficulties do not exist, because as you rightly say the market know what the policy is, but there are occasions when publicity given to holdings of a particular stock held would add materially to our operational difficulties.—*Mr. O'Brien*: I agree wholeheartedly. I am certain it would add to the difficulties. I feel anybody who wants to publish details of holdings has got to produce a very good case for doing so, and show what useful purpose it would serve.—*Mr. Cobbold*: On the first point I am afraid I should have to give a considered answer at a later stage.*

774. *Chairman*: May we come back to paragraph 17 of Paper 3?† It would help me if we could have a rough indication of the dates when these various institutions were set going?——F.C.I. and I.C.F.C. very shortly after the war.

775. Who provides the finance, the shareholders? There is no public issue?——The clearing banks provide the majority of the finance of F.C.I.

776. The Agricultural Mortgage Corporation?——In 1928.

777. Can you say what the purpose of it was? Are there specific financial purposes?——*Mr. Cobbold*: No, it was to help in the provision of agricultural and farming credit generally.—*Mr. Mynors*: There was provision for short term loans for improvements, but it never really came to anything.—*Mr. Cobbold*: That was, I think, a later development.

778. The Ship Mortgage Finance Company?——Just to assist in the particular problem of ship construction.

779. How long established is that?——Postwar; about 1948 or 1949.

780. Was Air Finance Limited later than that?——1952 or 1953.—*Lord Harcourt*: 1954.

781. *Chairman*: Commonwealth Development Finance Company?——December 1953.

782. *Chairman*: Any questions on paragraph 17? *Professor Cairncross*: Some of these bodies have been affected by the credit squeeze. I would like particularly to know about F.C.I. and I.C.F.C. Are they subject to the same pressure as clearing banks?——Yes; certainly in the case of I.C.F.C. Lord Piercy has made very full statements about that. His last two Annual Reports are available.

783. I have heard of cases where clients were referred to the I.C.F.C. by clearing banks and successfully negotiated a loan?——Lord Piercy was certainly feeling at one time that the credit squeeze was hampering his activities.

784. *Chairman*: Would the borrowing be under the control of the Capital Issues Committee?——*Mr. O'Brien*: Yes, it would, if it is above their minimum.

785. *Professor Sayers*: Does the Ship Mortgage Finance Company rely very much for finance on borrowing from the clearing banks as distinct from share capital?——*Mr. Mynors*: It has made two issues of debentures in addition to its share capital and what it borrows from its bankers.

786. *Lord Harcourt*: Would it not be fair to say that the Ship Mortgage Finance Company primarily relies on the life insurance companies for its long term funds?——*Mr. Cobbold*: Institutions generally.

787. *Chairman*: Paragraph 18: Crown Agents; paragraph 19: Oversea Central Banks, Colonial Development Corporation? Any questions? *Sir John Woods*: The Colonial Development Corporation is statutorily allowed to borrow £100 million. That would be unextendable?——I am afraid this is rather a guide book. I am not at all the authority on that.

788. If it needed more money that would be a Treasury matter?——Certainly.

789. *Chairman*: Paragraph 19? *Professor Cairncross*: Do you regard these various institutions as meeting the main requirements of the market, with no major gap remaining?——Yes.

790. You do not see a need for any additional financial help?——I do not see a need for another body at the moment. There may be some development in each of them or some of them.

791. You might think of more developed specialist institutions?——No; the development of these institutions.

792. *Chairman*: Then we pass to Part III of the paper; the discount market. Mr. O'Brien took us in detail through the special paper on this last time. No doubt there will be questions of policy involved in that?——I think it might be kind if I might see the evidence first.

793. The gilt-edged market? The nominal value of securities which leads to your contrast of £30,000 million and £22,000 million would not really be a very indicative figure for this purpose, would it? It tends, I should have thought, rather to reduce the standing, as it were, of non-gilt-edged securities as against gilt-edged?——*Mr. O'Brien*: I do not think I quite understand your question, Mr. Chairman.—*Mr. Cobbold*: I think your question is quite right.

794. It arose where the £30,000 million is broken down into two figures?——They are not figures to which we should attach any importance at all.

795. *Professor Cairncross*: Is there any point in the comparison when a high proportion of the gilt edged securities is owned by the clearing banks?——I do not think these figures are very important.

796. *Chairman*: Any other questions? In sub-paragraph (iv) you refer to the Government Broker who executes transactions on behalf of the Government, the Commissioners for the Reduction of the National Debt, and the Bank of England. Would I be right in supposing that when he acts it is not identified in the market in general how far he is acting on behalf of the Government and how far he is acting otherwise?——It does not appear except by intelligent inference by the market in general. If the Government Broker is a persistent seller of a particular line on the Chief Cashier's instructions, the market will tend to pick that fact up and deduce probably where it comes from, but no more than that.

797. *Professor Cairncross*: Would the Government Broker's operations on behalf of the Government be larger than his other operations?——It depends on the particular day, week or month. Some days he might not be dealing for us but for other customers, other days the other way round.

798. There are no customers as large as H.M. Government?——No, but H.M. Government and the Bank will not be dealing every day with large amounts and there are some other large customers.

799. *Chairman*: Are there any other questions on paragraph 21? Paragraph 22—I was a little puzzled at your sentence in sub-paragraph 1:—

"The small investor is an important factor."

Would you enlarge on that?——*Mr. Cobbold*. I think he is a less important factor than he was, but there is still quite a considerable amount of small investor interest, particularly for the well known household names, on a big issue which will still attract a very considerable interest from the wide public.—*Mr. O'Brien*: I think that also means the small investor, that is to say, somebody investing a small amount; the man in the background might be large, but the size of the deal in the non-gilt edged market generally, tends to be very much smaller than in the gilt edged market.—*Mr. Cobbold*: We very frequently get these deals in millions.

800. *Chairman*: Any questions on paragraph 23?—*Professor Cairncross*: You make no attempt to quantify all these things. I do not know whether you do so regularly, for instance, on the new issues. Are there regular figures you issue under these different headings?——*Mr. Mynors*: Yes, we compile and publish from time to time regular figures of new issues.

801. I wonder whether they appear under each of these headings?——I do not think we split our figures; only to the area of industry in respect of which the issue is made and that kind of thing.

802. *Professor Cairncross*: There are some matters of quantification in this paper we may want to come back to.—*Chairman*: You would not like to indicate on what lines you wish that done?—*Professor Cairncross*: I think I can do that later.—*Mr. Cobbold*: Certainly.

(*Adjourned until* 2.30 *p.m.*)

* See Qns. 1812 to 1815.
† Memoranda of Evidence Part I No. 3.

C. F. COBBOLD, ESQ., H. C. B. MYNORS, ESQ., L. K. O'BRIEN, ESQ., and M. H. PARSONS, ESQ. further examined.

803. *Chairman*: In paragraph 23, under the heading "Hire Purchase", you are referring to the sources of capital they draw upon. They " . . . raise money by borrowing from the banks (credit restrictions have, however, limited this source), from the public directly by acceptance of deposits, or from the discount market by bills drawn on London accepting houses." If there is discouragement about bank finance being provided for this purpose, as I know there is at present, does the same discouragement apply to the use of bills drawn on the discount market or on accepting houses?——*Mr. Cobbold*: That is a very small item.

804. It is not thought worthy of attention for that reason?——*Mr. Cobbold*: The emphasis would be towards discouragement, and in any case it is a very small section.—*Mr. O'Brien*: Not specific discouragement, but discouragement in the general climate prevailing.

805. Otherwise, if it were a substantial thing, it would be in effect a way round?——*Mr. Cobbold*: I would say firmly it is pretty small. I have not got the figure with me but it is certainly limited as compared with other sources.

806. Are there any questions on paragraph 23?—— Might I just say that Mr. Parsons is now with us. He is the executive director mainly concerned with exchanges and the commodity markets and so on.

807. Paragraph 24: do I understand, in sub-paragraph (ii), that the system allows authorised dealers to deal freely with each other within the limits upward and downward?——Quite correct.

808. But behind each there stands the Bank who will always deal in spot within the limits?——*Mr. Parsons*: At the limits.—*Mr. Cobbold*: At or within, at their discretion.

809. *Sir John Woods*: I thought this meant that you always bought at the lower limit and sold at the higher? ——*Mr. Parsons*: That is perfectly correct, but of course we still reserve the right to deal within the limits as well; at the limits we are under an obligation.—*Mr. Cobbold*: This passage describes an obligation.

810. *Professor Cairncross*: Do you ever exercise that discretion of operating within the limits?——*Mr. Parsons*: I should say very frequently.

811. *Chairman*: What would determine the policy one way or the other, either to deal at the limit up or down, or within it?——*Mr. Cobbold*: The general state of the exchange markets. That is a general question of exchange rate policy within those limits. Sometimes we should be supporting a little at one place; at other times we should be evening out a little at one place.

812. *Professor Cairncross*: Are we to interpret this as meaning that you are trying to prevent any violent fluctuation, or is there more to it than that?——That would be generally correct.

813. *Chairman*: It is the same approach as I think we were discussing with one of your witnesses on the money market in general, that if you are to have a market the bank feels it has responsibility to make it as smooth a market as possible?——As smooth as possible.

814. *Professor Cairncross*: When you decided, in conjunction with the Treasury, what these upper and lower limits would be, were you moved by pre-war experience, or had you some particular reason for fixing them within the present limits?——*Mr. Cobbold*: I do not think I could properly answer that. That is a question which should be addressed to the Government.—*Mr. Parsons*: There is one general thing one can say: there are certain Bretton Woods obligations.—*Mr. Cobbold*: But Professor Cairncross was asking, why did we fix the Bretton Woods obligations, was he not?—*Professor Cairncross*: Yes.—*Mr. Cobbold*: I think that is a question for the Government.

815. If I may just recall the pre-war situation, there was a spread between the buying and selling prices of gold, and the amount of the spread was a matter of debate. Presumably this still applies?——*Mr. Parsons*: We are under an obligation now. The Bretton Woods legislation has adopted the spread of one per cent. either side of parity.

816. That is written into the Agreement?——*Mr. Parsons*: Surely.—*Mr. Cobbold*: It is not exactly the limit; it is a rounding off of the limit.

817. It is rather less than one per cent., is it not?—— *Mr. Parsons*: A little less than one per cent.

818. *Chairman*: You say about the commodity markets in paragraph 25 (ii):—" . . . all major commodity markets in the United Kingdom have been re-opened. With the exception of grain, cotton and refined sugar they possess full facilities, provided by dealers, for purchase in any part of the world for any currency with a view to subsequent re-sale for sterling." That means an application through a dealer? You may have dollars, for instance, allotted to you, to buy any amount of a commodity in any part of the world?——*Mr. Parsons*: That is right; in the markets other than those three you are free to buy any amount you choose, the limiting factor being, if it is for domestic consumption, an import licence; otherwise you are free to buy any amount you choose for resale. If it is a commodity other than one of the three mentioned you can buy in any currency. If it is one of those three commodities you can only buy and sell in the same currency

819. But for any commodity except those three—I am taking dollars—you get your dollar allocation through your dealer?——It is automatic; the dealer will get his dollars through his bank.*

820. Then the purchaser can resell it for sterling if he likes; there is no control over the ultimate result of the transaction? It can emerge in sterling or in any other currency?——*Mr. Cobbold*: It can emerge in any other currency, but we have arrangements with those various markets by which they submit figures and make continual reports to us so that we see what is happening, and if there were any speculative position or anything being taken that appeared to us to be odd we should have the opportunity of looking into it and discussing it with them. And we have regular routine meetings with the various markets at which we keep a close eye on the exchange aspects of this question.

821. *Professor Cairncross*: I am not quite sure I understand what is meant by "keeping a close eye" here. If the dollar price is below the sterling price can the scale of these transactions run up to any limit?——What I meant by "keeping a close eye", I think, would be to be quite certain that dollars which are made freely available for these purposes are in fact used for these purposes and that there is not any leak or overspill through these arrangements. These are rather wide arrangements which have been given to these markets, I think you will agree; so part of the understanding when those arrangements were made with the commodity markets was that they should report and justify the fact that those dollars were being used for the purpose intended. We are not concerned with the price aspect.

822. *Professor Sayers*: If there were no check at all, these facilities might be abused to allow a flight from sterling into other currencies?——If there were no check at all.

823. It would be open to abuse?——I think it could be open to abuse if there were no supervision either by the market organisations themselves or eventually by us. In each case the market organisation, which is a highly reputable organisation, takes a responsibility to us that these facilities will not be abused.

824. That is your interest: preventing that kind of abuse?——Exactly.

825. *Sir John Woods*: Am I right in assuming that these three commodities are excluded because if they were not the cost in dollars might be too great?—— *Mr. Parsons*: Undoubtedly that is the main reason.

826. *Professor Cairncross*: Would we also be right in supposing that in the markets where this is practised the sterling and dollar prices do not diverge, or if they do diverge the dollar price would be above the sterling price?——*Mr. Cobbold*: In the other markets I think I should be right in saying this mechanism provides a means of keeping the prices pretty closely aligned.

827. May I also ask about the nature of the speculative position referred to? We are dealing, I take it, here with transactions involving import and subsequent re-export and not import for consumption. There might be extensive purchase for stocking, for holding with a view

* See Appendix to Minutes of Evidence.

to later resale. Do you then limit the forward position that anyone in the market can take?——*Mr. Parsons*: We will check this point and confirm it, but I think I am right in saying that there are no formal limits to the amount that the market may hold. The checks which the Governor has referred to, of frequent consultation and statistics which are provided by the markets to the Bank, are considered in the light of the circumstances of the moment. I do not wish to make this sound too rigid, but to take an example: if there were a feeling of nervousness which looked as though it were giving rise to a stocking process, that would be a matter for comment.*—*Mr. Cobbold*: I think I would answer by reference to Professor Sayers's earlier question. If we formed an impression that this was in any sense becoming a flight from sterling rather than a purely commodity question, we should immediately go into action.

828. Have there been occasions on which you have taken action?——No, never. There have been one or two occasions where we have called the attention of the body to a particular series of transactions and asked them to see what the particular member concerned was doing, and that has always been solved to our satisfaction.

829. For example, in the early months of 1955 when there was some divergence of the rates, or in the autumn when there was some weakening again, did anything of this kind arise?——No trouble.

830. *Chairman*: There must be a lot of people at any one time holding sterling in London which is not convertible and which they would like to make convertible. What is to prevent them using that sterling to buy a commodity in this market and then giving orders for it to be despatched to some part of the world and sold, say, for dollars?——That is really part of a wider question. There is nothing in practice to prevent them acquiring dollars or other currencies by other means through the transferable market. If it is not the sort of sterling for which they can acquire dollars through the official market there are wide forms of other markets, particularly the transferable market, where in fact it has been the practice that anybody who wishes to get rid of sterling can get it into dollars or Swiss francs at approximately 1 per cent. discount on average. That would be a cheaper method of doing it probably than going through the commodity markets.

831. *Professor Cairncross*: When that discount widens, as it did in the spring of 1955, it never reaches the point where a commodity operation becomes possible?——Not since we took the measures we took in 1955.

832. I was going back to January?—In November and December, 1954, we were getting very bothered about that particular aspect. There was a great deal of commodity shunting at that time, and that was one of the considerations which led to intervention in the transferable market in February.

833. *Chairman*: Are there any more questions on that paper? I think we might put that paper away and take Paper No. 7.†——Might I just make one general comment on papers 7 and 11, Mr. Chairman? I did mention this in the covering note which I sent to the committee. I assume that at some later stage the committee will probably be looking at a number of external questions and, so to speak, rather together. The purpose of these two papers was to call the committee's attention to the effects that external situations have on the domestic money side. We were not trying to present you with a picture of exchange questions and external questions generally, but rather to draw attention purely to the effect this was having and was likely to have on the domestic questions.

834. *Chairman*: I do not know whether there are a great many questions which will arise. Paragraph 1? Paragraph 2? Paragraph 3? Paragraph 4? Paragraph 5? Paragraph 6 gives us the clue to where the new part of the paper starts:

"Sterling still retains the lead as an international business currency and is still equipped with a more extensive international network of banking establishments and connections than any other currency. As a reserve currency, on the other hand, its position has changed."

* See Appendix to Minutes of Evidence.
† Memoranda of Evidence Part I No. 7.

Then we begin to study the nature of how that change has come about and the stages. Are there any questions on paragraph 7? Paragraph 8? Paragraph 9? Paragraph 10?——*Professor Cairncross*: May I ask when the last change in the number of scheduled territories took place? Has the sterling area been constant now for some time? ——One or two Middle East countries went out; I think Persia and Egypt were the last two. Egypt was the last, I think. It was not unallied with political considerations in each case.

835. No one has asked to be added to the list?——*Mr. Parsons*: Not formally.—*Mr. Cobbold*: No.

836. Would it be fair to say that there were other countries before the war who were in effect in the sterling area?——The sterling area as we have set out here was a rather different thing from the scheduled territories in that sense. It is still true that there are a great number of countries outside the scheduled territories who conduct a great deal, in fact the majority, of their international business in sterling and might in pre-war terms still almost be said to be within the sterling area from some points of view.

837. *Professor Cairncross*: Some of these countries hold their reserves in gold and sterling; some hold, I suppose, no gold. Are they free to decide for themselves exactly how much gold they will hold?——So far as the scheduled territories are concerned, that would be a matter of negotiation between the governments concerned and Her Majesty's Government in the United Kingdom.

838. When the negotiations took place, the negotiations would fix a limit?——A purchase of gold for those purposes would be a matter of negotiation.

839. In the case, for example, of South Africa, is the present position one in which they are free to decide for themselves exactly how much gold they will have?—— South Africa, as gold producers, are in a very different position from the other members.

840. *Sir John Woods*: I am not sure I have quite understood this. Leaving out South Africa as a special case, if you took any gold or dollar earner like the West African colonies, I have been under the impression that their gold and foreign exchange were automatically sold to the Exchange Equalisation Account?——That is correct, and any purchase or retention would normally be a matter for negotiation.

841. Would that be true of all the colonial territories? ——Of the colonial territories and the scheduled territories generally speaking, though South Africa is in a somewhat special position.——*Mr. Parsons*: May I just say that there is a distinction between the colonial territories and the self-governing Commonwealth countries in this. Colonial territories hold their reserves in London as a normal rule in sterling, and do not normally hold an independent gold reserve; in fact, I do not know a colonial territory which has an independent gold reserve. The self-governing countries are in a different situation. They have their own currency, managed by their own central banks and the matter as to how much of their reserves they hold in sterling and how much they hold in any other form would be a matter, as the Governor says, for discussion. If the proportion of their holdings of sterling and other forms of reserves were to change significantly, or the level of their holding of gold were to change very significantly, that would undoubtedly become a matter for discussion between them and Her Majesty's Government.——*Mr. Cobbold*: The arrangement is that they, so to speak, have an automatic blank cheque on the gold and dollar reserves here; that is to say, we automatically provide dollars or other currencies for anything which is approved by the exchange authority in the self-governing country. In consideration of that there is a general understanding that if the proportions were to be seriously modified that would be a matter for discussion between the Governments concerned.

842. *Mr. Woodcock*: Do I understand that there is gold in the Exchange Equalisation Account that is earmarked, that you could not use?——No.

843. You can use it all?——*Mr. Cobbold*: Certainly. —*Professor Cairncross*: In fact you are obliged to use it all if they cash their cheques.—*Mr. Woodcock*: Apart from that?—*Mr. Cobbold*: There is no earmarking in any sense.

844. *Professor Cairncross*: I wonder how many occasions there have been when these negotiations have taken place? I know Ceylon, but I imagine there have been other countries?——Could that question be addressed to the Treasury?

845. Many of the independent members of the sterling area have been, if I understand it aright, drawing on their allowances, have been net spenders of dollars, in the past few years, and the British colonial territories on the whole have been net dollar earners. Is it possible to disentangle these operations and give us some picture of this?——*Mr. Cobbold*: You mean to say how many dollars one particular area has drawn and how many dollars another particular area has contributed? One could get some figures. Of course all the dealings come through London in sterling and I think you would find it very difficult to apportion exactly a particular dollar content on any particular sterling transaction.—*Mr. Parsons*: There are a number of complications in this. For example, what we see in London is the net, as it were the overspill, of a particular territory which may be earning dollars and spending dollars at the same time, and net requires dollars and buys those through the London market. That, to begin with, rather complicates the thing. I would not know without asking the statisticians how far we could get in producing a picture of this.*

846. Clearly this question would be of no interest if the answer were marginal, but in practice has there not been a very striking contrast between the situation in relation to some members and in relation to others?——If I may make one comment on that, another thing that complicates the whole question is that to make it a sensible and fair comparison one has to talk about dollar savers as well as dollar earners.

847. I was looking at it from the point of view of your position purely as central banker, and how you would be placed if particular members joined or left the area, whether a country contributed to or drew from the pool?——*Mr. Cobbold*: I think probably more reliable figures come from the balance of payments estimates and statistics of that type rather than from pure exchange statistics.—*Mr. Parsons*: A good number of figures would have to be provided by the territories concerned; we would not have them available ourselves.—*Mr. Cobbold*: I am not suggesting we do not know broadly which are dollar earners and which are dollar spenders; of course we do.

848. I take it also that these movements in reserves are coupled with substantial movements in foreign investment, so that it is conceivable that by allowing long-term investment to proceed in one part of the sterling area we are allowing the country borrowing that capital to draw from the central gold and dollar reserve?——If they were at the same time drawing down their sterling balances, there is a potential liability there. The colonies are a very obvious case in point.

849. *Mr. Woodcock*: If the purchase was approved by the exchange authorities in the country concerned you would just provide the money required?——That is the normal practice.

850. The arguments about whether they would be able to undertake this I suppose are at a much bigger level?——Yes.

851. *Professor Cairncross*: The position in the sterling area is, as I understand it, that funds can move freely from this country to other members of the sterling area, subject in some cases to the Capital Issues Committee's ruling, or the ruling of the Treasury. I take it also that there are remarkably few restrictions on trade so far as we are concerned. But are all these conditions reciprocal? Do the other members of the sterling area equally permit withdrawal to this country of sterling?——No, there are local restrictions in some parts of the area on outward movements even to other sterling area countries.

852. These restrictions are again subject to negotiation, I take it, or representation?——*Mr. Cobbold*: Certainly. —*Mr. Parsons*: By and large it is fair to say these countries regard their sterling as their reserve, as it is, and they use the same sort of restrictions in safeguarding those reserves as we use in safeguarding ours. In other words, Australia and India, taking two examples, have a considerable exchange control as regards the movement of sterling out of their country in any direction.

* See Appendix to Minutes of Evidence.

853. I am trying to see the position between this country and other members of the sterling area alongside the relationship between this country and other countries not members of the sterling area. If we are dealing with a country not a member of the sterling area, I take it we are in a position to negotiate both on the movement of funds for investment and on trade, but these things do not appear to be coupled together in our dealings with countries who are members of the sterling area?——*Mr. Cobbold*: The whole basis of the sterling area system is a very considerable similarity of approach of the exchange authorities in each of those countries, and very close and continual contact both on financial policy matters and I think also on trade matters.

854. The presumption is that these other countries are pursuing policies broadly similar in relation to dollar and exchange control positions?——I would not say the restrictions in a particular part of the area were necessarily the same as the restrictions here at any particular moment of time.

855. Has it appeared to you that this was a justifiable assumption in the last five years, that there was a broad similarity of approach to these problems?——*Mr. Cobbold*: On exchange control matters, yes.—*Mr. Parsons*: I think it would also be true to say there has been an easing up throughout the sterling area in the sense that there has been perhaps a greater liberalisation in one area than another even in regard to dollar expenditure.

856. It would certainly be thought so in relation to South Africa?——*Mr. Parsons*: South Africa are a somewhat special case.—*Mr. Cobbold*: I do not say the policies are identical, but there is a good deal of working together on it. Under wartime conditions I think the pattern was very closely held together indeed, and that has probably progressively loosened.

857. *Lord Harcourt*: On the question of restrictions, the pattern tends to diverge? As restrictions are made less onerous in every area, so the differentiation between them becomes greater?——Yes indeed, as world trade is freeing up. Take the case in the war when there was complete control over shipping and everything was controlled everywhere; then the pattern was similar. As that has eased up, I should think the similarity of the pattern has got very much less. But there is still, I emphasise, close co-operation between the authorities from day to day, and I think we should feel it easier and more normal to raise and discuss these things in a very intimate way with these countries than with countries outside the area.

858. *Professor Cairncross*: Were there not a number of protests at the time of devaluation at the extent to which members of the sterling area had been consulted before the decision was taken? On matters of major policy is there consultation now with all the independent members of the sterling area?——I think major policy must be a Treasury question, please.

859. *Mr. Woodcock*: In some of the British colonies where they have tourists from the hard currency countries it seems to me, purely as an observer, that there is a fair amount of traffic at a purely individual level in hard currencies. Do you know anything about that?——*Mr. Parsons*: If I understand your question, it is really saying this: is the exchange control in those countries effectively or not effectively preventing people from conducting illicit deals in currency?——*Mr. Woodcock*: Not quite so strong as that. All I have seen is hotels helping customers for their own convenience and I wondered if you knew about that. I do not mean trying to dodge on any extensive scale—*Mr. Cobbold*: Inevitably there is a certain amount of small stuff of that sort—*Mr. Woodcock*: But it does not amount to much?——*Mr. Cobbold*: It is of no consequence, no.

860. *Chairman*: Paragraph 12:—

"Since the end of the war the total of externally-owned sterling has fluctuated but has not been reduced There have, however, been important changes in the place of its ownership."

That, as you say, is studied in Paper 11. Then the next paragraph begins:—

"Apart from the difference in the amount of the external holdings of sterling, the working of the sterling system has largely re-established itself in its essentials."

That difference is very great, of course, as you have been illustrating in the earlier paragraphs, but where do we find what it means to us for purposes of our work? Does this really lead up to the warning that you give us at the end of Paper 11?——In paragraph 13 of Paper 7 the stress is on the working of the sterling system, so that a great deal of international trade is carried and can be carried freely and easily in sterling with, we believe, great advantage to us nationally, and I think with great advantage to the world. We would definitely maintain that the degree of freedom that has been restored to sterling for international transactions has been a very important contribution to the free world as a whole, and by no means only to this country or to the Commonwealth.

861. From the point of view of service to current international transactions you say sterling is on a satisfactory basis and has got back to the satisfactory basis that made it so useful in the past?——For a very wide variety of great normal commercial payments sterling is used to a great extent in all parts of the world, not excluding Eastern Europe.

862. Then you distinguish between the satisfactoriness of the sterling system as re-established for current international purposes and the value of sterling as a reserve, which you say has changed very much. As a reserve for what? For sterling holdings?——It is used as a reserve currency by other countries, particularly by countries inside the sterling area.—*Chairman*: To see that enlarged upon we turn to Paper 11.

863. *Sir Reginald Verdon Smith*: At the end of paragraph 13 of Paper 7 the phrase is used "the United Kingdom has again emerged as the chief external source of new capital". Could it in fact be said that there has at any time been any other chief external source?——I think what that means is that it was not doing much external lending during the war period, but it has now started again. It has not supplanted anything else.

864. Swiss francs are not a material issue in this?——No; there has been a certain amount of Swiss franc lending, but it is quite minor.

865. *Sir John Woods*: I imagine we shall at some time have some figures about the amount of new capital for sterling area countries which has been found, divided between the different sources, either public issues on the Stock Exchange or direct investment by concerns abroad?——*Mr. Mynors*: We only have very imperfect figures on that, because a lot of our best figures are derived from exchange control material, which gives us an automatic pick-up for a lot of information. We have no exchange control between ourselves and the sterling area, so our figures on that are not very good. We could see what we could produce on that, but it will not be as good as one would wish it to be.—*Mr. Cobbold*: They would have to be residual figures to some extent.*

866. Perhaps the Treasury keep a better record? I take it you exclude export credit transactions which I suppose for this purpose are regarded as credit to U.K. manufacturers and traders, though in effect they are credit to overseas purchasers?——In effect the same transaction would probably have been done before the war by lending the money to the other country.

867. *Professor Cairncross*: May we be quite clear what are the restrictions on the movement of capital from this country to the rest of the sterling area? Do the restrictions apply exclusively to new issues, or are there any other restrictions?——Only the Capital Issues Committee.

868. *Chairman*: Suppose that a big industrial concern in this country decides to indulge in expenditure on some scale in another part of the sterling area out of its own resources and the Capital Issues Committee is not in the picture; first of all, there is nothing to control it or prevent it carrying out the plan?——No.

869. Secondly, is there any system which would tell us on what scale year by year that is being done?——*Mr. Parsons*: As the Governors were saying, there are no precise figures on this because there is no machinery for picking up these figures.

870. Would it not be a very important piece of information, since public borrowing for these purposes on the Stock Exchange has been, I imagine, almost non-existent in recent years?——*Mr. Cobbold*: Not non-existent. There have been quite a number of issues floated for various parts of the Commonwealth and the sterling area over the past five years.

871. By local governments?——By local governments.

872. It seems to me that, without a reporting system, it is very hard to get at just what moneys from the large industrial spenders are going out in the form of capital to this area?——*Mr. Mynors*: We know very little about that.

873. *Professor Cairncross*: Is it not the position that throughout the postwar period, although investment inside the country by industry was severely controlled for a good part of the time, similar investment taking place in the rest of the sterling area was not controlled by direct controls?——*Mr. Cobbold*: Yes, I think that is probably true.

874. I know this is a matter of major policy, and that it is primarily for the Treasury; but it also affects the Bank of England. Are you quite satisfied that in all circumstances the sterling area must remain on a basis in which capital movements between this country and the sterling area escape control?——"All circumstances" is a big word. We should take the view that the balance of advantage has certainly lain in that direction up to date, and I see no reason to change that view at the moment.

875. *Professor Sayers*: Has the fact that there is no control, other than capital issues control, over what goes to the sterling area for investment purposes any influence on your choice between methods of control of investment at home? I am thinking that, in so far as you use interest rates as weapons for influencing the volume of investment at home, you are also influencing investment of British money in the sterling area. The fact that there is no other control by Britain of the investment of U.K. sterling in the sterling area might seem to be an advantage of using the interest rate rather than the other weapons?——I think that would certainly be a consideration, that it affects investment all over the area, as you suggest.

876. Am I to infer from your hesitation that this has not been a relevant factor?——No, I think it is a relevant consideration. I would not regard it as ever having been a main influence in anything we have done; not decisive, but certainly a factor in our minds.

877. *Professor Cairncross*: Exchange control, if I may raise the general issue, applies at present largely presumably to capital transactions with the dollar area, and does not greatly affect current transactions? Or do you hold a different view?——*Mr. Parsons*: I should say that throughout exchange control (I do not think we need restrict this to the dollar area) exchange control is concerned more with capital than with current transactions at the moment.

878. I think that would be certainly true. I was asking whether, in respect of current transactions, the existing exchange control really means very much?——*Mr. Cobbold*: It allows payments pretty freely for current transactions.

879. This is in contrast to the sterling area where capital transactions are completely free and where, I agree, restrictions may be much more difficult to employ. You have a complete antithesis between the two situations. If I can just recall the prewar line of thought, it used to run not in terms of dollar and sterling but capital transactions and current transactions; at one time it was thought it might be appropriate to apply restrictions to all capital transactions and free current transactions. Now we have a situation in which in the main the restrictions apply to dollar transactions rather than to sterling transactions?——No, not quite. They apply to transactions in all parts of the world other than the sterling area, which is not quite the same thing.

880. Not quite the same thing, but not very different, with the E.P.U. system. Have you contemplated, looking ahead (because we have to look a little ahead here), that dollar restrictions might disappear, and that at that stage you might want to retain some kind of control over capital movements?——Broadly speaking, I would have said that current restrictions on payments outside the area had been progressively relaxed very considerably over the post-war

* See Appendix to Minutes of Evidence.

period pretty consistently, and now the relaxation has got to a very advanced stage. It has by no means been static since the war.

881. Certainly, but if you were looking to the progressive relaxation of these restrictions until they in effect disappear, would you regard that as the most satisfactory arrangement that we could come to?——It would certainly be my ambition to progress along the road on which we have been progressing since the war.

882. Even with your reserves at the level they are at present?——*Mr. Cobbold*: No, that must be a reservation.—*Mr Parsons*: Undoubtedly the most obstinate part of the exercise is the removal of capital restrictions.

883. But it may be that the reserves are where they are now because capital movement is free within the sterling area? I think you agreed earlier there might be some relationship between these two facts?——*Mr. Cobbold*: There might be some relationship. I would have said that there is a potential claim, on the movement as it is before you on these papers, but that it is probably more a potential claim than a realised claim over the last few years.

884. *Chairman*: If by reserves we mean foreign and gold exchange reserves, I do not see how freedom of movement within the sterling area affects them?——I think Professor Cairncross's point is this: if we are, for example, investing in a colonial territory, whether it be the Government or the Colonial Development Corporation or what have you, that results in an increased sterling balance held by that territory through capital movements. They can then proceed to draw that down to some extent by using dollars and drawing on their London funds for foreign exchange purposes. The answer I was giving was that at the moment I would regard that rather as a potential than a realised effect, on these figures.

885. *Professor Sayers*: If the position of our balance of payments is such that we can reasonably leave current transactions both inside and outside the sterling area free from control, but that we cannot afford to leave capital movements unregulated, would it not be logical to say that all capital transactions, whether with the sterling area or outside, ought to be controlled?——That is a high policy question, and I think it is really more for the Government witnesses than for myself. My own view would be that one of the bases of the Commonwealth and sterling system is the accessibility of London and British industry to development in those areas. I put it as one of the absolute bases of the whole Commonwealth conception.

886. And you would rather for such reasons retain control of current transactions with other parts of the world, with a view to taking emergency action from time to time, than control capital movements inside the sterling area?——I do not think it is quite as easy as that. We are getting into a slightly technical field, I am afraid, but the idea that you can control capital movements with the rest of the world if you have not got a current movement control is really a non-starter from a technical point of view. We could not do it however much we thought it was a good idea.

887. *Professor Cairncross*: You think you can do it in relation to the dollar area, do you not?——*Mr. Cobbold*: No, not without control.

888. I mean even as it is?——As it is, because we have a control.

889. Is it effective?——*Mr. Cobbold*: No controls are 100 per cent. effective; it is pretty effective.—*Mr Parsons*: I think it is effective over a very wide field, and particularly over the large individual transactions. But I quite agree there are large loopholes in any control which is not a total control.

890. At any rate you just do not feel you could exercise control over movements of capital without controlling the whole field?——*Mr. Cobbold*: No. That is a matter which has been up for consideration again and again, and we have come unhesitatingly to the negative answer.—*Mr. Parsons*: May I make one point on this question which has been asked about the sterling area? I do not want to embark on the major policy question to which the Governor has referred, but the other question is the very close, intimate and extraordinarily complex union between this country and the rest of the sterling area financially. To control this would be something quite considerable, much more difficult than anything we have attempted so far, I believe.

891. *Professor Sayers*: And presumably in a time of stress you would be prepared to make representations to other parts of the sterling area with a view to dampening movement of sterling between those countries rather than imposing any control?——*Mr. Cobbold*: That often has been done, and that would be my preference. I am speaking personally here, but I attach immense importance to maintaining as much of this freedom within the sterling area as we possibly can; and indeed with Canada, where we have administratively allowed a great deal of investment to go through during the last few years.

892. *Mr. Woodcock*: Are representations your business or Treasury business?——I think it would be a joint discussion.

893. My impression has always been that these problems in the larger sense are discussed with the Commonwealth Prime Ministers?——Certainly. It is Treasury business; we should only be concerned as agents here, as I have made clear throughout.

894. *Chairman*: When you say that a system of controlling capital movements as such without a general control is a practical non-starter, I would like to get the reason for that. Is it the difficulty of identifying a capital movement as such?——Broadly, yes.

895. I suppose even a re-stocking movement might have a capital element?——*Mr. Parsons*: It is always very difficult to know where the line is drawn.

896. *Professor Sayers*: I remember in the I.M.F. Charter there was a distinction drawn between exchange restrictions on current transactions and on capital transactions. Does that provision still remain?——*Mr. Cobbold*: I think that has been interpreted gradually as time went on to mean being pretty free with current exchange restrictions but not necessarily removing them statutorily.

897. *Professor Cairncross*: May I just pursue one of Mr. Parsons's answers? He suggested that the power to control the movement of capital to the dollar area rested in part on the large individual transactions. Is it your experience that the control of capital movements rests on control of current transactions?——*Mr. Parsons*: I think the Governor was saying that unless you have power to control all accounts, which must of course mean both capital and current, it is virtually too easy for somebody to make payments on current account which in fact are capital payments. So you must formally have the power to control both capital and current in order to prevent capital movements.

898. It is difficult to discuss this more fully here, but is it not reasonable to point out, as the Governor did, that evasion always takes place and, whatever controls you impose, there will be some evasion?——*Mr. Cobbold*: Without doubt.

899. Do not some sterling areas control capital movements to the United Kingdom and yet not control current transactions to the United Kingdom?——I cannot answer for certain. I should rather suspect the statutory form applies to the whole field, but that they only, or mainly, apply it to capital; in some cases I can think of they apply it to both. I am not aware of any case where the statute or the regulation only applies to capital, but I may be wrong on that.

900. *Lord Harcourt*: Your contention as regards the control of capital movements to the sterling area is that the imposition of that control would fundamentally alter the relationship of members of the sterling area one to the other? It would alter the conception of the sterling area?——It would particularly alter the relationship of the outer sterling area to this country; I think it would alter that quite vitally myself. Of course, the relationship of our banking system, for example with Australia, or with a colonial territory, is wholly different from the relationship of the banking system, for example, with a Latin American country.

901. *Professor Cairncross*: Do not most member countries of the sterling area already find it difficult to get capital from here?——There have been difficulties on market financing of the same type as everybody has found; the markets have not been over easy, as you know, in

recent months. What I think is generally under-estimated in public discussion on this subject is the amount of industrial investment that has gone on pretty consistently and is still going on to quite a number of sterling area territories.

902. But it is not your suggestion that there should be preferential access to the London capital market in favour of foreign operators even if they are in the sterling area, in discrimination against British industry?——Not at all, no.

903. *Sir John Woods*: We are talking about control in relation to capital going from this country to the sterling area in terms of exchange control. There are surely other forms of control to prevent the raising of money between members of the sterling area?——There is C.I.C. control.

904. There would not be free access to capital in London for sterling area countries?——No more than for the United Kingdom; it is the same.

905. *Lord Harcourt*: Their access to the London market is *pari passu*?——It is *pari passu*, because in fact any industry could raise the money and remit a part of that to Australia, New Zealand or what have you.

906. *Mr. Jones*: Would it be easily possible, Mr. Governor, for companies with substantial financial reserves to transfer those reserves to capital investment in other parts of the sterling area?——Yes, easily.

907. So that the question of pressure of inflation could arise from that point of view, could it not? There is a difference between raising money for investment in the financial market and transferring money which is already available?——Yes. That is to say, they would have to get the Capital Issues Committee's permission for raising new money either for using it at home or for sending it out to the sterling area, but if they had the money they would be perfectly free to send it out.

908. There would be no interference? There would be no obstacle in the channel of transfer?——No.

909. What effect does that have upon the question of inflation in this country as you see it, as Governor of the Bank of England?——I prefer to put it in a slightly different way: the effect it has on the demand for capital. It has certainly been an addition to the total amount of the demand for capital in this country.

910. We have certain resources in this country, and the challenge to the country at the moment appears to be that we must match investment by saving. To the extent that we have resources that are taken for investment out of the country, what is the effect of that upon the inflationary position in this country?——It certainly increases the demand for money available in this country. I think the point of your question is that the savings in this country need to be greater if they are to take care of investment in the Commonwealth countries. Our view as the Bank of England certainly is that it is extremely important that there should be some money over available for those purposes, and that requires a greater balance of savings over investment *pro tanto*.

911. And the converse would be the position if creditors in the sterling area made available their resources in this country for capital development in this country?——In a sense; it is slightly complicated, but through holding their sterling balances they are in a sense lending those sterling balances here until they use them.

912. You said in this document earlier on that the sterling balances have increased by about six or seven times the extent they were before the war?——*Mr. Cobbold*: And at the moment those are being used.—*Mr. Jones*: For our internal well-being?——*Mr. Cobbold*: For our savings, in effect; is that not correct? As Professor Cairncross said, they represent a potential claim, and if they were drawn down very heavily we should have to increase our overall surplus to take care of that drop.

913. Supposing the banking we do for the sterling area, shall we say at £3,700 million, led to a situation where there was a call for the reduction of that credit in dollars. Would that not put us in a pretty difficult situation?——If it all happened at once, which of course is practically impossible. Certainly if they were drawn down at once either in dollars or in demands on our own resources it would be a very difficult situation. If, for example, the whole of those sterling balances held by overseas were suddenly used to buy things in this country that would have a very obvious effect on prices in this country at once.

914. Let us assume the figure is £3,700 million; I think that is somewhere near the figure which you gave us. Supposing there was a run for the redemption of 10 per cent. of that; that would be redeeming £370 million of the reserves. Would that be serious?——Ten per cent. in a quick run would be distasteful.

915. *Professor Cairncross*: On exchange control in relation to the sterling area, do you feel that other members of the sterling area maintain restrictions which are parallel with ours and as severe as ours over the movement of capital?——Some yes, some no.

916. It is possible by moving money round the sterling area to find a soft spot?——*Mr. Cobbold*: A couple of soft spots have been recently dealt with.—*Professor Cairncross*: There are still some that are softer than others.

917. *Sir Reginald Verdon Smith*: Might I ask Mr. Governor if he could explain a little the last sentence of paper No. 7, where the contrast between reserves and liabilities which is being underlined, the contrast between pre-war and post-war experience, is stated to lie mainly within the United Kingdom itself?——*Mr. Cobbold*: That is, I think, shorthand for the fact that we have fought a war and spent a lot of money on one thing and another. It is what has happened internally in the United Kingdom, the expenditure for war-time purposes and other things, which has given rise to the differences in the situation. It is not something that has happened to us from outside, in other words.

918. *Sir John Woods*: I am a little puzzled by one sentence in paragraph 14 of paper 7:

> "Moreover, the broad correspondence between movements of the externally-owned balances and movements of the United Kingdom's own reserve . . ."

That is shown in the second chart in the Appendix. Earlier on, in paragraph 8 onwards, you explain how the link between the reserves and the overseas sterling holdings has been broken. Has the link been re-established?——It went haywire during the war owing to war expenditure, but the broad correspondence has been observable again in the fifties.

919. I accept that, as a fact, obviously; but it is not that you re-established the link, and that gold was freely purchasable in London?——No, not at all.

920. Why then do you think this has emerged? For example, if you look at 1952 in chart II in the Appendix, the gold reserves were at the bottom point in 1952, and they mounted again in 1954. What was the cause for the rise in the overseas sterling holdings at the same time? Was it simply that they were selling a good deal to us at higher prices, or what?——There will be a certain amount of confidence, with people actually holding more sterling.

921. You think they were feeling more confident and were more willing to hold sterling than they had been?——Certainly.

922. *Mr. Woodcock*: There have been a lot of questions asked and answered, and I am beginning to be doubtful if several things I have assumed have not been questioned. Am I right in thinking, so far as you are concerned, with exchange control and the management of the Exchange Equalisation Account, that, apart from any leaks that may occur as a result of doing things or the failure to do things, you do not care what happens within the sterling area?——So far as we are concerned with exchange control and the Exchange Equalisation Account, we are not concerned with movements to the sterling area.

923. If there are no leaks because of mismanagement, or failure to manage, the others are questions of high policy; e.g., we ought to prevent capital investment in, say, British Guiana in order to maintain it here. But so far as control is concerned?——Statutorily the scheduled territories are excluded from the control and we, as

agents for the exchange control, have no right of interference at all.

924. It does not matter to you whether the balance is held here, or held under the name of Australia or Great Britain, except in so far as if you hold it under one it might lead to fewer leaks than it would under another?——It matters to us in the sense that if it is held by Australia it is a potential claim on resources.

925. That is the only point; a potential claim?——Yes.

926. *Professor Cairncross*: In the final paragraph of Paper 7 I notice the argument is in terms entirely of liabilities; you are speaking in terms of balances?——We are speaking in terms of what is called "overseas holdings of sterling", which we have defined in the middle of paragraph 2 of Paper 11.

927. But there is presumably in the period shown in the graph another movement which is left rather on one side, involving the reconstitution of our overseas resources?——Certainly.

928. That is of some considerable dimension?——Certainly.

929. The contrast you are drawing between assets and liabilities relates entirely to the short end?——*Mr. Parsons*: To the marketable end, not necessary the short end.

930. Are you not leaving entirely on one side all our investments in the independent sterling area?——*Mr. Parsons*: And all the sterling area's investments in the United Kingdom, which is the other side of the picture.—*Mr. O'Brien*: You mean marketable investments?

931. Portfolio movements are left entirely out?——*Mr. Parsons*: Only on one side; portfolio movements, in the sense that Australia holds gilt edged securities as part of her sterling balances, would come in. But, for instance, U.K. holdings of Canadian equities would not come in.—*Mr. Cobbold*: As far as Courtaulds and I.C.I. have invested and so on, that is out.

932. Could we have some rough figure of what you think the total of external investment adds up to over the period since the war with the countervailing element?——May I look at it with the Treasury and see what we can do?*

933. *Chairman*: Would you clear my mind as to the value to this country of these sterling balances which are kept on current account? They are money lent to us, in effect?——Yes. Let me make it clear at once, I should much prefer not to have the liability. I do not regard them as valuable in the sense that they are a liability, and I would be happier without them.

934. They are lent to us, except so far as they are kept in bank balances on current account?——Yes. Even so, they are lent to the system; they add to savings while they are here, in effect. So far as they are held in Treasury Bills, for example, the Government has to borrow less on Treasury Bills from the British public.

935. We pay interest for the privilege of having them?——Yes.

936. I suppose they are all employed in the short term market?——Short, or very near short; there are a certain number in gilt edged securities of one sort or another.

937. So we cannot regard them as money which we have borrowed for anything like long term investment in this country?——Only to the extent that they do tend to keep fairly stable over a period. As you see from these tables, they have gone down in one area and gone up in another area, but there has been from the area as a whole an approximate level in the figure of sterling left here.

938. *Lord Harcourt*: But they are in fact all current liabilities?——They are all current liabilities.

939. *Mr. Jones*: Supposing 10 per cent. of this credit were realised in a year, what effect would that have on the balance of payments?——It slightly depends how it was realised. Take the extreme cases, to explain it: if they all bought Cadillacs with it, then it would draw down so much of our dollar reserves; if they all bought Austins with it, that would put up the demand and price for Austins within this country and take out so much of the available materials in this country. You cannot exactly say where it will fall, in practice. Of course it would fall in both places, but it would be a charge on our resources in one form or another, whether it takes out foreign exchange or goods.

940. And it would affect our balance of trade and payments very substantially?——Yes.

941. *Professor Sayers*: I was a little surprised to hear you say you did not like having them. Surely, so far as they are banking balances, they are working balances of sterling area countries, and the existence of these balances is just a symptom of the working of the sterling area?——I am sorry, I may have perhaps got that a little wrong. What I meant was that I did not like the fact that we have incurred a great number of liabilities overseas, and I would be much happier if we had not incurred them. That goes back to the war story. I may have used the wrong phrase; what I meant was that one never likes incurring debt.

942. But it may sometimes pay to incur debt, and this is an addition to our usable resources now as compared with what we should have if all these balances were drawn down?——I did not say that I would rather see them drawn down than maintained. If I did, that is not at all what I meant. What I said was that they are liabilities, and, if it had been possible to get through the last twenty years without having created those liabilities, I should be very much happier.

943. We are agreed that, if these resources had not been shot away during the war, we should be better off. There is nothing more to it than that?——There has been some investment and so on post-war, but that is the fundamental reason for it.

944. It is that which you were regretting?——That was what I was regretting.

945. *Mr. Woodcock*: This money is not particularly hot?——No, on balance it is not. It has proved to be fairly stable on the whole. As we set out in Paper No. 11, it has been drawn down pretty heavily in one or two areas and counterbalanced by movements in other areas.—*Mr. Parsons*: But we go on to say that the possibilities of it tending to decline are rather more real now than has actually been the experience in the last few years.

946. *Sir John Woods*: And there you point out quite rightly that there has been a relative stability, if you take 1951 and 1956; there was a very nasty drop, £400 million or thereabouts, in a period of loss of confidence in 1952?——*Mr. Cobbold*: Yes. We feel—and I am sure the Treasury witnesses would say the same thing; it is primarily their business, but I am sure the Treasury mind and the Bank of England mind are the same on this—that this potential liability is one of the things that must be taken into account in framing overall policy.

947. May I just see if you agree with this: if there arises a sense of crisis and a loss of confidence in sterling, we cannot rely on the sterling area as a whole being a sort of buttress?——I think that is a fair statement.

948. *Chairman*: Could we have a look at Paper No. 11† in more detail? Are there any questions on paragraph 1? Paragraph 2?—*Professor Cairncross*: Have you any idea what the total float is in commercial transactions with other countries? You refer to it in paragraphs 2 and 3.——I would not like to give a figure on that.

949. I put it this way: have we any conception of what the maximum swing is due to delay in payment or acceleration of payment?——*Mr. Mynors*: I think we are not much better off on that than taking trade figures from the countries concerned, seeing what their monthly turnover is, and saying there was, say, a swing of two months' trade. That is the only sort of way.—*Mr. Parsons*: I discussed this question in Germany with two extremely well qualified people who had all the figures available independently, and one was twice the size of the other, which is a demonstration of how difficult it is to arrive at any figure.—*Professor Cairncross*: It might still help us if we had any idea of what the figure was, even within that limit.

950. *Chairman*: Paragraph 3? Paragraph 4? Paragraph 5?—*Sir Reginald Verdon Smith*: On the last sentence of paragraph 5: "It is not from these quarters that further major and continuing problems are most likely to arise", I was very glad to see such a confident statement. I do not think I fully understand the nature of

* See Appendix to Minutes of Evidence.

† Memoranda of Evidence Part I No. 11.

the debtor position of the U.K. in the E.P.U., to understand reliably how this indebtedness can be paid off by consolidation agreements. Perhaps this is just a question of fact?——*Mr. Parsons*: The E.P.U. question is very simply that under the credit system in E.P.U. we have overall taken a substantial amount of credit. That has from time to time been consolidated with the main creditors in the system on an approximately four to eight year basis, varying from country to country, and we now have an annual obligation to those countries to pay off. As regards the other figure that is mentioned here, that really constitutes the main working balances in sterling of countries which use sterling very largely for international payments. Merely as a general impression we have the feeling that short of a major crisis this is the kind of balance that they need in order to continue to finance themselves in sterling for their current trade.

951. It might be a secondary problem to us if some other disturbance arose, but not primary?——In a crisis, of course, even these sorts of balances can show a large movement. On the other hand it is interesting to take this example of what happened last time there was a serious problem.

952. *Professor Cairncross*: Is there any tendency to finance trade in deutschmarks? Any movement over to the deutschmark from the pound?——I should say, taking this current position with, say, five years ago, there is more trade financed in deutschmarks now than there was.

953. Then there is more German trade. Is there more trade financed in deutschmarks in proportion than there was?——More in proportion, possibly.

954. But nothing very striking?——*Mr. Cobbold*: Mostly for German trade; as between two third parties, not very much, I should say.

955. *Chairman*: Paragraph 6? Paragraph 7? Paragraph 8? Paragraph 9? Paragraph 10?—*Sir John Woods*. In paragraph 10 you say "The growth in Colonial sterling holdings had virtually come to a halt in 1956". Is there any special reason for that?——*Mr. Parsons*: One substantial reason is possibly the change in the trend of commodity prices, which has played quite an important part, I think, in halting this movement upwards in colonial balances.

956. *Chairman*: Are paragraphs 11, 12 and 13 the reasons for what has been said before?——They are, I think, more the reasons as to why they may tend the other way. The major reasons I think are: the fact that commodity prices have ceased on the whole to go up with the speed they have been; and secondly, I think, that independence has meant possibly a slowing down of the movement of sterling balances to certain territories for capital purposes.

957. *Sir John Woods*: So far as it reflects commodity prices it can be a temporary position?——Surely.

958. *Chairman*: Are there any questinns on paragraphs 11, 12, 13 and 14, or 15? Would it be realistic to suppose that these oil territories also invest a good deal in dollars or gold?——*Mr. Cobbold*: I should say the ones which have gone up quickest are mostly in sterling.

959. By "gone up quickest" you mean?——*Mr. Cobbold*: Their total reserves have gone up quickest.—*Mr. Parsons*: On the whole I think it is fair to say that the oil territories in the sterling area, which are the major oil territories holding sterling, have not got large dollar resources as well.

960. *Professor Cairncross*: Are these countries that have large current sterling deficits, or large dollar deficits, to meet from year to year?——*Mr. Cobbold*: Some of them are countries which have, except by rather artificial development programmes, got very little deficit to meet. On present figures these are bound to mount up pretty heavily.

961. It is an important contingent liability, because these are countries which might one day want to transfer some of their money elsewhere, and the negotiations to which you referred in dealing with the independent sterling area might assume a different character in dealing with these countries. I think the issue would be in part whether they have large dollar payments to make. Do they make use of dollars at all?——The majority of these countries do not necessarily have large dollar payments to make.

962. *Chairman*: Are there any more questions on paragraph 15? Paragraphs 16, 17, 18?—*Professor Sayers*: In paragraph 18, Mr. Chairman, I am wondering about the first sentence: "There would also be important market consequences". I have difficulty in seeing that this market problem is an additional problem. If the sterling balances are down, that means that we have a favourable balance of trade. Provided that the gold and dollar reserves are held stable, the running down of the sterling balances has as its counterpart a favourable balance of trade; otherwise the balances do not run down. Do you agree?——*Mr. Mynors*: We follow that far, I think.

963. *Professor Sayers*: If we have a favourable balance of trade, that on the face of it means that people at home are spending that much less of their incomes, either on consumption or on additions to our capital equipment; is that so?——They are getting less for what they spend. Are they spending less, I wonder, to an equal extent?

964. Yes, that is a point. I was thinking that the favourable balance of trade would imply an increased capacity of the home market to take up Government securities of one kind or another, short or long?——Not if you got (this is very hypothetical, I admit) the home resources released to give you these exports replaced in order to meet continuing home demand by increased imports.

965. But you are not having the increased imports, or your sterling balances are not going down?——*Mr. Mynors*: You are assuming of course that the reserves remain unaffected?—*Professor Sayers*: Yes. If you solve the balance of payments problem you have not a market problem for your gilt-edged in addition, have you?—*Mr. Cobbold*: If we solve the all-over balance of payments problem; it rests on that.

966. *Chairman*: I do not follow the argument in paragraph 18, that it becomes more difficult to maintain market floating debt within manageable limits. What we are envisaging, as I understand it, is that there is a realisation of overseas holdings here by the holders letting Treasury Bills run off, or else by selling their gilt-edged securities, and taking the money. If they let Treasury Bills run off, why does it make maintaining market floating debt within manageable limits more difficult?——*Mr. Cobbold*: Broadly because they have to get the banks to buy them.—*Mr. O'Brien*: It implies too that the market is so bad for long term securities that you could not replace Treasury Bills by funding into long term securities.

967. *Professor Cairncross*: I think there are two different hypotheses here. If you were to assume that the withdrawal of these balances simply fell on reserves, then all that would happen would be the sale of some Treasury Bills which would be purchased by the Exchange Equalisation Account, and there would not be this effect. If on the other hand what we are assuming is that some change takes place in saving and investment inside the country, it is very difficult to predict in advance what distribution of maturities would match the new distribution of holdings of cash. It might become more difficult, but I can conceive of circumstances in which the floating debt would be the least of your problems?——I think there is a *prima facie* probability if they were selling Treasury Bills on a large scale we should have a problem, at any rate for a time, to replace those Treasury Bills, or, if they were selling gilt-edged securities, to find new holders.

968. It was in my mind that a large scale withdrawal of these balances might oblige the Government to take action through the Budget. If they took action through the Budget that would mean some intervention into the gilt-edged market to redeem debt. The effects are very difficult to predict, but I would have thought it impossible to be quite as precise as in paragraph 18?——Yes.

969. *Professor Sayers*: The market problem of dealing with the Government debt and the balance of payments problem are two facets of the same basic problem, the running down of sterling balances. There is no additional strain from the second problem: if you pay up sterling balances, you do not have the market problem at home. Is that not so?——*Mr. Mynors*: Perhaps it is misleading if we have suggested that there are two quite separable problems. Perhaps it would have been fairer to say that this first presents itself as an important market problem

I think we had in mind in drafting this paragraph that the immediate impact on our side, if they begin to drop, say, by a steady £5 million a week, is that we get a £5 million a week reduction in this corpus of Treasury bills which up to then have been fairly firmly held.

970. *Chairman*. And your problem on that point is to find new firm holders?——Yes, if only for the time being while the general remedial measures, which mean that in the end you can take the general effect satisfactorily, are being worked out. It may require, as Professor Cairncross was just saying, budgetary measures, but they, as we know, take perhaps months to take effect.

971. *Professor Sayers*: But during the time lag your gold reserves would have been running down?——Probably.—*Mr. Cobbold*: Not necessarily to the same extent as balances were going down. I think perhaps we should have said " There is also a market aspect of this problem ".

Chairman: Are there any more questions on paragraph 18 or 19? Then I think that brings us to the end of our programme today. Thank you, Mr. Governor.

(*Adjourned until Tuesday*, 10*th September*, 1957, *at* 10.30 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FOURTH DAY

Tuesday, 10th September, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E., (Questions 972 to 1058 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.,
W. E. JONES, Esq., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.,
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary, of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

972. *Chairman*: Sir Roger, we have got five papers from you, which we are taking as part of the evidence today and tomorrow morning. We have also got a list of titles of what amount to 10 papers altogether. It is always rather difficult, until you have seen the content of a paper, to see how far it goes. We have all been reading these papers which we have got down on the agenda today, and I think one of the difficulties that is fairly common to us is that it is not easy to explore very far such papers as those on Exchequer Management and the Financing of Public Investment, so far as they remain purely analytical. One wants, of course, to be able to relate them, and the events that they record and the analysis which they make, which is very valuable as a background, to the policy that was being pursued, in order to get some idea as to how far policy decisions taken have been implemented by results. Some of that, no doubt—I hope much of it—will be covered by your Paper 6, which we have not yet got, that is, the History of Monetary Measures since 1951?——*Sir Roger Makins*: Yes, It is now called Monetary Policy and the Control of Economic Conditions, and it is a fairly substantial paper. It will, I think, or at least I hope, give you the kind of material which you require for the wider aspects of your inquiry.

973. I have a feeling that it might help you and help us if, even at as early a stage as this, some of us put to you in a general way the kind of questions which we feel we must follow up, and which we would like to see, as far as possible, dealt with in advance by that or any other supplementary paper. So I think that, if one or two of our members started now by outlining the kind of questions which they think will arise, it would help to shape your evidence?——Yes, I think it would. May I ask leave, before we begin, to make a purely general statement about our position, and how we are laid out to assist you?

974. Yes; perhaps you would make it at this stage and we could follow it up?——In the first place, Mr. Chairman, I wish to say, on behalf of the Treasury, that we welcome the opportunity to collaborate with this Committee on the important and, I must say as far as I personally am concerned, very difficult subject of the monetary and credit system. We have submitted five papers to you, which are on your agenda. We shall be submitting further papers to you and we are, of course, ready to provide you with any additional material which you may consider to be relevant to your inquiry. I might say here that we have almost ready, and will circulate within a few days, a fairly substantial paper on Monetary Policy and the Control of Economic Conditions (that is the one to which I have just referred). We shall also submit in particular a paper on Debt Management.

It will, perhaps, be of help to the members of the Committee if I touch very briefly on the part which the Treasury plays in the conduct of monetary policy. There is a distinction here between policy and operations. In the broad field of monetary policy the responsibility for decisions belongs to the Treasury within the Government. The Chancellor is the responsible Minister, the Treasury is his Department, and the Treasury Ministers have the task of defending and accounting for the policy to Parliament and to the country. But that is not to say that the Treasury alone formulates policy; on the contrary, policy advice is continually forthcoming from the Bank of England and from other bodies with functions in the monetary system. But the ultimate decisions rest with the Treasury.

Apart from what may loosely be called the field of strategy, the main function of the Treasury is to take what one might call the principal tactical decisions which govern monetary operations. For example, in the field of debt management the Treasury sets the amounts and terms of new loans, it fixes the interest rates for lending to Exchequer customers or to local authorities under the Public Works Loan Board, and it issues general guidance on the control of borrowing to the Capital Issues Committee. But generally speaking the Treasury does not itself conduct operations. For example, in recent years it has been the policy to fund; within that policy the Treasury takes certain types of decisions, for instance, as I have just said, on the amounts and the terms of new loans, but it does not participate in funding operations. Market operations are performed by the Bank of England, the management of small savings securities by the General Post Office, of local authorities' loans by the Public Works Loan Board, and so on. But in one respect the Treasury does operate; it manages the Exchequer. This is not strictly a monetary function, but it is closely linked with monetary operations because of the effect on the money supply. Therefore, the Treasury has submitted the paper on Exchequer Management, and on the detailed figures for the flow of money in and out of the Exchequer over the past five years.

I have referred to the other bodies with executive functions in the monetary system. I would like, if I may, to say a few words about the relations of the Treasury with them. Much the most important is, of course, the relationship with the Bank of England. This rests formally on the Bank Act of 1946, the provisions of which are, of course, familiar to you; but in practice the relationship between the Treasury and the Bank is necessarily very closely knit. From one point of view it is that of customer and banker. The Bank of England holds the Government accounts, acts as the agent of the Treasury in a great many operations, and gives it advice on monetary policy, both domestic and external. There is, of course, a good deal of division of labour between the Treasury and the Bank. For example, in broad terms the Treasury looks after the public debt, and the Bank looks after the money market. In most matters the final authority rests with the Treasury, though this

is not formally the case with the movement of the Bank Rate; this is the Bank's decision, taken, in practice, after consultation with the Chancellor of the Exchequer and with his approval. This relationship, and the responsibilities to which it gives rise, call for close and continual contact and co-operation between the Treasury and the Bank, and this, in my brief experience, has been the rule at all levels in both organisations.

Then there is the Capital Issues Committee, on which a separate paper is before you. The Post Office manages small savings securities under Treasury regulations, and the terms of the securities are fixed by the Treasury. Then there is the Public Works Loan Board. This is an independent body appointed by the Crown, with discretionary powers to make loans to local authorities and some other bodies. Apart from appointments to the Board, the Treasury relationship with the Board is threefold: first of all it supplies the money they lend, since they draw on the Local Loans Fund and any new resources required for this Fund are supplied by the Exchequer; secondly, the Treasury fixes the rates of interest and charges paid by the borrowers; and, thirdly, the Board's general lending policy is the subject of arrangements made from time to time between the Board and the Treasury. A notable example of such an arrangement was the Chancellor's request to the Board in the Budget speech of the 26th October, 1955, to put applicants on inquiry as to their ability to raise their requirements in the market, before granting any Exchequer advances.

Then there are the National Debt Commissioners. They have responsibilities defined by statute for regulating the Trustee Savings Banks and for managing a number of official funds, the most important being the Savings Banks Funds and the National Insurance Funds. The day-to-day responsibility for the work is exercised by the Comptroller-General of the office. The three active Commissioners are the Chancellor of the Exchequer and the Governor and Deputy Governor of the Bank of England. The others are purely *ex officio*, and the Commission has not, in fact, met since 1860.

I should also say a word about the relations between the Treasury and other Government Departments. Since 1948, when Sir Stafford Cripps combined the functions of Chancellor of the Exchequer with that of Minister for Co-ordination of Economic Affairs, the Chancellor and, therefore the Treasury has had, in addition to the normal exercise of Treasury control through supply, the final responsibility for general economic policy. This is marked by the fact, among others, that the Joint Permanent Secretary dealing with economic and financial policy—that is at present myself—is Chairman of the Economic Steering Committee, which consists of the Permanent Secretaries of the Departments directly concerned with economic affairs. Under the Economic Steering Committee there are a number of inter-departmental sub-committees, most but not all of which have Treasury Chairmen. The Treasury is the regular channel of communication between other Departments and the Bank of England, which, however, is separately represented on the appropriate official sub-committees and participates in this way in the formulation of policy recommendations to the Economic Steering Committee and to Ministers. This official mechanism of co-ordination is, of course, supplemented by less formal contact.

Finally, one word about the internal organisation of the Treasury. As Joint Permanent Secretary I am responsible under the Chancellor of the Exchequer for economic and financial policy, internal and external. Three of the main Treasury divisions are concerned with this field, the Economic Section, the Home Finance division and the Overseas Finance division, and the team of witnesses will be disposed accordingly. Sir Robert Hall is here today as the Economic Adviser to Her Majesty's Government and Director of the Economic Section of the Treasury, and his long experience is at your disposal, particularly when you have questions to ask about monetary policy and the control of economic conditions. The other Treasury witness here today is Sir Edmund Compton, the Third Secretary immediately responsible for the Home Finance division. He will answer your detailed questions about the Treasury's functions with regard to the Exchequer and the national debt, the currency, and the control of borrowing and credit. Sir Leslie Rowan is the Second Secretary in direct charge of questions of external finance. He is not here today, but he will be available to give evidence to you in all those parts of his work which are relevant to your inquiry. I myself am cast in the rôle of principal witness for the Treasury, but it will be within your knowledge that I was transferred to the Treasury from other spheres of official activity on the 15th October last, and that I have had responsibility in the Treasury only since that date. You may find it more profitable, therefore, Mr. Chairman, to address questions on matters of fact and policy arising prior to that date primarily to my colleagues who will be able to answer them from direct practical experience, rather than from the fruits of research. That is all I want to say by way of introduction.

975. Thank you. There is one thing which is in my mind. I followed what you said about you yourself having only recently arrived at this particular point of your career, and we have Sir Robert Hall, as you say, to deal with economic theory and monetary policy, and of course you will arrange between yourselves as to who answers what, but are we going to find from you in your papers an exposition of the full purpose of monetary policy, as understood in your central department, and the relation of that to the events that have happened; because questions are hound continually to be directed towards that?——That is the subject of the paper to which I have just referred. Perhaps you would wait and see that. I hope you will find it adequate, at all events as a starting point for your questions.

976. *Professor Cairncross*: I take it you are going to provide us with some analysis of inflation, as you understand it, and of the various factors that have contributed to it over the past five years?——Whether it will be fully adequate to cover all that you require, I cannot really say at this moment, but it is intended to be comprehensive.

977. *Sir John Woods*: Would it be comprehensive, equally, in the sense that it will relate the external financial and economic problems to the central monetary policy? On the list of papers today there is nothing about the external side: balance of payments questions, and so on?——It will be of assistance to us to know precisely what you will require on the external side. I understand that the Bank of England has submitted certain papers to you covering the external side, and I think it would be helpful to us to know what further complementary or additional papers you would require from us.

978. I do not think I am prepared today to give a lecture as to what I would like to see on that; as far as I am concerned I will wait for Paper 6 and see what questions then arise. But I think it is an important side of the inquiry?——I entirely agree.

979. *Professor Sayers*: Might I illustrate a point that would arise in that connection? It would be very important, I think, for us to know how far external considerations have influenced interest rate policy during the past five years, and how far the Treasury considers now, in 1957, that external considerations affect interest rate policy, and in what ways interest rate policy should be governed by external considerations?——*Sir Robert Hall*: If I could touch on that, the paper does discuss the considerations in the external field which were present when various changes were made. It does not go in any great detail into the external side at present, but there is some indication along the lines that you suggested. I do not think it answers the question as to this moment in time.

980. Would that be a sufficient indication to give us a basis for questions?——I think so. I do not like to anticipate your marking of the paper.

981. *Chairman*: Of course, I am not putting these questions on the basis that I expect any paper is going to close the matter for us, but I think it does help you if we indicate to you the kind of things which, progressively over the months ahead, we shall want to explore and go into with you?——If I could just amplify what Sir Roger said in reply to Professor Cairncross, the paper deals much more with the balance of supply and demand than with cost inflation. The Government's view has been that the wage question is a somewhat separate question from the question of demand inflation.

982. *Professor Cairncross*: I think I should put this rather strongly to you: we have been asked to exclude

exchange rates on the one side, and it is natural to suppose we should exclude discussion of wage policy on the other side; but at the same time any monetary policy must be conceived in terms that seek to reconcile different objectives that may, in fact, not be capable of reconciliation. If we are trying to decide what has, in fact, dominated things, we are bound to look both at what has happened elsewhere in the world, and at what has happened to wages, because these various strands in economic and monetary policy are all intertwined and it is extremely difficult to disentangle them. I was hoping, therefore, that, although you might not wish to plunge too deeply into matters that are not within our immediate purview, you would say something about the emphasis that you would wish to place on the demand element in inflation, as opposed to other elements, and on the freedom with which monetary policy in this country could be conducted, without regard to events in other countries. If we were, for instance, considering the problem as it presented itself a generation ago, we would clearly have started from the supposition that the exchange rate was fixed, but we would recognise that that placed on the monetary authorities obligations of a kind which nowadays are not always in the forefront of policy?——The paper deals with monetary policy in relation to the balance of payments surplus, and touches on the capital aspects, which are the two main elements concerned. On the other question, as you say, there have been several elements which have been difficult to reconcile, and the paper broadly takes the view set out in the White Paper last year about the implications of full employment.

983. Perhaps, since the paper is not before us, but you may wish to make additions, I might amplify in one direction what I have said. I take it that you would regard monetary policy as operating largely on short rates of interest, rather than on long rates of interest. I should be interested to know whether the operations that are conducted in the field of monetary policy are designed to influence long-term investment, for instance, or whether you expect them to operate exclusively on liquidity, on stocks, demand as it arises through Bank lending, and matters of that kind, because it would be very easy to discuss monetary policy as if the short and long rates both moved together, and operations at one end of the market were successful in producing effects at the other. I am not sure how far you enter into all these matters?——We take the view that the complex of interest rates is linked and that monetary policy has some effect on long rates. Therefore, it is partly designed to influence fixed investment, as well as investment in stocks.

984. *Professor Sayers*: Given the weight of the National Debt, the nature of the relationship between short and long rates is very much bound up with debt management. Is your paper going thoroughly into the general principles to which the Treasury has regard in the management of the National Debt?——*Sir Edmund Compton*: That paper will not be ready for some little time yet, but it should cover that.

985. *Chairman*: I have searched for an indication of the freedom of manoeuvre for monetary policy since 1945, in the world in which we have lived; because, if one were asked to consider the system and make recommendations, one would find it very difficult to do so unless one had an idea as to how free the authorities would be, in any case, to bring about results. If they are not free to a large extent, it may be because of circumstances which are unavoidable, or because of institutions which produce certain results, and which could be altered. Shall we be getting light upon the freedom of manoeuvre?——*Sir Roger Makins*: Yes, you will. At all events, we shall expose enough of the objectives and of the instruments that have been used, illustrated by what has actually happened in the last five years, to give you, I think, a sufficient jumping-off ground for whatever further aspects of the general problem you wish to explore.

986. *Mr. Jones*: In the field of capital investment, will the Treasury have anything to say in their papers about that aspect of investment that does not depend upon raising money through the banks, or by new issues, where there is money to undertake the capital development and where the capital development is of lesser importance to the economy of the country? Will you be saying anything about that and about the effect of such a situation upon inflation?——I do not know whether that point is directly covered in this paper, but perhaps you would see the paper and then it would be easier to say whether it leads on to precisely the point which you wish to examine.

987. Are you telling us that, if that is a point that we consider should be covered by the Treasury and we have not got the material, the Treasury would consider providing information on their policy in that particular field?——In so far as we can make it available.

988. *Sir Oliver Franks*: One of the things which we have to achieve is to get questions asked and answered about the ways in which the policy framed has been carried out, and how far it has or has not been successful in application. I think it is also fairly clear that the papers which are in front of us now give very few handles for raising that type of question. They are more like annals, so to say, like the dates of the reigns of the Kings and Queens of England; basically they are important, but without the living history that lies behind the actual facts and figures, they do not easily lead in to discussion. The sort of thing which I hope that we shall be able to discuss is this: in 1955, both earlier in the year and later in the year, the Government took various measures because they thought that the then situation of this country was inflationary, and among them were monetary measures. I suppose that most people would feel that, at the beginning of 1956 or the end of 1955, whatever the expectation had been early in 1955, it had not been completely realised, because it was found necessary, in early 1956, to do more. What did those responsible think would be accomplished by the measures which were undertaken in 1955? Why in fact did things not turn out as was expected? What are the consequent reflections on the strength or weakness of the various measures employed, whether monetary or fiscal? These matters are obviously the actual stuff on which ultimately this Committee has to try to make up its mind. Therefore, they are the stuff on which we must hope to have a thorough discussion with the representatives both of the Treasury and of the Bank. Clearly, the more that you can lay out in writing, before we come to the stage of discussion, the easier it becomes for us to get on with the discussion, not to waste time and go to the heart of the matter. This illustration I give you simply to give point to my general question, which is this business of stating what the policy was at any given time, what the expectations of it were, how they measured up stage by stage against what actually happened, what was the analysis, and why it went wrong or fell short, if it did. Are the papers we have not seen really going to inform us upon these things, or are they going to be a bit like these, smooth and quantitative, and not giving us a handle to these real issues?——Perhaps I could say that these papers, which you describe quite rightly as rather of the type of annals, were what we understood you required at the outset to set out the organisation, the mechanism and so on. We therefore supplied these papers in this form to meet what we thought were your needs. We recognise what you say about the real stuff of your inquiry and it is as a contribution towards that stuff that we have been working on this paper, which is not before you but which will be very shortly. Until you have looked at this paper, I do not think you can say, and I cannot say either, whether it is going to be adequate for your requirements, but I certainly think that it is a paper quite different in character from the ones that you have before you today, and it ought to give you enough pegs, if I may so express it, on which to hang a number of important hats.

989. *Chairman*: I think that we have done what we can at this moment to clear the ground about the future. Perhaps we could take up the papers which we have on our agenda today. The first are the Exchequer Financing Tables and Exchequer Management. We can take Exchequer Management* first. The way we have been going on up to now has seemed the most useful; I call out, paragraph by paragraph, the questions come from anybody. They are not necessarily intended to exhaust the points raised, by any means, but are intended to be progressive; we will come back to them later, if

* Memoranda of Evidence Part II No. 2.

necessary. I will follow that procedure with this paper. Are there any questions on paragraph 1? Paragraph 2? —*Sir John Woods*: I would like, if I might, to ask a question about the last sentence. It says:

"It is an object of Exchequer management to avoid this last expedient as far as possible, and banking Ways and Means Advances, when they occur, are seldom outstanding for more than a single day."

Can you explain why that is so?——*Sir Edmund Compton*: The reason is really two-fold: first, that it is a failure of good Exchequer management if, at the end of the day, one has had to overdraw at one's bank, which is in effect what happens when we have banking Ways and Means Advances; secondly, though this is perhaps more for Bank of England than Treasury Witnesses, it has usually been held that to finance the Government by Ways and Means Advances from the Bank is the most inflationary form of Government borrowing that there is. There is the third point, that they are interest bearing. It is perhaps more tradition than anything else, but none the less we have to pay interest to the Bank on Ways and Means Advances, whereas our other forms of borrowing —those from our own departments—are interest-free. I think those are the three reasons.

990. *Chairman*: On the second one, it is only a day-to-day adjustment. Why is it more inflationary?——I repeat that I think that is perhaps more for the Bank of England to answer than for me; but I think the answer is that, in so far as the Government is financed by an overdraft at the Bank of England, that does from some points of view broaden the credit base.

991. *Professor Sayers*: But the Bank of England evidence knocked the bottom out of that argument. The evidence from the Bank of England was that the effective credit base was the liquid assets of the commercial banks, possibly even going beyond the generally recognised categories, and certainly not the cash. Ways and Means Advances affect the cash element in the liquid assets base, but they do not affect the total. The second of your three reasons is the only one which could be said to be of substance, is it not?——I think that perhaps the other point is that a large Ways and Means Advance, or a large overdraft at the Bank of England, would look as if the Treasury was not managing its affairs as it should.

992. It is because the view embodied in your second point has commonly been held that it would be thought to be had, if these things appeared. This is not a substantial point, is it? It is consequential on your second reason? ——I was really attempting to state, as a matter of fact, the considerations on which this tradition of operation has been based. If the tradition is disturbed then it would be quite possible for the Treasury to change its basis of operations, but that is the tradition.

993. *Professor Sayers*: We are asking whether you subscribe to the Bank of England view that the bottom of the argument has been knocked out?—*Chairman*: It is a little difficult for Sir Edmund if he has not got in mind what they said?——I am bound to say, in the relationship that we have as a customer with the Bank of England, they being our bankers, that the Bank of England would, I think, take a very poor view of the Treasury, as a customer, if we were continually asking them for an overdraft. In other words, they join with us, as a matter of day-to-day operation, in so arranging our management of the Exchequer as to avoid this overdraft, to avoid Ways and Means Advances, as far as possible. That is, in fact, what they do as operators. I do not know how consistent that is with the evidence they have given.

994. *Sir John Woods*: The failure of management surely does not consist in showing or not showing a deficit. It consists of having a deficit, does it not; and the question you are asked here is: why is it better to sell Bills rather than have an overdraft with interest?—*Professor Sayers*: Why, in effect, would the Bank of England take a poorer view of your having your Ways and Means Advance than if you were selling Treasury Bills to the Bank?—*Chairman*: It comes down really to whether there is anything at stake in avoiding the Ways and Means Advance, if the alternative is the sale of a Treasury Bill? ——*Sir Edmund Compton*: I think the choice between those two rests largely upon the preference between those two which the Bank of England has as a matter of market management. That is why I am rather diffident about expressing a view.

995. As a customer you are indifferent?——As a customer I am indifferent.

996. *Lord Harcourt*: You pay interest on Ways and Means Advances but, equally, the sale of a Bill by the Treasury attracts interest, so that in cash it makes no difference to the Treasury?——Either way we have to pay interest.

997. *Professor Cairncross*: May we know why you pay interest on a Ways and Means Advance?——It is a Ways and Means Advance from the Banking Department of the Bank of England.

998. It is not a book entry, as one might have supposed?——That is a good example of the relationship of banker and customer between the Bank of England on the one hand and the Exchequer on the other. It is not as though each penny of interest we pay to the Banking Department comes back to the Treasury as profit.

999. How is the rate of interest determined? What rate of interest do you pay, and how is it fixed?——The rate of interest is fixed by agreement between the Treasury and the Bank of England when there is a change in conditions, and that in particular means on occasions when there is a change in the Bank Rate.

1000. Do you pay more on Ways and Means Advances than on Treasury Bills?——On the whole we pay less, so from the strict point of view of the cost to the Exchequer I suppose it would pay us better to get our money by Ways and Means Advances than by the sale of Treasury Bills, on the other hand, as part of what is, I repeat, the current practice of minimising Ways and Means Advances, our agreement in advance with the Bank of England on the rate of interest only relates to the first £20 million of Ways and Means Advances. On any Ways and Means Advance above that sum the rate of interest is a matter for arrangement. In fact in the last four years I cannot recollect having had a Ways and Means Advance of more than £20 million; the question of arranging has not arisen.

1001. *Sir Oliver Franks*: Must it not be the case that whatever the form—and I do not mean that the form is therefore unimportant—the rate of interest that you pay, if the parties who have to decide are the Treasury and the Bank of England, must in the end be determined by the Government? The Bank of England and the Treasury may talk about it and they may in the normal course agree but, since both are in different ways institutions or departments of the Government, it must be the Government that determines what the rate of interest on Ways and Means Advances is. We are dealing with an element of free play or independence within a system of institutions which are wholly Government. Is not that right? ——The constitution of the Bank of England is in fact laid down by the 1946 Act and by its charter, and one of its functions is to act as the Government's banker. In that capacity it agrees with us the rate of interest that we will pay if we overdraw; that is in practice how the thing is done.

1002. I agree; but I am raising a further point. This is a purely hypothetical case to bring out the point of principle. If somebody had to agree to what the other side proposed, it must in the end be, must it not, the Government that decides, and in the end the voice of the Government is the voice of the Treasury, because of the general position which Sir Roger took up in his preliminary statement?——Yes, if one were to conceive a process which ended up with a conflict, then in the last resort I take it that the Bank of England would defer.

1003. *Sir John Woods*: If they did not defer they would be given a direction?——There is power to give a direction to the Bank.

1004. *Sir Oliver Franks*: It follows, I think, from that that what the rate of interest on the Treasury Bill or on Ways and Means Advances is cannot be crucial in determining which way the Government obtains its money from day to day, because all these things are in the end under the control of the Government?——I think that is so, and it is perhaps brought out by the fact that on the one hand it is, rightly or wrongly, an object to minimise these Ways and Means Advances as the

paper said, but, on the other hand, the rate of interest we pay on a Ways and Means Advance from the Bank is less today than the rate which we pay on a market Treasury Bill; it is not a penalty rate.

1005. Would not what Sir John Woods has just said be the important thing in the matter? If the Government is in deficit, as seasonally it must be—perhaps sometimes critically—the fact of the deficit is what matters, and whether from day to day it is financed one way or the other, in the present status and structure of the institutions concerned, is a matter of interest traditionally, perhaps, but not of importance. Would you disagree with that?——I would not like to leave this room feeling that I was going to operate the Exchequer from now on with a feeling of indifference as to the two methods of borrowing. I would prefer in the first place to work out with the Bank of England what would happen if, for example, we expanded our Bank of England Ways and Means Advances by £100 million, or some substantial figure. I do not know what effect that would have upon their market balances, but until I do I would not like to say it was a matter of indifference.

1006. *Mr. Jones*: The sale of Treasury Bills, Sir Edmund, rehabilitates your current account in the Bank of England?——Yes.

1007. It is when that current account falls below certain levels that you have to resort to Ways and Means advances? It is the last line of operation?——Yes.

1008. We are told in this paper that Ways and Means Advances only operate for a period of 24 hours, and we have seen in another paper that there are fairly substantial expenditures on certain days that have to be met by the Treasury. Have there been, or are there at any time, experiences where you require Ways and Means Advances two days together, or where you cannot rehabilitate what you have taken in Ways and Means one day on the next?——It is very seldom indeed that we need a Ways and Means Advance for more than 24 hours. The reason for that is that in the meantime we shall either have replenished the Exchequer account by the sale of Treasury Bills or we shall have made other arrangements for bringing our account into credit.

1009. What could those other arrangements be?——It would probably be either a receipt of revenue (it might well be that the Exchequer was in deficit because some revenue that had been expected was a day late in arriving) or alternatively we might have sold stock in the market. There are various ways in which the Exchequer can be brought into balance besides the sale of Treasury Bills.

1010. *Chairman*: You call on one of the Departments which holds stock to realise it and bring the proceeds into the Exchequer?——I was envisaging that there would be a sale in the market of stock, and in practice all market sales of stock are done by the Issue Department of the Bank of England. When we speak of "Departments", in practice that means the Bank of England.

1011. The Issue Department manages this for the other Departments; is that it?——No, because as a matter of practice I would say all, or very nearly all, the market operations in stocks are those of the Issue Department.

1012. *Lord Harcourt*: When we talk in a loose way, as everyone in the financial world does, about "Departments" we are in fact really talking about the Issue Department in every case, are we not?——In practice, yes. That is not to say that there are not occasions when the National Debt Commissioners do acquire stocks in the market, but in practice, as a matter of management, it is usually done through the Bank of England. That is to say, if the National Debt Commissioners for one of their funds require a market stock they will normally buy it from the Bank of England and not from the market.

1013. But when the National Debt Commissioners acquire stock or sell stock they are either buying it or selling it as the result of some independent decision of their own, and not for market purposes? They are either acquiring or selling stock as a result of the operation of an independent authority which they have; they would not be operating for purely market reasons?——No, the National Debt Commissioners in fact are buying and selling because of the needs of the funds which they manage. Having said that, I think it is useful to say at once that the net amount of the transactions that they carry out of that sort is quite small in relation to the total of market operations as disclosed to you in these Exchequer financing tables. The Exchequer financing tables in the paper in front of you have a line showing the increase or decrease in the holdings of the Issue Department and the National Debt Commissioners. If you look at the figures for the last two years, for example, the increase in the holdings of the Issue Department and the National Debt Commissioners in 1955-56 is £499 million. The National Debt Commissioners' element in that is £13 million. Then in 1956-57 the net increase in the combined holdings is £55 million; the National Debt Commissioners' element in that is £8 million. I just mention those figures to show that the effect of their operations on the market is not really very substantial, that being basically due to the situation that they have two main funds or groups of funds; on the one hand the Savings Bank Funds, on the other hand the National Insurance Funds. The Savings Bank Funds are on the whole sellers of securities, but the National Insurance Funds buy. The result is that between the two the National Debt Commissioners as a whole have not much net buying to do.

1014. *Professor Sayers*: The Issue Department operations obviously are fairly weighty: who conducts them?——The Bank of England, if by "who conducts them" you mean "who is responsible for market operations, for day-to-day decisions on what to buy and what to sell".

1015. Who decides from week to week?——I would put it this way, really in amplification of what Sir Roger Makins said in his opening statement about our relations with the Bank of England. We have a general policy agreed between the Treasury and the Bank, and at present it clearly is one under which funding is to be done when opportunities occur. That is a very crude expression of what the policy consists of. Then it is the Bank's job to carry that out, to seek out the opportunities and to sell whatever description of the stocks they can sell. The week to week decisions or consideration come when the Treasury is watching the Bank's performance as funders and discussing with them to what extent the policy has been successful and what modifications might be required in order to make it more successful, as for example whether the time is coming for an issue of stock either to replenish the resources of the Issue Department or to deal with a maturity. For that purpose we have a system of regular weekly review, a working arrangement between the Bank and the Treasury under which we have before us a report on, among other things, the net sales or purchases of securities in the market, and are able to judge that in relation to the supply or withdrawal of cash from the market. We call it for want of a better name "Factors affecting Bankers' Balances" because in effect the amount of cash shown in this review shows us how the combined effect of the Exchequer operations and the Bank's funding and market operations has affected the cash in the market and therefore the cash that is available to the bankers. That is a description of the weekly review that is made of the result of the Bank's day to day funding operations.

1016. Shall we have in the papers that are going to be before us a discussion of the operations of the Issue Department during the last five years?——No, I think we relied upon, or we thought that you would probably call upon, the Bank of England, as operators in the market and of the Issue Department, to give you that account. In fact, in terms of market operations, I think it is within our knowledge that the Bank of England have submitted a paper to the Committee covering that ground.

1017. This is a subject on which you must have views from week to week. You have a weekly discussion on the conduct of the Issue Department's operations; may we have an account of the views you have taken from week to week over an appreciable period? I am thinking, for instance, not merely of the pace at which securities were pressed on to the market but of the terms. Presumably in your weekly discussions you discussed the terms on which the Issue Department should be a seller. What considerations have been in your minds in deciding those terms or to put it another way, in discussing those

terms with the Bank? This is a Treasury matter and I think we should like to have the Treasury's view?——I think perhaps I would like at this stage to take note that that is a matter on which the Committee would like evidence and to see to what extent it can be covered in the paper that is in preparation for the Committee on debt management. I do not want the Committee to over-estimate the extent to which the Treasury concerns itself in funding as a market operation. As Sir Roger Makins made clear, we regard it as the Bank's function to operate in the market, not the Treasury's. On the other hand, the terms under which they do it are our concern because they affect Government credit and the terms on which we are borrowing, seeing that once you sell a stock to the market then you are paying interest to the outside world and not to the Issue Department whose profits are in effect the Treasury's. I accept that and, if I may, I think we ought to take note of your desire when we come to write the Treasury paper on debt management.

1018. In thinking of the terms on which the Issue Department should operate is the Treasury concerned solely with its point of view as the payer of interest on the National Debt? Does it not consider the broader monetary effects of a structure of interest rates?——We are undoubtedly concerned as a matter of policy with the level of interest rates. If, for example, funding were pressed, if it were feasible (which I do not think we believe) by funding to lower market prices and to raise interest levels to some much greater height, it would be obviously of great concern to the Treasury. That is not a matter on which we would leave the Bank of England complete discretion.

1019. I am thinking now of the kind of question that enters into your mind when you discuss the matter from week to week with the Bank of England. You say that the present policy is one of funding. I take it that you mean the maximum funding irrespective of price, or almost irrespective of price; but that in itself is a policy decision. You might conceivably take the view that it is more important to have the long rate of interest either up or down than to secure any given amount of funding or any funding at all. If on the grounds of general monetary policy you did decide that the interest rate structure should be different, should that not enter into your discussions with the Bank on the conduct of the Issue Department?——It should indeed be at the back of one's weekly or day to day discussion on operations, but in fact the main point that one takes in this day to day or weekly review of their operations is the quantity point: how much? Have there been market opportunities? Have they sold stock; if so, how much? To what extent has it covered, for example, the buying up of maturing stock, which is the other aspect of the Bank's day to day operations?

1020. *Sir Oliver Franks:* I put this question in terms of persons responsible only as a way of trying to bring out the point. If the discussions with the Issue Department of the Bank of England on matters that we have been talking about were essentially conducted by the person or the department in the Treasury responsible for the management of the debt then one would expect, other things being equal, to find emphasis on trying to manage the debt so that the cost of interest on the debt as a whole was minimised rather than maximised. It would be in the interest of efficient management of the debt that that should be so. Now there are other policy considerations which can affect the same subject matter. For example, it is a consideration of policy whether at any given moment the floating debt is of such a size that steps should be taken to secure the funding of some part of it into longer term debt, even if that affects the rate of interest quite considerably and one has to pay more in order to get the funding done. Those considerations are wider financial and economic interests than the management of the debt by itself. Is the same person or department in the Treasury dealing with the Issue Department of the Bank of England, talking about these matters and carrying responsibility for both these types of policy, or are those who look into debt management and have the regular meetings with the Bank of England dealing with the efficient management of the debt, while another department of the Treasury is dealing with this other issue that I have described? This might quite easily lead to a discussion within the Treasury itself as to whether the cheap management of the debt or alternatively the prosecution of funding were, within limits, the course that had to be pursued at a given moment. How does all that work itself out?——The continuous contact between the Bank and the Treasury in this matter is really with me, at any rate with my side of the Treasury, which has among its responsibilities debt management, and therefore the cost of what they are doing is, and I believe it is my duty it should be, always present in my mind.

But I go on to say that as part of the, I hope, efficient liaison inside the Treasury, what the Bank are doing in this matter of funding is known too to the Economic Section and Sir Robert Hall, and I hope he will not disagree with me when I say that we are in close contact all the time about the wider economic aspects of what these weekly figures and performances show. It is not my only function to look at the cost of the debt; it is also part of the policy of the Treasury, policy laid down which I am responsible for carrying out, to take funding as far as it can be taken, and that policy is taken in the knowledge that funding can cost money. One must not make the assumption, of course, that the higher the rate of interest goes the more funding you do, because in fact, at any rate in our experience of these last few years, such funding as we have done has been on a rising market. That is what is meant by opportunities for funding. On the other hand it is accepted policy, which it is the Treasury's job to carry out, that there should be funding, and also that the rate of interest should be such as to encourage saving and discourage borrowing, which means that the Exchequer for its part has got to pay the cost of a dear money policy. So all that comes into one's consideration of the weekly performance of the Bank of England.

1021. It is to you as representing the Treasury that in regular contact the Bank of England has to look for a reconciliation of the possible conflicting aims at any given moment of the cheap management of the national debt and the requirements of funding, also in its task of trying to deal with an overgrown floating debt?——As a general rule, yes, though I would not like that to be interpreted as meaning that I am the sole channel of communication; nothing like it. For example, that is a matter which they might well join in discussing with the Economic Section as well as the Home Finance division.

1022. *Sir John Woods:* Would it be fair to put it this way? The whole business of the management of the debt, including its wider policy, is the responsibility of the Home Finance division of the Treasury, but in exercising that responsibility they will consult with the other people concerned, obviously the Economic Section, and I suppose from time to time the Overseas Finance division?——Yes; I apologise for omitting that, but naturally the effect of what we do, for example, on the Bill rate may well be of concern to the Overseas Finance side in relation to the return on foreign balances in London.

1023. I think it has been said—I do not ask you to agree—that if the Home Finance division did its work properly there would be no need for an Overseas Finance division?——*Sir Roger Makins:* Mr. Chairman, I should not like it to be thought as a possible implication of this discussion that the Treasury is a department which works within itself in watertight compartments. Naturally these questions of policy, like all questions of policy, are considered by the senior part of the Treasury on the instructions of Ministers. The Home Finance division is the department which within the Treasury is responsible for this general area, but naturally when any question of policy arises which requires discussion outside the Home Finance division then that discussion takes place, and where necessary ministerial instructions are obtained. I would just like to make that clear.

1024. *Chairman:* Yes. You used the phrase, Sir Edmund, "to take funding as far as it can be taken". I was not quite sure what was covered by the qualification?——*Sir Edmund Compton:* I really meant as far as in practice it can be. That is a market matter on which the Treasury must largely be guided by the Bank of England as our market operators.

1025. Are the limitations absolute, or are they imposed by bringing into consideration certain other considerations which count against it?——In my experience the limits really consist in the readiness of investors to buy.

1026. At any price?——It has again been our experience that we do not get investors to buy simply by offering our stock at knock-down price. I think our view, which I believe we share with the Bank of England, is, first, that it takes two to make a bargain; secondly, that on the whole we sell our securities when prices are rising, not falling. What the investor periodically needs to feel in order to buy our securities is that some bottom or other has been touched in the market, and we do not achieve that by knocking down the price of our securities.

1027. *Professor Sayers*: Is this judgment perhaps unduly coloured by the experience of five years in which the Government has scarcely made up its mind on interest rate policy, and markets have therefore been continually sagging, and it has been perfectly natural therefore that selling has only been possible in a bout of market recovery? It might be a highly profitable question to consider not whether it is possible to sell otherwise than on a rising market, but the level from which the market should rise?——I find that a very difficult question to answer, because it presupposes that one could form a judgment about some new, and I take it lower, level from which the market should rise.

1028. *Sir Oliver Franks*: But might it not have a different presupposition? It might be the case that the Treasury, and possibly the Bank of England as well, had a view that if possible the rate of interest on longer term government stocks should not be encouraged to go below a certain level; or alternatively the view might be that the rate of interest on stocks of that kind should be absolutely left to the market, to go up or down according to other influences in the market, but not according to any policy or operation as agreed between the Bank of England and the Treasury. Whether the rate of interest on long-term government stocks over the last five or six years has in fact been left wholly to the play of market forces, or whether there have been views which with greater or less success the Treasury and the Bank of England have succeeded in making good in the actual rates of interest prevailing for long-term government bonds is a very important question of policy, is it not? Would you disagree if I said, with no knowledge at all, looking at it from the outside, that it seemed to me that the rate of interest on long-term Government stocks had rather more been let go free in the last eighteen months or so than had been the case in the three or four years previous?——I would say that at no time has the Government or the Treasury forgotten the cost of the debt. It cannot be forgotten because it has got to be paid for. It is a matter on which the Government is always due to be criticised and attacked in Parliament, and it affects the Budget balance. Therefore I think it would be misleading this Committee to say that in pursuit of monetary policy the Treasury has at any time ignored or decided that it could ignore the effect upon the Exchequer of paying a higher rate of interest. I think it is important that you should know that that is always in our minds and is bound to be in our minds. Having said that, I think it is right to say that the Government and the Treasury have felt more consciously in perhaps the last two and a half years that this is a price which must be paid, and defended as being a good price to pay, if the result of paying that price is to get results in the way of controlling inflation. I think perhaps you can date a shift of view of that kind to the Bank Rate change of February, 1955. I think that the paper on monetary policy that is coming before you will show you that we activated monetary policy as from that date or thereabouts, and that carries with it the implication that from that date or thereabouts, we were more ready to pay the higher price of dear money.

1029. *Sir Oliver Franks*: Will the paper when we see it enable us clearly to understand what the balance of argument was which led to that shift of emphasis in the thinking of the Treasury when the Bank Rate was changed in 1955? Clearly from the point of view of this Committee's work the relative weight attached in any historical set of circumstances to the cheapness of managing the national debt or alternatively trying to do something about an unwieldy floating debt is of the greatest importance? Shall we find the pros and cons of that argument or consideration set out in the paper?——In so far as you do not, I think the Committee has the right to look for that in the subsequent paper on debt management.

1030. *Professor Sayers*: Shall we also have the Treasury's present view in the light of the experience since that change came about? Has its view been modified in either direction as a result of experience since that change of policy?——*Sir Robert Hall*: I think the paper will throw some light on these questions, but probably not deal with them in such an explicit manner as Sir Oliver's questions. Again, there are pegs on which you will be able to hang your questions, but I feel myself that decisions are arrived at in practice without reducing the whole thing to detailed lists of pros and cons There are considerations that you have in mind.

1031. *Professor Cairncross*: Sir Edmund told us that you consider the cost of interest to the Exchequer. I think by that he means you consider the direct financial cost; but do you consider the cost net of tax, or do you attempt to work out what the ultimate consequence is both on tax payments and on savings when rates of interest go up? Or are you only concerned with the financial burden on the Exchequer of the higher rates of interest?——*Sir Edmund Compton*: The first thing that strikes us is of course the effect upon the Exchequer and upon the Budget balance. Now it is true that in so far as we are paying higher rates of interest we may get some of that back in higher taxation; that is already allowed for in the Budget balance, on the left-hand side of the account. The Inland Revenue estimates of receipts on which we are working take account of the increased yield of taxation that they expect if dividends are higher.

1032. Are you presented with a separate estimate from the Inland Revenue of the anticipated additional revenue from higher rates of interest?——No, but the Inland Revenue take account of that.

1033. It is lost in the global total?——It is a comparatively small element in the total, especially having regard to the fact that certain important institutions, whose stock in trade is money, do not in fact pay tax on their dividends at all.

1034. You have no figures?——We have no separate figure.

1035. You have in fact no estimate of the net cost to the Exchequer?——*Sir Edmund Compton*: No. There are a number of reasons, including statistical ones, why the actual figure——*Professor Cairncross*: Clearly there are no statistics; I was asking if you had estimates?——*Sir Edmund Compton*: We have taken estimates; but I must say that we never found them of any great value for our purpose. The best use we have been able to make of them is really to remember that we must not count it over twice. In defending an increase in the debt charge before Parliament a Chancellor is unwise to say that the real cost to the Exchequer of this debt charge is not, say, an increase of £100 million but an increase of £60 million because of tax, when that additional yield of tax is already in the Budget accounts in the Inland Revenue receipts.

1036. That may be so, but would you agree that a change in interest rates alters the distribution of the national income in ways that will have an effect on the Inland Revenue and the Exchequer, and will also alter it in a direction which is bound to affect savings? These are important consequences which I should have thought you would have worked out, however roughly?——The effect of a given rate of interest on savings and on so-called National Savings—the small savings—is certainly something that we take account of in our interest rate policy. The difficulty there is to make any estimate, in fact the impossibility of making any estimate, of the yield that you get in increased savings from a given decision about a rate of interest.

1037. The suggestion was not that higher rates of interest were an incentive to save more but that higher rates of interest gave some people more money out of which they might save. It is the distributive effect which I should have thought was the important consequence?——But when there is a shift in rates of interest, when, for example, the Bank Rate goes up to a marked extent, the

10 *September* 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B. [*Continued*

effect of that upon the rate of interest that the Exchequer pays is first of all and primarily on the Bill rate. That is where the immediate effect is felt. The fact that we are paying a higher rate of interest on Treasury Bills does not add much to the amount of income that anybody has got to save. The next point at which it affects the Exchequer is in our Exchequer loan operations when, for example, we have maturing debt to repay. There again, judging by the experience of the last two years, our issues of Government stock have been to banks in the main and other institutions, and I do not think the fact that we are paying them higher rates of interest has meant that that has caused any additional income accruing to individuals out of which they can save. I am bound to say that this consideration that by paying higher rates of interest the Government can increase the amount of dividends that people can save instead of spend just has not been present in our minds.

1038. The levels of interest rates and profits tend to be related and, if you are operating in the market on fixed interest rates you are also operating on other investments so that the entire national income is affected. That may have important consequences, both for tax revenue and for saving. May I ask you, on another matter, whether you have any estimate that would allow you to judge whether the average maturity of the debt is increasing or diminishing? Have you any measure of that? You say you fund it, but how do you judge whether you have succeeded in funding except in the sense that you have purchased or sold certain securities? There have been heavy maturities; large issues must be maturing every year. These are being knocked off, and you are at the same time issuing new securities and these have to be added?——In the first place we measure funding by the extent to which we are able to reduce the market floating debt.

1039. *Professor Sayers*: In the sense of Treasury Bills?——Yes, the floating debt. In so far as we are successful in that, and the Exchequer financing tables show up that figure quarter by quarter, to that extent we have funded, and to a large extent that funding is done not by the issue of longer-term securities but out of revenue or by the lending to the Exchequer of money collected by the extra-budgetary institutions like the National Insurance Funds. So to that extent that is the first point at which one can say funding is taking place and the debt is made longer term. The second kind of funding operation really consists of the drive to sell small savings securities. I do not know whether that counts for your purposes as funding or not. So far as we sell a Savings Certificate, to that extent, other things being equal, we reduce our market floating debt. On the other hand, that Certificate is repayable on demand, and you may not think that is funding at all.

1040. When you say the policy is to fund at any price you mean that you must reduce the volume of Treasury Bills?——Yes, but I never said that the policy was to fund at any price. I would go on to say that for this purpose one needs to define the expression "funding". Quite strictly, "funding" means to raise money on a security which the Treasury under the loan contract need never repay. The funded debt, strictly speaking, consists of "old" Consols, 2½ per cent. Treasury Stock and 3½ per cent. War Loan; but I think more generally funding means (I was using it as meaning this) the replacement of market floating debt by borrowing from the public either on small savings securities or by the issue of market securities other than floating debt.

1041. *Chairman*: If I understand it you might achieve reduction of the floating debt, represented by Treasury Bills under our system, by some quite extraneous operation such as the fact that you are running down your reserves in the Exchange Equalisation Account, and that would put the Exchequer pro tanto in funds to reduce the debt. There is no funding in that because next month the thing may be reversed again?——Then funding will be reversed, too.

1042. It is not funding in the sense of any definition you have been giving? Is a reduction of floating debt achieved through that cause?——It is funding in this sense, that in so far as we are able to reduce the market floating debt we are reducing the liquidity in the banking system. If that is the objective then any form of borrowing which replaces market floating debt counts as funding. This is the thesis Mr. Macmillan developed in his so-called "Savings" Budget of April, 1956, when he justified the measures for increasing borrowing, by small savings and other means, on the ground that this reduced the floating debt and, therefore, the liquidity of the banking system.

1043. *Sir Oliver Franks*: But is not the question here the definition of the term? If something happens, like the Exchange Equalisation Account running down, as a result of which Treasury Bills are, quite simply, cancelled, and the floating debt goes down but no other change happens, then it would seem that to use the word "fund" is artificial, because I should suppose that the word "fund" means the movement of securities from one form into another; an element of transition or change is implied. Is it not legitimate to distinguish between those things which happen to the amount of Treasury Bills outstanding which simply produce a cancellation or decrease of the amount, and those other operations which produce a decrease in the amount of Treasury Bills outstanding because of a movement of money or securities from that form into another form, i.e., a form of longer duration, whether it be a one year bond, a ten or a twenty year bond? Surely, the idea of funding carries with it some such notion of movement from one form to another; or is that wrong?——I find it difficult to say. When we speak of funding as a policy it is generally understood that what we are trying to fund is market floating debt—Treasury Bills—and, therefore, when we say that we have achieved a measure of funding according to the amount of the reduction in the outstanding total of market bills, those market bills have in fact been reduced; there has been a cancellation at maturity of market Treasury Bills.

1044. *Sir John Woods*: I should have thought that funding, however loosely expressed, really implied some degree of permanence in what you have done. If that is right, surely the Chairman's point of view is right, that, if you retire Treasury Bills simply because the E.E.A. has sterling to invest in the Exchequer and that process may be reversed within the next month or so, there is no element of permanency in that?——No, but if the definition of funding is turned into the permanent reduction of the floating debt, then the definition strictly becomes a lot narrower. All reduction in the market floating debt that is done by the selling of small savings must be disqualified on that account because any holder of a certificate can apply for repayment, so to the extent of £6,000 million you regard the national debt as unfunded.

1045. *Chairman*: I do not think you can introduce the idea of perpetuity. This arose out of your original statement when you were asked what funding meant, and you said in the first place it consisted of reducing the volume of Treasury Bills outstanding. I thought a little more refinement was probably needed for the description of the operation than that, but, of course, you may not be able to give it?——I think it is not an irrelevant definition of funding if one has specially in mind the objective of monetary management.

1046. *Professor Cairncross*: You seem to be making funding the inverse of liquidity; but liquidity is not a matter exclusively of the Government's debt operations but the public debt. You will agree that it is possible for commercial operations to be carried on with a greater or lesser degree of indebtedness arising and a greater or lesser degree of liquidity on the part of the average business concern independently of the Government and of the monetary system. That might be a matter that causes you as much concern as an increase in general liquidity arising out of the increase in the floating debt. In other words, you cannot identify the conception of liquidity with the conception of funding although the two things are clearly very closely related. May I ask one last question on this point? I would like to know from you, Sir Edmund, either now or later, a little more about the operations of the National Debt Commissioners. We have been referred to the evidence of Mr. Norman Young to the Public Accounts Committee: there may be a number of questions arising from that evidence we would like to put to you, possibly on the basis of the paper you are putting in. Would your paper cover the ground in regard to that evidence?——*Sir Edmund Compton*: It was not intended that it should.—*Sir Roger Makins*: I think it probably arises on the finan-

cing of public investment but we would be prepared to deal with it on that paper, or at any time.

1047. *Chairman*: I am not quite sure how far our questions are going to go on it now. I am rather in favour of following it up now if we are on it.—*Professor Cairncross*: I do not propose to go very far. It seemed to me that you gave an account of the dealings between the Treasury and the Bank of England in which the National Debt Commissioners were not included; but clearly they manage a fund of about £5,000 million, which puts them in a very strong position, and they have independent access to the Bank of England which is, if I understood properly, also the Commissioners' agent. What we would like to know is how far the National Debt Commissioners receive guidance from the Treasury on the investment policy to be pursued?——*Sir Edmund Compton*: There is a constitutional point on that. The National Debt Commissioners, the active ones, are the Chancellor, the Governor and the Deputy Governor. Secondly, in that capacity—I cannot speak for the Governor and the Deputy Governor—but the Chancellor, I think, is a different person, as Mr. Norman Young said in his evidence to the P.A.C.,* from the Chancellor as the head of the Treasury. He has, after all, several roles. He is the Minister for the Treasury, he is a National Debt Commissioner, he is a Church Commissioner; he has a number of different functions and this is one of those different functions. The policy of the National Debt Commissioners really depends upon the nature of the funds that they have to invest. Leaving out the small ones you can really isolate this to the two big blocks of the Savings Bank Funds which amount to just over £2,500 million, and the National Insurance Funds which amount to £1,800 million. The nature of the Savings Bank Funds is that they are either stationary or slight net sellers of securities and that is because there is an outflow of deposits; the deposits are going down rather than up in the Savings Banks. That is cushioned as a matter of history, to a considerable extent by the way in which the big increases in Post Office and Trustee Savings Bank deposits were invested in wartime. They were invested with the Exchequer in terminable annuities and, therefore, you have a flow of repayments of principal and interest to the National Debt Commissioners which to a large extent look after the drain on deposits, but not entirely, as the Exchequer financing tables show. The National Insurance Funds, on the other hand, have so far shown a steady excess of income over repayments and benefits which under the Act has to be invested. There is a distinct difference in the attitude on the part of the National Debt Commissioners and the Comptroller General, whose job it is to run it, between the disposition of the Savings Bank Funds and the National Insurance Funds. The Savings Bank depositor is really not concerned at all with the way in which his money is invested. He gets 2½ per cent. on his money and he gets repayment when he wants it. If it is invested well or invested badly it makes no difference to him. On the other hand the National Insurance contributor has or can be conceived as having an interest in the way those funds are invested. The National Debt Commissioners, as holders of that money, must hold it in a form which enables them to keep an appropriate liquid balance to deal with repayments and benefits and the rest of it as those occur.

There is, I think, nothing in the law which requires the Savings Bank Funds to be managed in any particular way. The law only lays down what types of securities they shall be put in. The same is true about the National Insurance Funds. The 1946 Act simply says that the National Insurance Fund shall be invested by the National Debt Commissioners in accordance with any directions that may be given by the Treasury in the same list of securities as is laid down as being the securities for the Savings Bank Funds. Even that leaves the National Debt Commissioners a very wide discretion about what they put the money into. On the other hand, there is not much new money for them to invest at any one time.

The National Debt Office, as a matter of practice, have for years, for as long as I can remember, kept in close touch with us at the Treasury about the policy they should pursue in accordance with the needs of their funds. It has never, as a matter of history, been necessary, or even thought desirable, that we should give them a direction, which we can do under the 1946 Act, about the investment of the National Insurance Funds. That has never actually been done.

I think the answer to Professor Cairncross's question about policy is that they have a wide discretion and pay attention to the needs of, and their duties to, their depositors, and that in carrying that out the National Debt Office keep in close touch with the Treasury. So far there has not been any occasion, that I know of, of any feeling of cleavage between their duty as trustees, if you like to put it so, and the advice the Treasury would wish to give them on grounds of either investment policy or monetary policy.

1048. Discussions are frequent between the National Debt Office and the Treasury on the types of security that they might sell or buy, are they?——Yes, but the amount of buying and selling that they do is comparatively small and infrequent. That, of course, results from the fact that the amount of money they have to invest is comparatively small. I think the operational contact takes place more between the National Debt Office and the Bank of England because in practice the bulk of their investment consists of a revision by them of their portfolio. The suggestion may be perhaps that it is getting too short, and they might make it longer, because at times they might get a higher yield. If so, the Bank of England can suggest some exchange of securities as between the Issue Department and the National Debt Office which will give them the desired result, and probably provide the Bank of England with securities which are more suitable to them for their market operations. That is the more general type of operational discussion that takes place and the Treasury does not take part in that.

1049. Mr. Young, in his evidence to the P.A.C., spoke of the accumulation of a reservoir of securities financed by the Savings Bank money from which additional investments for the trust funds could be made available from time to time. This postulates that there are periods in which funds are not invested. Is this a frequent occurrence? Are these movements of funds large?——No, we deal with that in the Exchequer Management paper. When deposits exceed withdrawals, that generates a credit balance with the National Debt Commissioners which they lodge temporarily with the Exchequer in the form of Ways and Means Advances and to some extent in Treasury Bills; they have a 'float' of Treasury Bills to enable them to deal with immediate withdrawals. Subject to that working balance the amount that they have available for investment is invested pretty quickly. But, as I say, the general experience, at any rate in these last few years, of the Savings Bank Funds has been of financing withdrawals and not of investing a surplus.

1050. *Mr. Jones*: The Comptroller-General of the National Debt Commissioners is responsible, as I understand it, for the investment of that particular section of the departmental funds of the Government. You have told us that because the Post Office Savings Bank and Trustee Savings Banks are guaranteed it is possible for money to be used from those particular funds without regard to the standard of earnings that might be realised on the basis of investment, and you have drawn a line of demarcation between that sort of investment to assist the running of the nation, or to help the funding of the National Debt, side by side with the situation of the funds that are available for investment from National Insurance. Now, in view of the fact that the National Debt Commissioners seek to secure the highest possible revenue in earnings for the Insurance Funds, is there at any time a situation whereby some part of the debt is being funded and where Post Office Savings and Trustee Savings are invested in that particular funding, for those investments to be held and sold later, probably at less than par, to the Insurance Fund Commissioners?——There have been occasions for switches between the Savings Bank Funds and the National Insurance Funds, but purely, I think, where the National Insurance Funds have had a surplus that they needed to invest, and the Post Office Savings Bank Fund, on the other hand, have had to realise something because of the withdrawal of deposits, so that it was clearly convenient that there should be a transaction between the two funds.

* See footnote to Qn. 674.

1051. Would it be possible, and does it happen, for the Post Office Savings Bank Fund to buy funded bonds at par and sell below par to the other departmental funds of the Treasury or of the State?——All transactions take place at market prices, so that you could have a situation in which the Post Office Savings Bank Fund had acquired stock at par, and then at a later stage had to realise that, because they had depositors to repay, and sold it at something less than par; that would be quite possible.

1052. In this process of funding are the Treasury at any time in a position to bring pressure to bear upon the Comptroller-General of the National Debt Commissioners to take up the unsubscribed issue in a new funding?——On the Post Office Savings Bank Fund the question, as I say, does not arise because they are net sellers of securities and not buyers at all. By and large, deposits are being withdrawn, and therefore, by and large, the Post Office Savings Bank Fund is not available to buy securities at all. They cannot subscribe to a security unless they have got the money to subscribe to it.

1053. Are all the Savings Bank deposits and the Trustees Savings Bank deposits available for some purpose or other for the nation? Is not that purpose substantially to take up these bonds as they become available in the market and as the issues are made?——They can only take up new issues if there is an increase in Post Office and Savings Bank deposits but, unfortunately, the Savings Bank deposits on the whole are going down, not up, and, therefore, the Savings Bank Funds have not got the money with which to subscribe to new issues.

1054. *Chairman*: I think we got the impression from the Bank of England that when new issues of Government stock were made there were what you might call departmental underwriters. I got the same impression from reading the Comptroller General's evidence to the P.A.C. There are funds available, which are used to take a piece of the issue and then later on, if I understand it, as there is money available in other funds they are passed on out of the reservoir. I think that is what Mr. Jones is on now, and that takes place, does it not?——It does take place, but I think Mr. Jones was referring to the Savings Bank, and I was saying that that particular department is not a subscriber because it has not got the money with which to subscribe.

1055. *Mr. Jones*: You say that Savings Bank deposits are going down. Would that not pre-suppose that savers are looking for the best market for their savings, and that there is a substantially better market for savings than the Post Office or National Savings in the present trend of events? Would that not substantially affect any effort that was made at any time, in this situation and in this climate, to fund some part of the very high floating debt?——Yes. I do not want to give the impression that there is a continual run on the Post Office and Trustee Savings Banks. The point I was making was that you do not get a substantial increase in deposits so that their circumstances would enable them to have funds available to invest. It is quite true, as things are at present, that Savings Bank deposits at 2½ per cent. are not attractive as a form of longer-term saving. On the other hand, they perform in the small savings field the very useful function of providing for the short-term saver and, really, for a certain amount of poor man's current banking. A large amount of the deposits we have there are of that kind; and, after all, they do amount to nearly £2,000 million.

1056. *Sir John Woods*: Would I be right in taking that as meaning that the Post Office Savings Bank is largely an institution where people put their savings for specific spending purposes not too far ahead rather than for a longer-term savings purpose?——Yes.

1057. *Mr. Jones*: Would there not be substantial sums in National Savings and in the Post Office that had been deposited there or invested there against the period of retirement? Might you not, therefore, have Savings Bank deposits and National Savings that went on for one or more decades, so that all your Savings Bank deposits are not accumulated on the basis of short-period savings?——There are probably some Post Office and Trustee Savings Bank deposits which have been there a long time, but, by and large, I would agree with Sir John Woods in saying that the money in the Savings Bank accounts was of a shorter term nature and that in the small savings field longer-term savings are probably in the other securites, particularly in the National Savings Certificates.

1058. But the smaller saver does not know very much about saying other than in the Post Office and in the Trustee Savings Banks and in National Savings Certificates?——Yes. I am only saying that if there is a division between longer-term and shorter-term saving in the small savings field I think the longer-term is in National Savings Certificates, and the shorter-term savings in the Post Office Savings Bank.

(*Adjourned until* 2.00 *p.m.*)

SIR ROGER MAKINS, SIR EDMUND COMPTON and SIR ROBERT HALL, further examined.

1059. *Chairman*: I am assuming that we have now finished points arising out of paragraph 2. I will go on to paragraph 3. Are there any questions?—*Lord Harcourt*: One small point: you say the law provides that all Government receipts must be paid into the Exchequer. Is that a specific law? Was there an Act which laid it all down, or has it just grown up, so to speak?——*Sir Edmund Compton*: It was the Exchequer and Audit Departments Act, 1866.

1060. *Chairman*: Paragraph 4? Paragraph 5?——May I just correct a statement of fact in paragraph 5, sub-paragraph (iv)? That description is not quite right: "issues of a capital nature which Parliament has authorised to be paid from the Exchequer out of monies borrowed for the purpose." That is so, when there is no surplus revenue from which to meet them. The strict definition is that they are issues for which Parliament has given us power to borrow. But we do not always exercise the power. For example, in a year like the present, all but £125 millions of our overall expenditure is covered by revenue above the line: in other words, we expect to meet the bulk of our below the line commitments out of revenue.

1061. Just give me a typical example of "Interest on the National Debt met from interest received from loans made by the Government," in paragraph 5 (ii). What kind of operation is that?——Those are the loans that have been made by the Government to the local authorities and to the nationalised industries that are financed from the Exchequer. Those are interest-bearing loans. Therefore we would have a large and growing receipt of interest from them. That is applied to the service of the National Debt before we use money from the Exchequer above the line for debt service. If you look at the Financial Statement, you see above the line the debt charge and below the line interest outside the debt charge. The amount of interest that we get from these public boards and local authorities is shown separately in our accounts in that way.

1062. *Sir John Woods*: It is therefore in effect a deduction from that part of the Consolidated Fund services which relates to the National Debt service?——Yes. For example, the current Financial Statement gives an estimate of interest on debt above the line of £640 millions. It shows as an item below the line interest outside the Budget of £175 millions. The total cost of servicing the debt is those two combined.

1063. *Chairman*: Paragraph 6? 7? 8? 9? You use throughout the following paragraph the words "invested in the Exchequer". There is no particular meaning in that?——In fact it is a loan to the Exchequer. It may be interest-free if it is departmental, or it may be interest-bearing if it is from outside.

1064. *Sir John Woods*: What form would a loan of this kind take?——It depends; it may be lent on Ways and Means Advance, in which case it is 24-hour money; or the Treasury may issue a Bill, in which case the Bill is repayable in three months. For example, the capital of the Exchange Equalisation Account is partly sterling,

and the sterling of the Exchange Equalisation Account is invested with the Exchequer. The Exchequer issues to the Exchange Account Treasury Bills and not Ways and Means Advances because of the amount. It is purely a matter of inter-accounting convenience.

1065. *Sir John Woods*: And if the Exchange Account cannot meet cash it sells Bills?——In effect. One of the details of management of the Exchange Account is to arrange their portfolio of Bills in such a way that Bills are maturing every day; they just let Bills run off.

1066. Every day?——Yes.

1067. *Chairman*: On paragraph 10, at some stage I should like to know your view as to whether the by-product of the operation of the Exchange Equalisation Account, its internal effect on the money market, is something which you think is desirable as a tie-up or not. Is it a necessary consequence and, if not necessary, is it a desirable one?——It is a difficult question to answer off-hand. I would say that in principle, when the Exchange Account is buying gold and dollars, that is an inflationary tendency. It has its counterpart, in Exchequer management, in the withdrawal of capital from the Exchequer, and consequently the need by the Exchequer to borrow in the market to replace that money.

1068. The general effect is that it supplies of money in the money market become larger because of the fact that the Exchequer is acquiring gold and reserves against sterling?——When we acquire gold and reserves against sterling, the effect on the management of the Exchequer is that the Exchequer then has to borrow so much more in the market. Generally that is the way it works, and it does look as though, in our management of the money market, that is the counterpart of the economic effect of an increase in the gold and dollar reserves, which broadly would be inflationary.

1069. May I ask you exactly what you mean by inflation in that connection?——*Sir Edmund Compton*: I mean, subject to correction by Sir Robert Hall, that when we are buying gold and dollars incomes are being earned without goods and services for them to be spent on.—*Sir Robert Hall*: Yes. I think this will become rather easier to deal with when we get on to the question of what determines the total supply of money. In the old days, under a pure gold standard, if gold came in it increased the supply of money, and if gold went out it decreased the supply of money. Now there is a similar effect with regard to Treasury Bills, but whether changes in the volume of Treasury Bills have the direct effect on the stock of money which changes in the supply of gold had in the old days is one of the questions which I imagine you will be asking. In my view it is not as simple as it used to be. Sir Edmund meant that it tended to decrease or increase the liquidity of the system.

1070. *Lord Harcourt*: I would like you to explain to me whether a drawing from the International Monetary Fund is inflationary or not inflationary. It is a question which I have heard people discussing at times, and I was never able to understand it. I wonder if you could give us an explanation?——*Sir Edmund Compton*: I think the answer is that the drawing is probably neutral. —*Lord Harcourt*: I think that is the textbook answer, yes.—*Sir Edmund Compton*: But when there is a drawing from the International Monetary Fund it is in fact drawn in order to replenish gold and dollar reserves which have been spent. So the real question is whether the spending is inflationary or the reverse, not the drawing from the International Monetary Fund. I think one has to go back to the previous transaction.

1071. *Mr. Jones*: Can you borrow whatever currencies you require in terms of foreign exchange from the International Monetary Fund, in addition to securing gold, if that is necessary?——*Sir Robert Hall*: I think you can take them out in other currencies, but in fact we have always taken them out in gold or dollars.

1072. *Lord Harcourt*: You can buy (it is a question of buying from the International Monetary Fund) any currency you like.—*Professor Cairncross*: Provided you can pay for it.—*Lord Harcourt*: You pay in your own currency. This is the bit which I never understand, that I was asking Sir Edmund about. What happens at the moment is that the International Monetary Fund holds a non-interest-bearing note from Her Majesty's Government. When the United Kingdom wants to borrow, so-called, from the International Monetary Fund it has in fact to redeem the non-interest-bearing note and buy either foreign currency or gold with an interest-bearing security of some kind, which is then credited to the International Monetary Fund?——*Sir Robert Hall*: I think the answer is that it ought to be inflationary, because you have substituted a distant liability for a current asset, and you are selling the current asset for sterling: it depends on what happens as regards internal monetary management whether you offset it or not.—*Sir Edmund Compton*: The actual transaction that takes place when we draw on the International Monetary Fund is in the first instance a purchase of dollars by the Exchange Equalisation Account. When the Exchange Account buys the dollars, it pays the equivalent sterling into the account of the I.M.F. with the Bank of England in London. But then the I.M.F. completes the circle by lending that sterling back to the Exchequer on the security of non-interest-bearing notes. In fact the actual borrowing from the I.M.F. is, curiously enough, a borrowing of sterling. We buy the dollars from that store, and we borrow the sterling with which to buy the dollars. The dollars which we buy are then lent to the Exchange Account to take the place of the dollars which we lost when we sold gold or dollars. So the point at which the transaction affected the public and the money supply was the previous point, at which gold and dollars had been sold to make a transaction, by which the country acquired imports out of our exchange reserves.

1073. *Professor Sayers*: Both this case and the ordinary case of the movement of gold into or out of the Exchange Account work as they do in relation to the internal system because the Exchange Account holds its sterling in the form of Treasury Bills. As Sir Robert pointed out, that is different from the old system under which the Exchange Account of the time held its sterling differently. Has the Treasury ever considered different ways of doing this—ways different from that of holding the Exchange Account sterling in Treasury Bills, having regard to the effects on the internal monetary system? Or is this another case of our having switched systems without ever considering one in comparison with the other at any time subsequently?——This system dates from 1939. The old system dates from the complete transfer of the gold from the Bank of England to the Exchange Account in April, 1939: and I think I am right in saying that since then we have used this system and none other.

1074. But have you thought about it?——Speaking for myself, no; not in terms of substituting another.

1075. It is different from the old system and therefore ties up with the internal monetary arrangements in a rather different way. I am not suggesting that it is either better or worse, but it is different: and it is not the only possible way. I wondered if the Treasury had ever given thought to this system in comparison with possible alternatives?——*Sir Robert Hall*: My impression is the same as Sir Edmund's: that we have not thought about it in those terms. We tend to think about a gain or loss of the reserves as part of the complex of the economic system, and deal with it, as will be indicated in our next paper, by a complex system of measures.

1076. *Chairman*: That is paragraph 10 (i). Is there anything more on (i)? Then there is (ii).—*Sir John Woods*: May I ask for clarification? You say that the counterpart of the American Aid is, after an interval, credited to Defence Votes. That has not always been done, has it? After all, there are these funds like the Revolving Fund for Industry, with which I am connected, where I understand the capital with which we are supposed to be operating, £700,000, is from counterpart funds?——*Sir Edmund Compton*: That statement is not 100 per cent. true, because there have been in the past certain deductions, for example, from these funds for the Americans' expenses in running Mutual Aid. Then there was another deduction, as Sir John says, for this revolving productivity account. But those are very small amounts compared with the total, as the financing tables show. The total applied in aid of defence votes runs: in 1953, £85 million; in 1953-54, £125 million; 1954-55,

£62 million; and then it has been tailing off since. It has been figures of that magnitude, as compared with the £700,000 which Sir John Woods mentioned as having been deducted.

1077. It is a close approximation of the truth?——Yes. I am afraid it is not 100 per cent. right.

1078. *Lord Harcourt*: It would be 100 per cent. right if it was American *defence* aid. Is not the difference between defence aid and economic aid? Because we are now only in receipt of defence aid.——*Sir Edmund Compton*: That has been so for some time.—*Sir Robert Hall*: And there is not any counterpart in defence aid: I do not think there is.—*Sir Edmund Compton*: In so far as there is no counterpart, the paragraph does not operate. Counterpart has a long history of argument with the Americans. Our view all along was that we should use the counterpart in cancellation of debt; and that in effect, at the end of the day, is what happens when it is credited to defence votes: but for their own presentation purposes they prefer us to pay it to our defence votes. The reason for the interval which is mentioned in this paragraph is that the actual drawing for credit to defence votes has always meant reference back to the United States and general approval by them, which was apt to take some time.

1079. *Chairman*: Thank you. Now we come to paragraph 11.——*Mr. Jones*: I am not sure that I understand the mechanism of the fiduciary note issue. If there is an increase of the fiduciary note issue, would not that have a substantial effect upon inflation? Would not the fact that you were increasing the fiduciary issue mean that you had not sufficient money and that the new money that you were issuing was not covered, and that it would therefore be inflationary?——I think that would be so if the increases in the fiduciary issue were sufficiently large in relation to the total amount of money supply. But I think the view we usually take of the fiduciary issue is that the size really depends on the liquidity preference of the individual holder of money, for instance, whether he wants to hold his money in the form of a bank deposit or in the form of a note; and the amount of the currency in circulation really depends on the demands made on the Issue Department by the bankers who, in their turn, depend upon the demands at their counters from their customers.

1080. When a note issue is made by the Issue Department, we are told in paragraph 11 that it is invested with the Exchequer. What does the Exchequer give to the Issue Department in exchange for that money?——A Treasury Bill.

1081. And that would be the anchor of the value for the Bank?——Yes; in fact the Bank Return shows the Issue Department separately, on the left-hand side the notes in circulation, and on the other side their Government securities; and so far as there is an increase in the notes in circulation there will be an increase in their holding of Government securities, which is Treasury Bills in the first instance.

1082. In what circumstances would an increase of the fiduciary note issue be required? Would the Exchequer be going through some period of difficulty and strain that could not be met by the ordinary currency available?——No. In our experience, the fiduciary note issue really fluctuates according to the demands made on the banks by the public. For example, we are accustomed to having a seasonal increase at Christmastime and then a reflux of notes after Christmas, and again at other times, with a reflux after that, according to the tendency of the public to use more notes in holiday periods.

1083. *Chairman*: But those are variations within the cycle of a year. There is another variation, which is a constant increase, year by year?——That is so, and that appears, so far as one can judge, to march pretty closely in step with the national income. If one takes a graph of the national income over the five-year period and then takes a line of the increase in the fiduciary note issue over the period, there seems to be some rough correspondence between the two.

1084. *Sir John Woods*: I think we were told by the Bank of England that the attitude of the Bank towards a fiduciary note issue was entirely passive. I took that to mean, as I think you have indicated, that these increases year by year in the fiduciary note issue really reflect a continuing increase in the appetite of the public for currency. Is that right?——Yes, in this sense: that I think the total amount of purchasing power in the hands of the public obviously has gone up over the period, and that therefore if their preference for notes within their total purchasing power has been the same over the period, naturally the total amount of notes must go up in proportion. I do not think that the increase in the note issue is a measure, or anything like a measure, of the increase of purchasing power.

1085. All I meant was that there is no attempt at all on the part of the authorities to use the fiduciary note issue as a means of regulating the amount of purchasing power in the hands of the public?——Certainly not. I think our view would be that the deed is done when purchasing power in the hands of the public has been increased. If, after that, the public want a certain proportion of it in notes they must be provided with them.

1086. *Mr. Jones*: Would you say that the note issue is important or not important, good or bad, in relation to inflation? Does the amount of notes you have in circulation matter at all? From what you are saying it would appear that it does not matter?——I think it would matter if, for example, one suddenly saw a spectacular rise in the note issue: that would be significant. If, for example, there was a sudden increase in the demand for notes, and therefore an increase of the fiduciary issue by several million out of season in a week, that would mean that for some reason the public wanted to hold large quantities of money in liquid form, perhaps for spending, and that would be a serious matter.

1087. *Chairman*: In the event of such a significant rise, there is nothing in the system that would correct that or prevent it happening, as I understand it?——I do not think there is, no.

1088. You may well say that something would have to be done, but at the moment there is nothing that would prevent it?——There is nothing which would prevent it in the system. Whatever else it is a question of, the danger in such a situation would not be met by a limitation on the amount of notes provided, because that would simply in effect put the banker in the position of being unable to honour a cheque put over his counter.

1089. *Professor Sayers*: That is reasonable, but I wonder if I am right in thinking that this view that the fiduciary issue is a passive element in the situation, coming into play very late in the process, has been held by the authorities for more than three years?——*Sir Robert Hall*: I think so. I should be very much surprised if it had not been held for more than the past three years.

1090. I should be very much surprised if your answer had been any different; but given that, why did the Currency and Banknotes Act of 1954 take the form it did by which there is a maximum issue, subject to the power of increase by Treasury minute on application by the Bank, subject to Parliamentary negative resolution, I think, after two years; something like that. I wonder why that procedure should operate, if that is a purely passive element in this situation?——*Sir Edmund Compton*: I would have thought perhaps one might answer that by saying that the Currency and Banknotes Act of 1954 really ratified the view that the function of the Issue Department was passive, for this reason: that before that the limit on the note issue was fixed by Act of Parliament, and the increase over that limit was, I think I am right in saying, only made as a wartime measure by Defence Regulation and when we were still depending on Defence Regulations for a considerable period after the war. The Act of 1954 laid down as the starting point the actual fiduciary note issue where it stood at the time, and then provided that that could be increased by order of the Treasury subject, as Professor Sayers says, to negative resolution of Parliament.

1091. *Professor Cairncross*: The ritual has not changed in ten years: all you have done in the Act is to enshrine

the ritual?——*Professor Sayers*: The ritual of the new Act is the ritual that had been followed for many years and was in fact first enacted (I forget the precise form) in 1928. Now I am asking why, when fresh legislation came in 1954, this system was re-enacted, which was based fundamentally on the idea that the note issue must be tied to the gold stock and that any departure from this was something exceptional that ought to be looked at by Parliament after two years and rather carefully by the Treasury in the meanwhile. That is all I am asking. Why have that system in the law, if both the Bank of England and the Treasury took this view of the position of the note issue in the system?——Professor Sayers is taking me back rather a long way to what prevailed before the 1954 Act. I wonder whether I might come back to this, if it is a point on which you would like further evidence. I would like to refresh my memory. I have a clear recollection, though I do not like to set myself up against Professor Sayers, that there was in fact an upper limit which required Parliamentary action in the regime before 1954, but that was removed by the 1954 Act.

1092. *Professor Sayers*: You mean that before 1954 a positive resolution was required and now is it a negative resolution?——I regret to say that the thing is confused, and this is why I am asking for leave to come back to it later.*

1093. *Chairman*: If you could, yes?——We had the Defence Regulation which in fact removed whatever ceiling existed before 1939 and which I think was abrogated by the 1954 Act. That is my difficulty. I cannot remember the Defence position.

1094. *Professor Sayers*: But that does not answer my question. Let me put it again. My question is not how you related present legislation to what happened before but why, when legislating on the subject, Parliament acted as though the fiduciary issue was something important in the system while in fact the Treasury and the Bank of England take this other view? That is my question: and no looking back beyond 1954 will answer that one. That is a question about 1954?——The fiduciary note issue is after all an obligation. It is simply an interest-free loan, repayable on demand. To that extent I think it was thought right that Parliament should continue to have an oversight over the total amount of that liability, which is in effect what the Act provides. The Treasury cannot borrow without Parliamentary authority; so also there has to be a Parliamentary authority for the total of the note issue. But they can fix a limit, and it has again a fairly salutary role in our legislation on borrowing, that there is an upper limit fixed to our powers of horrowing. It was, I think, considered, but there was no possibility of fixing the upper limit to the fiduciary note issue. If one thought of an upper limit, it would only be an indication of what the note issue might rise to at some period and the question would be asked, "What period?" and so the debate would go on. So the decision was taken to fix the total as it then stood, recognising that the note issue was pretty well hound to rise, but leaving Parliament with the right of intervention on the occasions when the rise took place: and I think that that, in effect, is what the 1954 Act did.

1095. *Chairman*: Is there anything on paragraphs 12 or 13?—*Professor Sayers*: May we hear why the issue of Treasury Deposit Receipts was discontinued and has not been revived?——I think that could be expanded when we come to the Debt Management paper, but the short answer I would give is that it was a wartime system and really was continued to deal with the abnormal level of floating debt that was inherited from the war, and that by 1952 we had reached the stage at which the floating debt requirements of the Treasury over the year corresponded to the liquidity required in the banking system. I think for more than a year before that it had been the practice to hold the borrowing by Treasury Deposit Receipts on a pretty even keel and allow the fluctuations over the year up and down to be taken by the issue of Treasury Bills. At the same time there was by this time a return to something like the conventional liquidity ratios in the banking system and so, I think, it seemed appropriate to regard the Treasury Deposit Receipt as having fulfilled its usefulness and to leave the floating debt requirements to be met by the issue of Treasury Bills.

1096. The Chief Cashier in his evidence stressed the embarrassment of the authorities resulting from the great size of the floating debt now. If the authorities are embarrassed by the size of the floating debt, is not this an instrument that ought to be looked at? Has it been looked at?——We do not remain blind to this and, indeed, to any other form of borrowing that assists our debt management and our monetary policy.

1097. *Chairman*: I think that, since we probably have to investigate it as a possible instrument in time of difficulty, the question is: has the Treasury recently reviewed its possibility in the pros and cons? It would help us to know if they had?——They have, and decided against it. The Chancellor has said as much; certainly Treasury Ministers were asked the question more than once recently in Parliament, whether we should re-introduce Treasury Deposit Receipts, and they said no.

1098. *Sir John Woods*: I do not want to anticipate the question on Treasury Deposit Receipts, but could you answer this shortly? Is one of the reasons against Treasury Deposit Receipts that they are not marketable as securities, and that, therefore, if you have a large volume of those, a certain amount of material with which you could manœuvre is taken away from you?——*Sir Edmund Compton*: I do not think that is the reason against them. —*Professor Sayers*: That is the reason for having them. —*Sir John Woods*: I see that. I was wondering whether the Treasury would produce opposite reasons.

1099. *Professor Sayers*: I was hoping that the Treasury paper would tell us what the pros and cons put to the Chancellor were on that occasion; that is to say, would have given us the Treasury's views of the advantages and disadvantages of this instrument. It is one that has been put forward in various quarters and we ought to discuss it in making our recommendations. It would help us to know what the Treasury thought about it?——*Sir Roger Makins*: Yes, we will certainly produce some information on that.

1100. *Chairman*: The Treasury Deposit Receipt as used during the war was not a compulsory system?——*Sir Edmund Compton*: No, the banks agreed to it as a wartime measure. It has been described as a form of forcible feeding. The Treasury, for accepted war-time purposes, was being financed by borrowing on a large scale. The banks had no way of employing the money which was therefore injected into the banking system. It would have inflated the total amount of Treasury Bills to an amount which would have been quite unmanageable in terms of the market, and so a short cut was taken of lending it on this short-term but unmarketable security. That was, in its turn, associated in war-time and after the war with a suspension of other conventions including the liquidity ratio. I think I am right in saying that, when Treasury Deposit Receipts were at their maximum, treating Treasury Deposit Receipts as a non-liquid form of hanking asset, the banks' liquidity ratio was down to something like 24 per cent.—*Professor Sayers*: Of course, the short cut, as you rightly call it, had a special attraction in 1940 when the authorities had to envisage the possibility of the London money market being physically shut down.

1101. *Chairman*: Paragraph 13? Paragraph 14?——*Professor Sayers*: In paragraph 14 the wording is as though an issue of stock were something done at a particular moment of time. In form that is so, but the Chief Cashier explained to us very carefully that issues are almost continuous processes, as in fact are the maturities also. The Government redeems the debt continually, and it continually issues stock. I wonder if you could tell us something of the reasons for which sometimes you say that there shall be a moment and you go through the form of making an issue?——The timing of issues of that kind is, of course, an important aspect of debt management. I think that there are two occasions when an actual issue of stock is likely to be appropriate. The first is in connection with a maturity that has to be dealt with. It is quite true that that maturity to a considerable extent may, in fact, be dealt with by the continuous process that Professor Sayers has referred to,

* See Memoranda of Evidence Part II No. 5 and Qns. 2337 to 2352.

of the Departments selling stock in exchange for the maturity which they are buying up; but none the less there is an expectation on the part of the public who are holding these stocks to have an offer for a stock which is nearing maturity. It may be that if the offer is the right offer there will be a proportion of direct conversion taking place as well as what you might call the market system of conversion. That would be one occasion. The second reason why an issue of stock would be appropriate would be simply because market conditions were favourable at that particular time, and there was a need in the market for a stock which, as it happened, the authorities could not provide by selling out of the existing portfolio. As an example one might produce the issue of a further tranche of 3½ per cent. Treasury Stock 1979-81. That issue was, in fact, made as an addition to the existing supplies of that stock in the hands of the Bank of England. The view was taken that it was the appropriate time to do it, in order to put the investing public on notice that supplies of this stock were available. That is, I think, the sophisticated view, if I might put it that way, of the reasons governing the timing of these issues. If it were not for that, given the fact that the stocks available for sale by the authorities are not known, the public would really be in the dark, without a lead from the authorities about what was available and what was expected of them as investors.

1102. Does it or does it not matter whether the public knows how much the authorities have available of a particular stock? I am thinking that it should be within the competence of the authorities to write out pieces of paper in the correct form for any amount demanded by the public without going through the process of a formal issue. Or is there some ulterior purpose in making a formal issue?——The total amount of any description of Government stock must be created and announced.

1103. Is that a matter of law?——It is certainly a matter of law that it has to be created, and it is certainly a matter of convenience to the investors that the total on issue of any description of Government stock should be announced.

1104. *Chairman*: If the system is that an unascertained amount of stock is retained for a longer or shorter time in the Issue Department or elsewhere, I do not quite understand the importance to the public of knowing the theoretical volume of the issue. In financing private companies or public companies, not the Government, it is a different matter because there are certain rights that a certain number of people may have to share together, but that is not in issue in regard to Government stock?——I think we have regarded it as being of importance both to Parliament and to the investor that the total amount of each description of Government stock should be known.

1105. *Professor Sayers*: Although you do not regard it as a matter of importance that the amount outside the authorities' own holdings should be known? And you do not, in fact, inform the investing public of the amount held by the investing public?——No, there is not published a distinction between that proportion of any given stock that is held in departmental hands as opposed to the proportion that is held outside.

1106. What is the importance attached to announcing the amount of the total formal issue, although that is generally something quite different from the amount that is held by the investing public?——The total on issue is the total for which the Exchequer is liable *vis-à-vis* Parliament for interest and repayment. That is a piece of information that is made annually available to Parliament, and, if there are transactions in the debt affecting that, they are covered in the Budget Speech.

1107. That is a matter of law?——I would not say that it is mainly a matter of law. I think that it is a matter of Parliamentary propriety. The authority of Parliament for the Exchequer to borrow is one thing. The total that we may borrow is laid down by Parliament but within that total the Treasury has, in fact, authority under the National Loans Act to issue such securities of such descriptions as we may think fit; so that the descriptions of stock are under the Treasury's control with the authority of Parliament.

1108. Yes, I see the point of having Parliamentary authority for the total amount borrowed, but that is something you do not publish at all. Again there is point in Parliamentary authority for the total power to borrow, but how the power to borrow is spread between different stocks seems to me a matter of quite secondary interest as compared with the amount held by the public?——Yes, I think we have regarded it as being our obvious duty to announce an addition to any description of debt when we make that addition.

1109. And yet you do not consider it your duty, as I understand it, ever to announce to the public the amount of the Government's debt?——I think that question really relates to the question whether the portfolio of the Issue Department should be published or not.

1110. *Professor Cairncross*: Once you have announced how much you propose to issue in one lot, do you invariably issue that amount in full? If you are left in the Issue Department with some stock unsold do you wait until that is disposed of before you make a further issue, perhaps on different terms?——*Sir Edmund Compton*: No. From the point of view of the Exchequer the total amount has been issued because the Issue Department is one of the investors who subscribed.—*Chairman*: That is, of course, strictly true from the point of view of the Exchequer. It is perhaps a rather limited approach to the general public interest.

1111. *Professor Cairncross*: Perhaps I might put the question in a different way. Would you consider redeeming part of an issue which you thought had been a flop, in order to release resources for the Issue Department prior to the making of another issue on different terms?——I find it very hard to see that as a debt operation.

1112. I would have thought this was inevitable. You are faced with a large issue and it has been a flop; the Issue Department gets stuck with large amounts of the issue. Then you have to decide if the Issue Department's resources are to be locked up in that form, or whether you free the resources of the Issue Department in order to support a quite different issue to take its place which the public might be disposed to buy?——The Issue Department's resources, after all, amount to £2,000 million.

1113. The National Debt amounts to £20,000 million, but has that any bearing on this?——In the years that are covered by these tables the year of the biggest single amount issued was in 1951 when we issued something of the order of £1,000 million Serial Funding Stock in exchange for Treasury Bills. That has been easily the biggest single operation that has taken place in the period. Apart from that I would not think that in any one year we have made an issue of Government stock of more in total than about £400 million, or a bit more than that. Even assuming, on your theory, that the Issue Department had to take up the whole of that, they would never have run down their resources in terms of their reserve held in Treasury Bills to the point at which they had nothing left in the till to buy these issues.

1114. *Professor Sayers*: This is postulating—and this is rather interesting—that the Issue Department has liquid resources on a gigantic scale in the form, presumably, of Treasury Bills, and that it is content that these resources should take that form. Is that not rather apposite?——The bulk of the assets of the Issue Department are, in fact, held in Treasury Bills.

1115. You are assuming, therefore, that it is a matter of no significance whether some of these Treasury Bills are disposed of or not?——*Sir Edmund Compton*: But when the Issue Department takes up some Government stock what, in fact, it does is to exchange a holding of Treasury Bills for a holding of Government stock.—*Professor Cairncross*: It may be rather important from the point of view of monetary policy whether it does dispose of the Treasury Bills or not.—*Professor Sayers*: An amount of £200 million may look very small in relation to the total National Debt and quite small in relation to the total reserves of the Issue Department, but it may he quite big from the point of view of the amount of Treasury Bills that are getting into the market. That is the point.

1116. *Chairman*: You said that the normal operation is that the Issue Department exchanges the Treasury Bills it holds for an issue of stock? Are the Treasury Bills

handed back and wiped out?——Yes. The market is not involved in that transaction at all. The bulk of the securities in the Issue Department consist not of market Bills, but of these tap Bills.

1117. *Professor Cairncross*: If the Issue Department is already loaded up with securities, either bills or bonds, and then you want £200 million in order to absorb £200 million of stock, it does affect your operations? You have to raise an equivalent sum elsewhere, unless you are presuming that the issue will be a flop and have made your dispositions accordingly?——The Issue Department subscribes £200 million to a Government stock issue. To obtain that money they run down their Treasury Bills by £200 million. But when they subscribe to that stock, they pay the Exchequer for it; therefore the transaction is completely sealed. At the end of the day the Exchequer, instead of owing the Issue Department £200 million in Treasury Bills, owes the Issue Department £200 millions in the new stock.

1118. *Professor Sayers*: You are saying, in effect, that within a matter of £200 or £300 million the total amount of an issue as announced to the public is a matter of indifference?——At the moment I was dealing with the point that it is not necessary for the Exchequer to raise £200 million by the sale of Treasury Bills in the market in order to finance the acquisition of that amount of stock by the Issue Department, because it is a simple exchange of securities on the part of the Department.

1119. *Professor Cairncross*: I do not really see how you can borrow the same money twice. If you have already borrowed £200 million from the Issue Department, in effect by your issue of notes, you have had your money. You cannot have it over again. Therefore, if you take it over again in the form of a subscription to a new issue, you are really £200 million short on your accounts somehow. This is how it looks to me, but I am quite prepared to read through your evidence later and see if I can find some other interpretation.—*Lord Harcourt*: Surely we have come back to the question of whether the Treasury has conducted a normal operation? It has done a quite conventional operation?——It has done a conventional operation with the object of raising money. A subscription is one way of putting before the public a scheme which is initially expected to raise £200 million from the public. If you fail to raise that £200 million, it is a flop, and the fact that you can make the operation look all right on the books by wiping out £200 million of Treasury Bills means that you are then £200 million short of Treasury Bills. You are transferring the difference from one point to another.

1120. *Professor Sayers*: This is not connected with the business of not announcing the total amount of the issue.—*Chairman*: I think Professor Cairncross has gone to a little wider aspect of it. Assuming that you can describe the thing as an exchange of a short term liability for a longer, he then points out that it does not raise money for the Exchequer itself; you would accept that?——Yes, Sir.

1121. Then we come back to the point which I think Professor Sayers wants to come back to now?——I would like to confirm that by saying, as this paper says at the beginning, that the Exchequer is always in balance. There is not a situation in which the Exchequer is short of £200 million and raises it by the issue of a loan. The Exchequer is in balance at the beginning and end of every day and on the day on which we issue £200 million of any stock we are not short of that amount of money. In so far as it is not taken up by the public and is taken up by the Issue Department, what we are doing is substituting that stock for Treasury Bills held by the Issue Department.

1122. *Professor Cairncross*: In this sense what you say is entirely intelligible: having failed to fund in one sense you have funded in another unintentionally?——But, in terms of the public, funding, the sale of stock to the public, takes place at the second instance, namely when the Issue Department sells in the market the stock that it has acquired from the Treasury.

1123. *Professor Sayers*: It seems a matter of absolute indifference what you write on pieces of paper in the Issue Department accounts because it is six of one and half a dozen of the other, but the stage of selling stock to the public does seem important, as it affects the general liquidity position of the public. But that is a stage about which no announcement whatever is made. You make these announcements from time to time of amounts that you have explained to us are of no importance whatever, but you say nothing about the amounts that are sold to the public. Now how can you explain that?——The first is announced for the reasons, I agree mainly Parliamentary, that I have given; but I think they have their market importance, namely, to put on record the total amount of the public debt in the various descriptions.

1124. But the composition of the debt is something you can alter at any time?——In so far as we alter the composition of the debt, we announce that. It is regarded as being of importance, not only to Parliament, but also to the public and to the investors, to know what the total amounts on issue are of the different descriptions of debt.

1125. They have got used to hearing that, I expect, and go on hearing it?——After all the total amount of the public debt is still considerably larger than the amount that is held in departmental hands. These amounts that are held in departmental hands and that are not immediately disclosed really relate to the comparatively new issues, the recent additions to the total of the debt.

1126. That is an interesting fact that we have not previously heard from anybody, and I do not think it is in published literature anywhere. It seems to me to underline the importance of our learning more about what is in the public hands and what is not?——I meant that the process, which has been described, of the issue of stock means that, in so far as it is not taken up by the public, it is taken up by the Issue Department and subsequently sold to the public as opportunity offers. That necessarily relates to new issues of stock.

1127. *Professor Sayers*: But if opportunity does not offer does the Issue Department get stuck with different stocks?—*Chairman*: What we do not know yet is whether there is undigested matter which remains over a period of years?——The figures we have provided for you, Mr. Chairman, are, of course, the figures of the transactions in terms of money, the current account, as it were, not the capital account; and you see from that the extent to which actual sales have taken place. The figure that you are missing is the capital account, namely the actual portfolio.

1128. I do not think we have any figures which would show us what kind of surpluses moved in and out, we only see the bulk result?——Yes.

1129. Obviously there are very large operations involved. I quite understand the view that the market is not capable of absorbing an issue of the size announced, but I think we have no picture yet over an average defined period of months to know what would be absorbed through departmental sales, or whether there are, as I say, bits which never get out?——I wonder whether we can consider how far that further detail can be brought out for you in the debt management paper. It does also bear, as I said earlier, on the question of the publication of the actual holdings of the Issue Department.

1130. *Professor Cairncross*: I assume that you will also take account of the conversion issues, because we have been told these are large. Liabilities have been accepted for redemption in the next few years running to several hundred millions, and our discussion has now been rather in terms of net additions rather than gross?——Yes. In fact the whole question of new issues of Government stock is dominated by the problem of the maturities and what can be done, the extent to which these should be the subject of conversions, or should be dealt with by new issues and the repayment of the maturing securities.

1131. *Chairman*. Paragraph 15? Paragraph 16? Principles governing Exchequer management. Tell me if this is right: there are two general aims in it; one is to avoid market disturbance, the other to pay as little for outside accommodation as you can. It may be put as shortly as that?——I think so.

1132. *Professor Cairncross*: May I ask about a third proposition? Do you attach any importance to keeping

an active market in bonds? Many of your operations seem to be designed to offset surpluses and deficits within the operating machine. Naturally that will be more economical, but at the same time it tends to restrict the total market. Do you attach importance to maintaining as wide a market as possible?——It is important, but as far as my experience goes it has been quite possible to achieve it without what would involve the extra cost to the Exchequer of managing our balances extravagantly.

1133. You do not feel the market has now fallen very appreciably since the war in relation to other magnitudes?——I do not think so.

1134. *Chairman*: Are there any questions on paragraphs 16, 17, 18, 19, 20? I cannot get from this statement of principles, naturally enough, any idea of the magnitude of freedom of choice which is left after all these other conditions, which rather threaten to dominate the scene, have been given effect to. I do not know if there is any way of expressing that? I do not want to trouble you to try to answer now, but it is a sort of thing which leaves one rather with a question unanswered.—*Sir John Woods*: I think your point applies to paragraph 21 as well. The choice depends upon consideration of national monetary policy outside the scope of Exchequer management. From where are we going to get the considerations?——*Sir Roger Makins*: You will get them on other papers. This paper is expressly limited to Exchequer management: other papers are left to other occasions.

1135. *Chairman*: You realise how tempting to us it is. Is there anything more on paragraph 21 with its analysis?——*Sir Edmund Compton*: Perhaps I should say that the figures at the end of paragraph 21 are simply extracted from the Exchequer financing tables, and the point of that reservation is that we would prefer, if you do not mind, not to defend the total figures of net sales of securities on this paper, but to regard those as being, in fact, the actual result of the choices and so on that were available to us in those years, to show you the end result of the whole operation, namely the increase or decrease in market Treasury Bills.

1136. *Chairman*: We will put this paper away, and I will take the Exchequer Financing Tables*, and ask whether at this stage anyone has any questions which they want to raise on them by way of elucidation?—*Sir John Woods*: Is the reduction of market Treasury Bills by £1,325 million in 1951-52 the result of the big Serial Stock operation you were talking about?——Yes, that was the result of the Serial bond operation in November, 1951, broadly described as the exchange of £1,000 million of Treasury Bills for the Serial Stocks.

1137. *Mr. Jones*: Under item 4 of the table for 1956-57 we have a sum of £64 million which is "Reserves: Receipts". As I understand that entry, there has been a sale of gold, and the £64 million is the sterling that is returned into the Account in respect of the gold that is sold. Does that mean, looking from 1951-52 onwards that we have been selling gold at the amounts indicated in this statement and buying gold only to the extent of £321 million? Would those be the Exchequer operations in respect of the gold reserves?——If there are detailed questions on the external side of this, I would prefer that they should be addressed to Sir Leslie Rowan.

1138. *Chairman*: These are net figures?——They show the effect on the Exchequer of these exchange operations. It is true to say that they show the magnitude of our gold and dollar losses in 1951-52, the fact that we earned gold and dollars in 1952-53 and 1953-54 (the figures 161 and 160), and then in 1954-55 that we were in, or nearly in balance, but that in 1955-56 there was a net loss on gold and dollar reserves. In 1956-57 the figure needs some explanation. The figure for the receipts by the Exchequer as a result of the sale of gold and dollars is £64 million but we should also take in, further down that column, the £195 million figure, that is, the receipts from the I.M.F. drawing as was explained earlier this afternoon. That was a purchase of gold and dollars from the I.M.F. to replace gold and dollars which were sold from the reserves. Therefore the total fall in the reserves of gold and dollars in this year 1956-57 was really the addition of those two sums, the £64 million and the £195 million.

1139. *Sir John Woods*: But the £195 million was sterling repaid to us?——Yes.

1140. *Professor Cairncross*: May I ask about the treatment of the Post Office capital expenditure? You explain that it is treated on a different basis in item 7 from item 2. That means that in "Issues of Marketable Stocks" it becomes the counterpart of the capital expenditure of the Post Office, although presumably no issue of stock was made by the Post Office?——It is included in the item "Guaranteed Stocks, etc."

1141. There is nothing marketable associated with that?——No. I am afraid there was no other way statistically that we could discover of giving the Committee figures that would be comparable for the period. We had somehow to deal with the fact that both the Post Office and the public boards were on the Exchequer in the last year, and the public boards were not on the Exchequer in previous years.

1142. But the figures for the other guaranteed stocks shown under item 2 do represent real issues to the market?——The way these figures are done is that those are the total issues of stock by the nationalised industries for each of those years; then in so far as any of those stocks were taken up by the Issue Department that would be included in the increase in the holdings of the Issue Department in 7 (*d*) (iii) at the bottom of the table, so that by difference you would get the total amount that was issued to the public.

1143. *Chairman*: Then I think we might take the Financing of Public Investment† next. Are there any questions arising on the first two pages of the explanatory notes?——*Professor Cairncross*: I have a general question. It is not clear to me from the figures in the subsequent tables how capital consumption has been treated, nor indeed how much of the financial resources required by public corporations to meet their programme of capital expenditure has been forthcoming out of their own self-financing for the year. It would seem to me that there is a very large total of fixed capital involved here, which represents a big drain on the country's resources, and corresponds possibly to a big increase in the assets owned by the Government and managed by the public corporations. I think it is important to know what is the impact of the operations of these public corporations on the capital market. As put here it is very difficult to see. Most of them appear to do their accounting on an historic cost basis. They may be living on their capital, and charging prices which are not related to the true current costs, but which would lead to the emergence of a cash surplus which is relatively small. If that happens they are forced on to the capital market to raise their money for expansion, where a private corporation in the same position might seek to raise its money internally. This is not an issue which is treated in this paper, but it seems to me the issue in which we should be interested?——I think perhaps in cruder terms the issue is how much, if any, plough-back there is in these figures.

1144. *Chairman*: This paper does not show anything about their charging or costing policy, how much they would expect by their charges for their current services to cover their depreciation or obsolescence or future expenditure. The other issue is how much of the revenue accruing is available for that purpose.——*Professor Cairncross*: There is a third issue which is tied on to the second; that is, what is their surplus? They do their accounting one way; other people would do it a different way?——The only figure we offer you here is the figure which is the same as is given in the National Income Blue Book, of undistributed income before providing for depreciation and stock appreciation.

1145. The latest issue of the Blue Book begins to say a little about capital consumption; perhaps the next issue will say a little more?——I think we should try to provide for the Committee a further analysis of that column. It is a matter of some difficulty to do it over a number of past years, simply because it involves an analysis of accounts some distance back, but I think it can be done.

1146. I am asking not what provision appears in their accounts for depreciation, but if we could be told a little about the using up of resources from year to year; in other words, I am asking that any figures given for investment should be based if possible on a replacement

* Memoranda of Evidence Part II No. 1.

† Memoranda of Evidence Part II No. 3.

cost assessment, so that we can really see what is the rate of accumulation in the hands of the public corporations, and the extent to which that accumulation is financed out of their own resources or out of funds provided by the market?——That would be a statement of wider scope than the one that is here provided. I think in providing this paper we attempted to show historically what were the amounts that were actually drawn from the market over the period, and compare those with the total amount of capital formation as here shown. But the gap that is left is the valuation of the assets of the public corporations as a result of that process.

1147. *Chairman*: We might perhaps talk a little about this paper, and possible variations of it, and see what we want to get at. You say the purpose for which you drew it up was to show what moneys had been drawn from outside over these years by these various organisations for their finance?——Yes, the impact on outside sources of finance, whether the Exchequer or the market.

1148. It does show that. Then I suppose there is the question: what proportion their claims for their purposes have borne to the total amount of claims for finance for other sectors, the Government sector and the private sector. Have we got anything on that?——No, there is nothing provided on that.

1149. On the third thing, which I think is related to what Professor Cairncross is saying: let us take the top one, the Post Office; gross fixed capital formation—I am not very familiar with these phrases, but I imagine that includes everything that was spent to create fixed capital, regardless of whether it was a renewal of existing capital that was depreciating or falling obsolescent or not?——Yes. The notes explain that the Post Office expenditure charged to capital account means their capital expenditure including renewals; where it is a straight renewal that is charged to revenue, but where it is a renewal with an improvement element that is charged to capital.

1150. And that is what goes into gross fixed capital formation?——Yes.

1151. Then if you look at the financing you see that in 1951 roughly half that expenditure is apparently charged against their revenue by way of depreciation charge and so on, and roughly half came from the Exchequer?——Yes. The gross fixed capital formation is in fact all expenditure on capital assets.

1152. *Lord Harcourt*: Whether renewals or not?——Yes, that is right.

1153. *Chairman*: Then, looking along to the financing, you find that roughly half was charged against their revenue and roughly half from the Exchequer?——Yes.

1154. But when you look at public corporations and local authorities, there is no means of getting even that much information about how the expenditure was related to depreciation or obsolescence?——No.

1155. *Professor Cairncross*: If you take this group as a whole, its total claim on the savings of the nation has been mounting year by year. Since 1951, the increase must be getting on for 80 or even 100 per cent., taking the latest figures. You anticipate, I imagine, that this will continue to be true, and that you will have an increasing programme of capital investment by the public corporations? Will this not lead to an increased difficulty in the market for Government bonds, which are responsible for financing a good part of this capital expenditure?——What the total claim on the resources of public investment should be is really the policy issue which has to be settled before figures can be given to this Committee about the future.

1156. That is one aspect of policy, but there is also the question of policy as to the proportion of this capital expenditure which should fall on public corporations themselves, and the proportion which should fall on the market. Are we in a position to judge whether this has been a rising proportion or a falling proportion? It is extremely difficult from the figures to get any picture of the extent to which the public corporations have been pressing more and more on the market or have been intending to increase their degree of self-finance?——*Sir Robert Hall*: You really want to know, I think, firstly, how much of the gross fixed capital formation is depreciation, and, secondly, how much of their total capital expenditure they are recovering in their charges or from other sources of income. In essence those are the two things you want, and I think you also would like to identify, if there is such a thing, any trend one way or the other?—*Professor Cairncross*: Yes.—*Sir Robert Hall*: Did you also want to go to the policy behind the pricing of these things? I was not quite sure from something you said.—*Professor Cairncross*: I touched on that. I do not think it would be appropriate to pursue that.—*Sir Robert Hall*: Because it is generally laid down in the statutes setting up these corporations. The whole question of the pricing policy of public corporations is a very wide one.

1157. It is laid down in the statutes, but I am not sure that the word "costs" or the word "profits" is defined in the statutes. It would be possible by treating depreciation in one way to get one result, and by treating it in a different way to get a different result?——*Sir Robert Hall*: Yes, but your primary interest, I understand, is how much self-financing they are really doing, after allowing for their true depreciation.—*Professor Cairncross*: Where the present trend would take us if the present degree of self-financing continued for the next five or ten years.

1158. *Professor Sayers*: I think we should be interested in knowing whether the Treasury thinks it is consistent with its existing powers in relation to nationalised boards to increase the proportion of the capital costs which are to be recovered out of their prices?——*Sir Roger Makins*: We shall need notice of these questions*.

1159. *Professor Cairncross*: There was one further question, which is implicit in what I was asking earlier. It is, I think, important for us to know whether this accumulation in the national assets that has taken place is commensurate with the increasing debt that is being incurred, or whether the depreciation policy pursued is such that in fact real assets are not rising at the same rate as the debt which is being created.——*Sir Robert Hall*: That raises some nice points about the changes of the price level.—*Sir Edmund Compton*: Not only that, but to quite an extent the Treasury has lent money to finance these assets, not by increasing the debt but out of revenue. It is only a proportion of the total that is matched by an increase in the national debt.

1160. *Professor Cairncross*: I was not thinking of the national debt here, but simply of the debt of these corporations. I agree that when one brings in the whole central budget the question takes on a different complexion. Taking only one aspect of the matter, the public corporations as a sector of the whole economy, are we in a position where we are adding to our assets rapidly or slowly, and are these assets being matched by an equivalent amount of debt?—*Chairman*: I did not quite follow Sir Edmund Compton's last point?——Professor Cairncross mentioned the increase in the debt, and I mistakenly thought he meant the increase in the national debt. In fact the increase in the amount of Government assets in the form of loans outstanding to the public boards and to the local authorities is considerably greater than the increase in the national debt that was incurred over the period. We have something, on my calculation, of the order of £4,500 million of interest-bearing assets in the form of loans to the local authorities, to the National Coal Board and to the other public boards, as a result of the post-war Exchequer lending to those departments.

1161. But your security for those financial assets that you have created by these loans is the actual charging powers of the various corporations?——Yes.

1162. Therefore it is relevant to know how they exercise their charging powers; otherwise the financial assets might be bad ones?——*Sir Edmund Compton*: Yes. The bulk of our lending to the local authorities has been spent mainly on housing, and there it is not a question so much of the rents on those houses as the ability of the local authorities to raise the rates. In fact our security for those loans is the rates.—*Sir Robert Hall*: But as I understood Professor Cairncross, he was more interested in what you might call the physical value of the assets than in

* See Memoranda of Evidence Part II No. 4.

their hypothetical value as a monopoly, was be not?—*Professor Cairncross*: Yes, indeed.—*Sir Robert Hall*: The Chairman was more on the point that, since they are a monopoly, they might, if they had the powers, always service their own debt.

1163. *Professor Cairncross*: The two shade into one another. There have been cases of public corporations in other countries which have made very large losses?——My only point was that they are separable issues. Just to be quite clear, when advances are made by the Exchequer to this field of investment from above the line surpluses, you did not want assets to be shown against those, did you? You regard that as self-financing?—*Professor Cairncross*: I would not regard that as self-financing.—*Sir Robert Hall*: You want on the one hand the debt created and held by the public corporations, and on the other the physical value of the assets?—*Professor Cairncross*: Yes.

1164. *Chairman*: We might now have a look at the paper on National Savings, paper No. 7?*——*Sir Roger Makins*: Mr. Chairman, could I say just a very few words in amplification of this paper? Really it is contained in the paper itself, but I would just like to point it up. This paper is limited to the way in which savings are organised by the State. It does not deal with other ways in which the Government seeks to influence personal savings, that is to say, by tax incentives. It is confined to organisation. That is the first point. Then the Government's interest in this subject is really twofold. The first is the encouragement of thrift, and that perhaps is an aspect which is not specially relevant to your enquiry. The other aspect is to encourage lending to the Exchequer, and this will be, I think, of very close interest to you, because the savings mechanism is the most important vehicle of non-market borrowing; so much so that the result of the efforts made to promote saving for this purpose is the existence of £6.000 million which are repayable on demand, which is, as is stated in the paper, almost one quarter of the national debt.

1165. *Professor Sayers*: It is of course possible that we might take the view that the stimulation of thrift might be important, and that we should like to know what the Government considers is its power to encourage thrift. By what means does the Government encourage thrift, what value does it attach to those means, what further means could it conceivably employ if it wanted to encourage thrift much more than it does now? That is relevant to our inquiry. May I enlarge a little further? The view that we take of the power of monetary policy to operate on the inflationary situation may depend in part on how far the Government has at its disposal means to encourage thrift. May we be told, either now or later, what the Government thinks can be done in this way, or whether it is completely sceptical of any power to encourage quick changes in thrift?——We can certainly think about that, but, as this paper shows, there are two streams of thought which join to make the accumulation of savings. The encouragement of thrift in the sense in which it is used in this paper is more of an ethical than a purely fiscal or financial concept; from the point of view of the Government I suppose, apart from such example which may be given or such influence as may be exerted by Government statements or general policies, the field in which the Government can operate rests so to speak on the financial side, of incentives or disincentives of one kind or another.

1166. In the Savings Budget of April, 1956, various changes were made in the terms offered for small savings. Were those changes made purely with a view to the social advantages of thrift? Were they not related to the inflationary situation?——*Sir Edmund Compton*: They were. The mainspring behind them, as I think the then Chancellor explained in his Budget speech, was financial. The object of organising National Savings is to encourage (*a*) saving, and (*b*) lending to the State, and the stress was on the second of those functions, to which I think some additional importance was attached. In other words, it was thought that, even though certain measures might not encourage more saving in the sense of abstention from spending, if they encouraged more lending to the State they were worth doing, because it was part of our anti-inflationary armoury in the sense that we should be borrowing more from the public and less from the banks. The defence, for example, for the relief of the first £15 of interest on savings bank deposits from income tax, was that the money was lent to the State; that facility was not offered to deposits in commercial banks because their money was not lent to the State.

1167. *Chairman*: With regard to these two objects, may I put this to you: thrift seems to me a long-term, not easily acquired, habit which has got a certain moral background behind it. If it is inculcated or acquired it cannot easily be turned off again. It cannot easily be acquired. That seems to me something which is not easily adjusted to the other idea, of the importance in various economic situations of stimulating savings either for the easier financing of the Government or to avoid inflation, which may be turned on or off according to the economic circumstances. You may in fact need to reverse the process and encourage people that it is right, in order to avoid deflation, not to save so much. One or the other must be the dominant approach; you cannot really run the two side by side?——*Sir Roger Makins*: No; and I think, as is shown by this paper, there is a good deal of history in this. The Savings Movement, as I understand it, started as a thrift movement, that is to say, saving for oneself or one's family or for the future, as a sort of ethical or social activity. It was only at a later stage that the idea of a Savings Movement in the sense of lending to the State came along and joined up with the other one, and the two have, as it were, been intermingled. I would have thought, though I cannot quote any particular statements on this in recent times, that it was clearly the view of the Government that thrift is a good social principle or activity. But what the Government can really do in the matter is to encourage or to adopt policies which encourage savings, that is to say lending to the State. Therefore it seems to me that the thrift concept, which the Chairman has referred to. is something which is as a matter of history inherent in the present approach towards saving, but is not one which is influenceable to any particular degree by Government action. It is therefore the second part of the proposition, the action of the Government to influence savings, which is most relevant to the question before us.

1168. *Mr. Jones*: But has not thrift been outraged and burgled by inflation? Is not the would-be thrifty man adopting a shrewdness which arises out of his experience of the decline in commodity value of his gilt-edged savings, particularly where he has not been able to realise the commodity value he put in, even after allowing for the interest added? Take the value of a National Savings Certificate that was purchased in 1947: 15s. was put in as a capital investment; the certificate has run for a period of ten years, and there has been no tax on the earnings of that 15s. It has earned another 5s., and therefore on realisation at the end of ten years it becomes worth £1 in currency value. But having regard to the inflation which has taken place from the period of investment to the period of realisation, actually the original investment has been outraged and burgled. What sort of situation does that put the Government or anybody else in to encourage thrift, especially in this particular field of Government savings?——You are really referring, Mr. Jones, to a process which has been going on for a number of years, the general effect of the inflation which is taking place. The facts are as you state them, and if you look at this and ask what is the effect of that on the general desire or incentive to save, I think the only answer I can give you is to point to the figures here in Appendix B, which shows the course which the various types of National Savings media have taken. You will see that there has been a steady rise in National Savings Certificates, there has been a fall in defence bonds, and the other Post Office securities have remained stable. Post Office Savings Banks deposits have steadily fallen; Trustee Savings Banks ordinary deposits have slightly increased; the Special Investment Department has more than doubled; and there is the additional contribution of the Premium Savings Bond.

1169. *Chairman*: Would you be readily able to put against these totals their relation to the national income of the same years, to see what percentage it was?——Yes.

* Memoranda of Evidence Part II No. 7.

1170. It is a little difficult to work merely from figures of volume in a period of inflation?——Yes, I appreciate that point.

1171. *Professor Sayers*: The figures show the success of the Savings arrangements in attracting savings into Government finance. That is the most important element in your view, apart from the general background of encouraging thrift?——Yes. It would be very difficult, I think, to evaluate the part which is played in all this by whatever motives operate in the desire to be thrifty or to save; apart from that all you can really point to is the actual use of the various media which are offered.

1172. *Mr. Jones*: Do you consider National Savings have been satisfactory, when you take into consideration the inflation which has taken place within the last five or six years, and you take into account that the amount of National Savings remaining with the Treasury or with the authorities responsible for their care and investment has only gone up by £120 million in that time, at the rate of less than £20 million a year? Do you not think that the shrewd saver is beginning to get concerned by the effects of inflation upon what he has sought to reserve to himself for the day when he requires it?——If you asked me whether it was satisfactory, I would say yes. If you were to ask whether we were satisfied, I would say no. As for the shrewd saver, I do not know that I really am in a position to state here what he or she is thinking at this moment.

1173. *Professor Cairncross*: May we just invite comment on the disparity which exists between the figures of National Savings as shown in Appendix C, and the very large figures which are always given for personal savings, rising to an annual rate of £1,500 million? Are these two figures easily reconciled? Do you know where the savings are going and who is making them?——*Sir Edmund Compton*: The Blue Book figure of personal savings, as is well known, is not a direct estimate, so one cannot build on that. This point is actually dealt with in paragraph 12 of the memorandum itself, where we point out that the other non-Government savings media have made great advances since 1947, whereas the National Savings movement has done little more than hold its own ground.

1174. *Chairman*: But these other media, life insurance and the others, were all available in the war. Why in your view did they suddenly take up the running after 1947 to this remarkable extent, as against National Savings?——*Sir Edmund Compton*: There was a paramount reason for investing in National Savings in the war. That was the conviction the public had that they were assisting the war effort in that way.—*Chairman*: I understand that. That was partly due to the form of the publicity by which they were promoted. I am sure they were assisting it.—*Sir Edmund Compton*: There was also the fact that the whole organisation of the insurance companies and the others was pretty well in abeyance during the war, whereas the National Savings movement was in full blast.

1175. *Sir John Woods*: Might it not also be that a large part of life insurance business is in superannuation schemes and industrial insurance schemes, which have increased very greatly during and since the war?——Yes, the momentum of organised long-term savings on the part of the insurance companies, particularly in superannuation and life schemes, has been greatly increased by all the retirement benefits and retirement provisions that have followed after the war. That has increased the volume of those contractual savings. The National Savings movement has in fact left the contractual savings field alone. The facilities offered for thrift by National Savings are the security of the State and the provision for repayment on demand. Whether the individual wants to hold his money there for ten years or six months is up to him, but he can be repaid on demand. It is in that kind of savings that the State has specialised. These other bodies, on the other hand, have specialised in long-term contractual saving. That has not only had its attraction for the individual but has been helped by the group superannuation schemes of various kinds which they finance. It has also had the support of the fiscal advantage in the shape of the tax relief that attaches to life insurance, whereas National Savings have had tax exemption within comparatively low limits; there is no tax on the interest on the Savings Certificate nor, since 1956, on the first £15 of interest on savings bank deposits. So there has been a marked shift of emphasis in the promotion of thrift as between National Savings and non-national savings in this period since, roughly, 1947.

1176. *Mr. Jones*: Has there been a marked shift in the way savings have been invested; in other words, are savings being invested other than in Government Departments, in National Savings, in the Post Office, and what have you?——I do not think so. This paper is, of course, confined to National Savings; that is to say, the arrangements we make for the provision of savings facilities and the way they are held. This is all, by definition, investment with the State.

1177. But this would not be the most profitable form of investment today; if it was, how is it that gilt edged are so low in price on the market? Is not that an indication that this is not the most profitable type of investment, and is not that something that we have got to have some consideration for?——National Savings is perhaps rather narrowly regarded if it is regarded as an alternative to investment in a market security. In fact this kind of thrift provision covers a very wide range of investments, ranging from a quite short-term deposit in the Post Office (putting your money into the Savings Bank this week, intending to spend it in a fortnight's time when you go on holiday, is quite a typical form of Post Office investment) on the one hand, to some of the still existing holdings of the first issue of National Savings Certificates from 1915.

1178. But would you not have sections of the community, who some years ago were finding their investment in this field, and who are now finding it in another field? I appreciate that the small saver is bound to use this field and does use this field, but has there not been a substantial migration of savers from this field in the bigger income classes?——I think that is a question on which one can have a wide variety of opinions, the reason being that one cannot identify the money that is invested in National Savings or withdrawn from National Savings. The transaction, as far as the Government is concerned, is over and done with when the money is either invested or withdrawn. What they do with their money is another matter.

1179. *Professor Sayers*: Sir Edmund Compton mentioned that the Savings Movement has concentrated on instruments that are payable more or less on demand. That choice was made as a matter of deliberate policy, I understand. Could you tell us the reasons for abstention from other parts of the demand?——The first reason, I think, is historical. Historically the Savings Movement is really built on the State provision for thrift, which was in its turn based on getting your money back at par when you wanted it. The whole thing has been based on that, and that is what is familiar. The second reason is really one of cost and efficiency, by which I mean that the field of long-term contractual saving is very thoroughly tilled by the non-National Savings organisations. They are fully organised to do that. It would, I think, be a wasteful duplication if the State tried to do it, too, and if they did it would certainly involve a tremendous increase in the State organisation. As it is, the cost to the State of organising savings facilities on this comparatively simple money-on-demand basis is high, because the State deals with the small saver, and is therefore in direct relationship with anything up to fifty million different individual accounts, most of them running at the rate of only a few pounds in total. That involves a staff, for the registration of securities and dealing with subscriptions and withdrawals, of over 10,000 persons, and the Premium Savings Bond added several hundreds by itself. It would mean a big increase in the State staff and organisation, if the State tried to venture into long-term contractual saving.

1180. *Chairman*: Here you have £6,000 million of money, a great accumulation of potential purchasing power, which is virtually repayable on call. I know it is not called under existing circumstances, and goes forward more or less as a permanent fund, but in practical terms is there any limit to the amount to which you

would wish, if you could, to stimulate the increase of that amount?——*Sir Roger Makins*: As far as I know we have not thought in terms of any limit.

1181. So far as you could get them, you would be glad to have them?——*Sir Edmund Compton*: We have to work very hard to stand still on this. In fact, our weekly savings figures are something like a receipt of £30 million to cover a withdrawal of £30 million.

1182. That is not the whole question, is it, because there are variations of terms which occur from time to time, and if you were really determined to push on at all costs I was wondering what you could not offer?——We have pretty well stood still in National Savings since 1947, whereas other savings moved forward a great deal. The meaning of the 1956 Savings Budget was that it was thought worthwhile to pay a good deal more in order to try and improve the National Savings record, and the amount that the State could raise.

1183. What has been the experience of improving the terms? Was not the last figure a good deal more favourable?——Yes. The two main features of the Savings Budget were the new National Savings Certificates and the Premium Savings Bond, which was an attempt to use some quite new attraction, in order to raise money for the State and achieve a measure of thrift as well.

1184. But you could improve the terms indefinitely, could you not?——Yes. It is true that we could improve the terms for these, as for other Government borrowings. It is a matter for judgment, the extent to which the increased cost to the State would realise a dividend in saving and lending to the Exchequer.

1185. *Professor Cairncross*: May I ask you again about your reconciliation of the trend in identified financial assets, shown in Appendix C, with the figures, however tentative or provisional they may be, for personal savings? You will have noticed that personal savings are alleged to have increased from about £200 million in 1951 to £1,500 million in 1956. That means that they have multiplied seven times over the past five years, and even with an allowance for depreciation they are still rather striking. Your figures here in Appendix C show an increase in identified financial assets from roughly £300 million to £700 million. Even in the last two years the margin between the two sets of figures has risen from roughly £100 million to £800 million. I appreciate that when you have two sets of official statistics it is a little invidious to say just which is the more to be relied upon, or which one should take as a guide. In this case we are taking the figures in Appendix C, which are based on the returns of various agencies, intermediaries and National Savings. In the other case, we are dealing with a residual total. Have you any explanation of this, since, if this kind of divergence continues, it must be very difficult for you to forecast the degree of inflationary pressure to which the economy is going to be exposed?——I think the table to which you are referring is table 27 in the Blue Book.

1186. *Professor Cairncross*: I was taking table 6, which shows the combined capital account of the United Kingdom, and gives personal savings in 1954 of £729 million, and in 1956 of £1,504 million; an increase of roughly £800 million in two years. The last line of Appendix C shows a rise in the same period of from £642 million to £712 million as the identified increase in financial assets. I should have thought that this divergence was a rather striking one, and one for which there must be some explanation?——Yes, I think there is, but so far as I know it has baffled the national income statisticians year after year. We have done our best to provide the material to close the gap by the figures which are in table 27 of the Blue Book, which I quoted, of the identifiable increases in assets. I agree they only provide a fraction of the total.

1187. May I ask if you take any steps by a sample inquiry, or any other way, to find out just what is happening currently to savings?——*Sir Roger Makins*: I think if you will allow us, we would like to look at this a little further.*—*Sir Robert Hall*: The counterpart of the aggregate savings in table 6 is given in the bottom under capital formation at home and abroad. Those are the two aggregates, and since the identifiable increase in financial assets in the personal sector is much less than the top line of table 6, the counterpart of the difference must presumably be in the acquisition of physical assets by the personal savers.

1188. Not necessarily?——Not necessarily; physical assets or un-identified financial assets.

1189. I have in mind that, if you are trying to deal with an inflationary situation, in which the current level of savings is one of the important elements, it is obviously very important to be able to predict roughly what will happen to savings, and to know, as a basis of that prediction, what are the current trends. For that purpose it is easy to look through a number of accounts of building societies, insurance companies, and so forth, and get as far as you do in Appendix C. But is it not also rather important to try to approach the matter from the other end, and try to get some idea of who is currently saving, and whether they are saving more than they did last year, as is done in the United States?——*Sir Roger Makins*: We would like to think about that.

1190. *Chairman*: Perbaps we could break off at this point. We will start tomorrow morning on the Capital Issues Committee paper, so as to make sure that we deal with that tomorrow.——That would be perfectly agreeable to me.

* See Qns. 1285–88.

(*Adjourned until Wednesday*, 11*th September*, 1957, *at* 10.30 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTH DAY

Wednesday, 11th September, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, Esq., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary, of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

1191. *Chairman*: Sir Roger, we arranged to start this morning with paper No. 8 on the Capital Issues Committee.* The opening three paragraphs are narrative of the past, taking us up to the outbreak of the war in 1939. Then you say:—

"In May, 1945, a fresh Memorandum was prepared ... to ensure that the order of priority of capital issues after the war should be determined according to their importance in the national interest."

Are there any questions on those three paragraphs?——*Sir Roger Makins*: There is one point I would like to make in advance by way of amplification of this paper; it is a general point. We have attached to the paper the published guidance to the Capital Issues Committee since 1951; we have not attached the guidance issued before 1951. Although none of this has been withdrawn a great part of it has been overtaken by events and circumstances, and it is available to you if you wish to see it.

1192. In your view would it be of any assistance to us?——*Sir Roger Makins*: I should have thought not. I do not think it is really relevant although it is still on the books. There is a memorandum of 1945 which was published as a White Paper.—*Sir Edmund Compton*: I would have thought that the guidance since 1951 is the guidance on which the Committee is working today.

1193. I read the document of 4th December, 1951, which we will come to, as really being a new basis. It refers to "... the light of the new economic policy which is being developed by the Government." I thought that it was intended to be self-contained?——*Sir Roger Makins*: That is really the case, but I thought I should draw your attention to these other documents, which are still on the books.

There is a further point to which I wish to draw your attention at this stage. These documents which we have submitted to you contain all the guidance issued to the Capital Issues Committee since 1951 by successive Chancellors, with one exception; this relates to housing in the period 1956-57. On this subject the attention of the Capital Issues Committee was drawn to the then Chancellor's policy, to which he referred in Parliament on 24th February, 1956, in the so-called "little Budget" speech, and again in the Budget speech of the same year, to encourage borrowing for private house ownership while maintaining restrictions on finance for other types of building. The Committee received from time to time guidance from the Treasury in regard to the detailed application of this policy, but this detailed guidance has not been published. With the passage of the Rent Act this year the present Chancellor gave instructions that the Treasury guidance to the Capital Issues Committee should be amended so as not to preclude the Committee from recommending consent for finance to build any form of living accommodation; but he did not think it advisable to encourage applications for this purpose by publication of this advice to the Committee. Apart from this there has of course been other unpublished semi-official correspondence between the Treasury and the Committee relating to the administration of the control, either on questions of procedure or on elucidation of points arising on the detailed application of the policy guidance. That is in the category of semi-official correspondence. What I have been referring to is official guidance to the Committee. I wanted to make that quite clear.

1194. When you say "semi-official correspondence", how are we to regard that?——It is semi-official correspondence between members of the Treasury and the Secretary of the Committee dealing not with questions of policy but with questions of elucidation, procedure and so forth.

1195. *Sir Oliver Franks*: Would it not be fair to say that those letters must in fact deal with the application of policies to particular cases on occasions? The documents which we have before us lay down what we might call the grand lines of policy. It is natural, when one body lays down the general lines of policy and another body has to apply them, that the applying body should from time to time consult with the policy-making body on how to apply policy in relation to a particular application or a particular type of application. I suppose the semi-official correspondence is the sort of correspondence which goes on for the most part between government departments? It is the method by which questions of procedure, or questions of application of policy to particular decisions, are dealt with?——That is correct.

1196. *Chairman*: As we see from your figures, the Committee is dealing with 1,000, 2,000 or 4,000 applications a year; what is the volume over the year of particular applications on which such exchanges take place?——*Sir Edmund Compton*: I would say it might consist of about 50, on average one a week. Supposing the Committee is dealing with, say, 50 cases a week, which is roughly the order of magnitude, I should have thought on the average there might be a question on the application of policy in a particular case on one of those.

1197. *Sir Oliver Franks*: But it would be reasonable to suppose that within the general lines of policy a number of those cases on which there was informal consultation would be leading cases; the way in which they were determined would settle the way in which a number of similar cases were determined. For example, let me suppose, in ignorance and hypothetically, that, when at a certain stage this year the question of tanker credits came before the Capital Issues Committee, it was the subject of informal consultation and semi-official correspondence between the Committee and the Treasury, and that that arose on a particular application. A certain outcome is reached on the particular application, but of course the Committee looks to a certain consistency in dealing with applications of a similar character; therefore that outcome

* Memoranda of Evidence Part II No. 8.

will in fact be the equivalent of a decision in a leading case. Is not that a clear inference?——*Sir Roger Makins*: Yes, perfectly clear.

1198. *Chairman*: I suppose any body of that kind builds up a series of decisions over the years which govern other applications which come before it?——*Sir Edmund Compton*: To take that particular example, the published instructions to the Capital Issues Committee are, in effect, that they should test the applicant's ability to raise the money from non-market sources, however good the purpose. They are dealing with two clauses: (*a*) the purpose and (*b*) the source of the finance. The question of the source of the finance became new ground for them at the stage of the Chancellor's Budget speech, which included this new directive to them. The question immediately arose how far they could go in investigating the efforts made in the market by an applicant who had come to the Committee saying that he wanted to borrow from a bank. In effect, the practice that the Committee entered into at the start of this new operation is becoming a guide to what they are doing as a regular routine by this time, when we are several months away from the start.

1199. *Professor Cairncross*: When Sir Edmund says that there is semi-official correspondence about perhaps one case a week, is it relevant that the number of cases rejected is about one per week? Would a high proportion of the correspondence be about applications that are not granted? ——*Sir Roger Makins*: Not necessarily, because I think it emerges that the Capital Issues Committee deals with certain cases, as being obviously within their terms of reference, or as raising no particular point, without reference to the Treasury. But in a number of cases—for example, if the application is for over £1 million or if the recommendation is turned down, or if it has been limited, modified or changed in any way—then it is referred to the Treasury automatically, with the advice of the Committee but for the Treasury to decide. In that case there is a reference of a particular case. That, I think, is in a slightly different category from the sort of semi-official correspondence which may take place on procedure and interpretation of guidance. There may be as many as ten or fifteen cases a week referred to the Treasury because they fall within one or other of those categories. We were not, I think, including consideration of cases in that way in the amount of semi-official correspondence.——*Sir Edmund Compton*: No; I was trying to estimate the amount of reference back, in the sense of a suggestion by the Committee that they would like to know whether they were correctly directing themselves in a particular case, or perhaps a reference by the Treasury back to the Committee on a recommendation which had been specially referred to the Treasury because it was either a "magnitude" case such as Sir Roger Makins has described or because the Committee recommended refusal.

1200. *Chairman*: I have not derived from the paper any picture as to how much goes on, either of cases being sent from the Committee to the Treasury with a request for the Treasury to decide and not them, if that does happen, or of cases where the Treasury, faced with the advice or recommendation of the Committee, expresses itself as not satisfied and either takes another line or sends it back. I think you were saying on the average about one a week? ——I would not like it to be thought that it happens once a week. The point I was making was that the number of cases which might be the subject of interchange with the Committee might be of that order on average.

1201. How often has the Treasury acted contrary to the advice it has received?——*Sir Roger Makins*: On occasion. These cases are referred to the Treasury because the Committee, being strictly advisory, refers such cases with advice. Then various things may happen. The Treasury may send them back for further consideration, and the Committee will then re-consider the case and perhaps modify or re-affirm its advice. Then the case comes back to the Treasury, the matter is considered and then Treasury Ministers may either accept the advice of the Committee in the light of their re-consideration, or from time to time they may decide not to accept the advice of the Committee, there may be some special aspect of the case which has to be considered, or some special reason outside the ordinary ambit of the Committee's purview, that arises on some other part of the Government's policy. In those cases—there have been very few of them, as far as I know—the Treasury has explained to the Committee the reasons for which they have taken the view they have taken, and the Committee has accepted them. Naturally, the Committee being an established body of persons of proved experience who have been, so to speak, in the business for a long time, the tendency is to accept their advice. But it does sometimes happen otherwise.

1202. *Chairman*: Would it be right to think of it as very rare for the Treasury to take a view, if you like after having invited reconsideration by the Committee, that is different from that of the Committee?——*Sir Edmund Compton*: Yes, I think you could say very rare. It has been so exceptional that one can really number the cases on the fingers of one hand for, say, the last five years of these operations.

1203. *Chairman*: In paragraph 4 you tell us of the 1946 Act which gave the Treasury power, and then you refer us to the Treasury Order, the effect of which is that there is this complete control on any issue of capital and any borrowing, except borrowing in the ordinary course of business through a bank, and, by definition, on any capitalisation issue, the permitted limit being at first £50,000 within any twelve months and then reduced in 1956 to £10,000.—*Lord Harcourt*: On the question of the capitalisation of reserves may I ask what is the underlying thought which makes the Treasury feel that it is necessary to control the capitalisation of reserves? Any company can only have one equity, and that equity is represented by a slice owned by somebody. I do not see myself how it affects the capital market in any way if somebody says they are going to denominate that equity in a different form, in other words by the capitalisation of certain reserves, or split shares, or something like that? ——*Sir Roger Makins*: You are referring primarily to this question of bonus shares?—*Lord Harcourt*: I prefer to call it capitalisation of reserves, but it is the same thing.—*Sir Roger Makins*: The answer to that really rests on the history of the case. The policy in this matter has been laid down and re-affirmed by successive Chancellors. It was laid down in particular by the then Chancellor of the Exchequer, Mr. Gaitskell, on 17th April, 1951, in a memorandum which was published. He specifically asked the Capital Issues Committee to bear certain points in mind. The first was that the application to capitalise reserves should relate as a single operation to the capitalisation of true reserves; the purpose of this was to ensure that an issue of this kind was made only occasionally, for example to bring the capital structure more into line with the current value of the undertaking. The second point he made was that the issue should benefit the stability, credit or efficiency of the undertaking; the purpose of this was to ensure that an issue was made only when a company could justify it on a conservative view of its finances, having regard to the problem of replacing assets when costs are rising. The third point was that the issue should not take a form which would enable tax liabilities to be reduced. The purpose of this was to prevent the shareholders taking out the undistributed profits of the company in a capital form which would not attract income tax or surtax. That was the policy laid down by the then Chancellor in 1951.

After the Government changed in 1951 this question was reviewed, when it was raised in the House of Commons, and the then Chancellor replied—"I see no need for any fresh instructions"—that is to say, instructions to the Capital Issues Committee—" since I am content to rely on the good sense of the Capital Issues Committee on this matter." That left the policy as it was, but gave the Capital Issues Committee a certain measure of discretion in applying it. That policy has been re-affirmed on a number of occasions since that time. I perhaps need not go through all the occasions on which it has been raised, but the most recent was in March of this year, when an approach was made to the Chancellor asking that at least no objection should be raised to the approval of issues of this kind on the score of frequency. In reply the Chancellor maintained his view on this; he said that the instruction was intended to ensure that capitalisation issues were made only as required from time to time to bring the capital structure into line with the permanent value of the undertaking, and that the Capital Issues Committee had recommended consent in cases in which companies whose undertakings had expanded vigorously had been able to show that they had built up true reserves, even though a

relatively short time had elapsed since the last capitalisation issue was made. I am relating this to explain to the Committee that this is a matter of policy which has been the policy of successive Governments and successive Chancellors, and that that is the reason why the Capital Issues Committee in considering such applications has taken the line that it has taken.

1204. *Chairman*: It is a very wide question which Lord Harcourt has raised. What puzzles one at first sight, the general subject of these restrictions being the raising of capital out of the issue of shares or by borrowing, is what capitalisation has actually got to do with it. It is your answer, really, that the Committee has been guided by the various directions issued from time to time by Chancellors about this matter?——As far as I know I have related to you the guidance that has been issued on this, and that has really been all. The Capital Issues Committee has let a certain number of applications go through and has turned one or two down, applying in their best judgment the policy which has been given to them. No doubt that policy is a debatable one, but it is a question of policy rather than a question of the particular actions of the Capital Issues Committee.

1205. *Professor Cairncross*: Is it possible to divide the figures of applications made and granted between bonus issues and others, and may we have those figures?——*Sir Edmund Compton*: Yes.—*Sir Roger Makins*: There are some statistics in paragraph 21 of this paper, and these statistics can be elaborated and broken down further; some work is being done on that for you, I think, by the Capital Issues Committee.—*Sir Edmund Compton*: Yes, and it is also the subject of more amplified statistica which are now being worked up for publication independently of this inquiry.—*Chairman*: We would think it essential to separate the capitalisation applications from the others; otherwise we might be using a delusive figure.—*Professor Cairncross*: We have no means of judging, on the figures in front of us, what proportion of the applications refused are in respect of capitalisation.

1206. *Lord Harcourt*: Would I be right in inferring from the answer which you have given, and from the guidance that has been given, that the Treasury's objection is not in fact to the major capitalisation of accumulated reserves, but to the constant paying out, or the constant capitalisation, of comparatively small profits paid out as a so-called stock dividend yearly?——*Sir Roger Makins*: That is one of the points, but not the only one.—*Lord Harcourt*: Even in that case, the only way in which the shareholder can make a profit is by selling his share and therefore reducing his equity in the company. It is relevant, I think, to that clause in the original guidance about the avoidance of tax. The only way in which you in fact get anything out of a stock dividend is by selling the equity which has been issued to you and thereby reducing your interest in the company. You may get a little bit of cash but you have in fact reduced your capital interest in the company.

1207. *Professor Sayers*: Did the blessing given to the Committee's good sense lead to any perceptible change of practice?——*Sir Edmund Compton*: I think it must have led to some change in practice because they then regarded themselves as being guided but not, as it were, fettered by the rather detailed instructions that they had had in the memorandum of 1951, but one cannot express the difference statistically.

1208. *Mr. Jones*: Is my impression right that any new capital required in excess of £10,000 can now be raised only with the consent of the Capital Issues Committee if the money is to be raised in the money market or through the banks? To what extent have undertakings who are holders of capital sums of £10,000 or more the right to institute their own investment programmes without reference to the Capital Issues Committee? I take it they are entirely divorced from the Capital Issues Committee because they have a means of raising their own capital?——This is a control over the raising of money by borrowing.

1209 Supposing you have an industrial or commercial business undertaking with substantial reserves, the directors or shareholders of which take a decision to capitalise some part of the reserves; in view of the fact that that is something within the control of that particular undertaking, where does the Capital Issues Committee come into that capitalisation of reserves?—*Chairman*: In so far as it is a capitalisation by an issue of shares, it comes in by the terms of the Order?——Yes.

1210. But supposing the directors decided, having large reserves, to make an expenditure of a large order; as long as they had the money in their possession the Capital Issues Committee would not come in?——No, because the undertaking would not be borrowing money.

1211. *Lord Harcourt*: There are two slightly different points there, I think. I think Mr. Jones is presuming that company reserves are necessarily cash; in fact they very rarely are. Reserves are generally an excess of value of fixed assets over the nominal value of capital, and they are very rarely represented by cash. In other words, they are not spendable; they are the result of past expenditures.—*Chairman*: Let us follow it up so that we have no misunderstanding. Suppose the company has, in the course of years, deliberately put aside into short-term investments a large fund, and it then decides to extend by creating a new factory. I think Mr. Jones's point is that all that would go on, because it has got the money in its possession, without the Capital Issues Committee having any hand in it at all?—*Mr. Jones*: Yes, that is my point.——*Sir Roger Makins*: Yes.

1212. *Professor Sayers*: Are you satisfied that the Treasury has legal power under this Act to control the channels through which money is raised, as distinct from the amount and the terms on which it is raised?——*Sir Edmund Compton*: The Control of Borrowing Order does not, of course, do as much as might be done under the Act. Moreover there are certain things which under the Act are outside control. The exemption limit of £10,000 is laid down by the Act; therefore borrowing under £10,000 is not subject to control without amendment of the Act. Secondly, borrowing in the ordinary course of the business from a bank is exempted by the Act, and that again would mean that if it was desired to control that form of borrowing—to control the act of borrowing, not the act of lending—it would be necessary to amend the Act. Those, I think, are the main points that occur to me where control is limited by the terms of the parent Act.

1213. If you look at paragraph 25 and at paragraph 30 you will see that a restriction has been imposed on the use of bank advances for particular purposes. This is a control of lending on the face of it, not a control of borrowing; it is saying in effect to the banks: "You must not lend for such-and-such purposes although you may lend for other purposes, and although the person concerned may seek money elsewhere for that purpose."——May I distinguish, in reply, between the requests to the banks which are itemised in paragraph 24 onwards, and control over borrowing. The requests to the banks are in fact requests, not statutory action at all, but requests to the banks for them to respond, as a voluntary matter in regard to their lending. There has been a long series of those requests in parallel with and right back from the start of the capital issues control in September 1939. Those are not statutory.

1214. I have always understood that it was the Government's policy to keep those requests in line with the statutory powers that were being exercised in other directions?——The Government's policy has been to indicate to the Capital Issues Committee in general terms the purposes for which borrowing should be encouraged or discouraged. In parallel with that, those same purposes have been made known to the banks, and the banks have been asked to have regard to them in their credit policy, which is outside the scope of statutory control.

1215. But is that not something different in kind from saying that certain kinds of lending are not appropriate for the banks? You would not think, for instance, of saying to Woolworths that they may not sell saucepans because they have not done so in the past, or because they have only sold a saucepan here and there. You say to the banks: "You shall not lend in certain particular ways". That is a different kind of restriction; I am asking whether it is in keeping with the statutory arrangements. I understand that it does not need to be covered in the statutory arrangements, because it is not the exercise of a statutory power; but is it in keeping with statutory powers?——I think broadly the view that has been taken, certainly by successive Chancellors, in this

matter is that the two should run in parallel. Certainly it has been the standard practice over the years, when fresh instructions have been issued to the Capital Issues Committee, to draw the attention of the banks to those instructions and to ask the banks to have regard to them in their lending policy, so that the banks could have an indication of the official view about what purposes it was desirable to encourage or discourage.

1216. But this request is not something parallel to what is being done under statutory authority by the Capital Issues Committee. Is it not, on the face of it, a restriction on private people's business of a different kind?——I would have thought not; and I can only quote the successive directives and requests to the bankers to show that successive Chancellors have thought not.

1217. *Chairman*: I got the impression that the Capital Issues Committee were supposed or invited to read whatever was addressed to the banks as well, and apply it to their own cases where they were dealing with applications not for bank lending; is that right?——I think it has usually been the other way round, that the banks have been asked to read the directives to the Capital Issues Committee.

1218. I follow that, but does it not equally apply in reverse? If the Capital Issues Committee were faced with an application that was not admissible in terms of the prohibition in paragraph 25 would they not think they were supposed to turn it down?——Yes. I think in the case of the directive of 4th December, 1951, the only point made in the request to the banks that is not found in the directive to the Capital Issues Committee is the point about banking facilities not being given to the speculative buyer. Certainly the Capital Issues Committee in their turn have applied and regarded that as part of their instructions.

1219. I tried to read the two sets of directions in relation to each other, and could not exactly match them up. I have no doubt that they are directed mainly to the same purposes?——I think that is perhaps partly because the purposes for which the banks will lend, as Professor Sayers says, are not always purposes for which people would borrow from other sources; and also, I think, this request to the banks was amplified in the special circumstances of December 1951 to cover speculative transactions; I think I am right in saying that that had been part of the standard guidance already given to the Capital Issues Committee in previous memoranda which had not been rescinded.

1220. *Professor Sayers*: Is not this control over the channel of lending an innovation of the last two or three years?——Up to 1951 the request to the banks was really confined to the purposes for which banks might lend. The banks were asked in successive requests, up to 1951, to note the purpose of directives of the Capital Issues Committee. Then in December 1951 something new was put in, which instituted a measure of control over the channels, because then the banks were asked, notwithstanding the exemption for bank loans in the ordinary course of business, not to lend for capital expenditure; in other words, to treat such loans as being loans not in the ordinary course of business. Therefore it was really in December 1951 that the practice started under which banks told their customers: "If you want to borrow for a capital purpose, that is not a loan in the ordinary course of business, and you must get Treasury consent for it," which imposed reference of this sort of loan to the Capital Issues Committee. That intervention in the channels of lending was stopped in 1953, as we describe in paragraph 27 of the paper, but was reimposed in April this year.

1221. And reimposed with a rather different wording, a wording that suggested that certain kinds of lending were improper business for banks? "Inappropriate" was the word used?——*Sir Roger Makins*: I do not think that there was any implication that we would be judges of the propriety of any particular aspect of banking business. Indeed, in the Budget the Chancellor was careful not to say that such matters were inappropriate to banking. He said that his objective was to secure that capital expenditure should be financed from non-banking sources for other reasons, because of the hope, or the expectation, that financed by market borrowing it would attract more saving.

1222. *Professor Cairncross*: Is it your view that the cessation of Government guidance and requests to banks would lead to a large increase in the amount of bank advances?——*Sir Edmund Compton*: It is difficult to answer that. I think the banks themselves are the best judges of that. But I would have thought that there must be some measure of restriction on bank lending as a result of these requests. If, for example, the Capital Issues Committee has been asked to look at applications in a vigorously critical spirit, and to say "no" to all cases which are not regarded as urgent under current requirements (which is in effect the directive operative today), I would have thought that the bankers, having regard to the same words, would lend less than if those words were not on the record.

1223. Do you feel that those who are refused bank advances have genuine difficulty in obtaining funds elsewhere? Do you think this amounts to a great deal in its impact on the financial situation of the country?——If the borrower, having been refused accommodation by a bank, borrows elsewhere his loan will be subject to the Capital Issues Committee, if it is over £10,000 in one year, and if it involves the issue of a security.

1224. *Professor Sayers*: But the Treasury may consent, notwithstanding the fact that the bank has had to refuse the business in accordance with a Treasury request? Are you satisfied that that kind of restriction is in accord with the intentions of the control of borrowing legislation?——If that result should occur it is in accordance with the policy of the Chancellor, as set out in the Budget directive of April 1957.

1225. *Sir Oliver Franks*: Does that mean that we have to accept the position as a matter of policy not susceptible to further discussion?——I would find it difficult to take it further, except in the terms in which the Chancellor made the proposal and defended it in Parliament.

1226. *Professor Sayers*: But we are asked to inquire into the system and to make recommendations. We are seeking your views, in the light of your rich experience of this matter, on the wisdom of this particular part of the control.—*Chairman*: I think that the original question was directed to the efficacy rather than the wisdom, and I think that is something that we could fairly draw from you, so far as you are able to have a view on it.—*Professor Cairncross*: May I just pursue the matter one stage further? Let us leave the banks for one moment and take the figures in paragraph 21. Clearly those figures show that the applications made to the Capital Issues Committee which are not granted do not amount to a very large capital sum, particularly since a substantial proportion almost certainly relates to bonus issues. If this were all that were involved one might be doubtful whether this machinery was really worthwhile. But I take it that it is also in your minds that a large number of applications are never made to the Capital Issues Committee? Have you any idea as to how many applications there might be if applications were freely granted?——*Sir Roger Makins*: Your point, I think, is well taken. The existence of this control, and the limits within which it is exercised, mean no doubt that applications, as you will see from the percentages which are granted, are generally only sent in if they are clearly within the limits of the control which are known to everybody through the published guidance to the Committee. I do not think that anybndy can say or judge what loans would have been made, or what amounts would have been lent, within this general field, if this control had not existed. I do not see how one could arrive at an estimate of that.

1227. *Chairman*: I cannot make out whether the Capital Issues Committee, basing itself on its major document of December 1951, is working a priority system, or is working a system under which certain things are capable of being attempted, and certain things may not be attempted. The approach is very different according to which system it is working. If it is working a priority system I find it difficult to see how it works, unless there is some conception of the overall amount that is available to be allotted. What is the position?——I think there has been a change in circumstances since 1951. In 1951 there were still a great number of physical controls in the economy of one sort or another, and that implied the idea of priorities. In the course of the last

five years most of those controls have been removed, and therefore the question of priority, in the technical sense, has ceased to be of much relevance to the work of the Committee. The directive under which they are working now relates not so much to the question of priority, in the technical sense, but to the purpose and the urgency of the application.

1228. You say that a lot of things have been choked-off, and that that is the value of the work it is doing; but, if I were an applicant trying to find out what I had a chance of, I would not find that many things were quite impossible in the terms of the guidance to the Committee. They are asked to discourage applications in respect of projects for the production of inessential goods, but "inessential goods" leaves a very wide margin of judgment, and I might perhaps think that I could have a shot at that. Therefore, when I am told that 99 per cent. or 98 per cent. of all applications have gone through, I am wondering what are the kinds of things which are covered by the ones which have gone through, because there is no limit set to the volume of capital that may be allowed in a year. It is that that I really feel we ought to go into, if we can?——*Sir Robert Hall*: I do not know whether I can help at all on this. I think that in any year there is an atmosphere which is based on a quantitative judgment about the total amount of investment that is likely to take place in relation to the resources that may be available. If you look at the table in paragraph 21 you can see that in 1953 and 1954, which were on the whole years when the Chancellor of the Exchequer was stimulating investment, the number of applications turned down was, in fact, very small. That seems to me to reflect that the Capital Issues Committee was aware that the general view of the Government towards investment was less restrictive. In 1955 and 1956 the feeling, as will appear in other papers coming before you, was that there was a danger that investment was getting too high, and indications of that were given in various speeches by the Chancellor of the Exchequer, and it does not seem to me to be unconnected that in 1955 and 1956 the proportions of applications granted were falling away. So I would say that there is a general background indicated by the Chancellor of the Exchequer, which affects the stringency or otherwise with which the Committee regards applications.

1229. *Professor Cairncross*: This is not in the table. 1954 and 1955 are very similar, but if you disregard the final column, the percentage of applications granted, the value of the applications refused does not differ very greatly. As for 1956, we are warned in paragraph 23 that the figures are not comparable because of the reduction in the limit of exemption from control, and the large number of applications made by people who were not familiar with the general terms of working of the Committee. It may be that the screw is put on in some years and that some applications are then not granted; but the impression made by these figures, taken in conjunction with the very large volume of capital expenditure which is self-financed in industry, is that a very small proportion of the total applications, and of the total amount of investment that industry is seeking to make, is weeded out in this way?——Yes. My own view is that in the course of 1955 the climate became much more expansionist, and that the relative stability of the figures for 1955-56 obscures the fact of the atmosphere having become more severe. It is impossible to say how the figures would have looked if this control had not been there, but my own view is that you would have had a rising instead of a practically flat line.

1230. I want to put to you the problem of the man who is attempting to expand a new business which may, in its early stages, be regarded as inessential, just as a large proportion of our present export trade grew out of activities that would have been regarded before the war as inessential. A man in that position may have difficulty in getting the approval of the Capital Issues Committee, because he has not a long established record in industry, and the things that he is seeking to put on the market are not of a kind that have yet acquired the respectability of long usage, and are therefore not regarded as essential; but they may in the long run be of extreme importance in the export industries. Both in the application of the work of the Capital Issues Committee and, I should imagine, also, of the banks, is there not a danger that people of that kind are excluded from finance? Is there not also an onus on the Treasury to see that the up and coming men in industry, who are in the small businesses, get the finance they need?——*Sir Edmund Compton*: I think that that is a point which should arise and does arise when applications are before the Capital Issues Committee, and are referred by them for advice to Departments. Throughout the Capital Issues Committee's work, whatever other changes there have been made, encouragement of exports has always been part of their instructions. If an applicant bases his case on an export potential, that is a matter upon which the Board of Trade should report, and the Board of Trade's report is in fact part of the Capital Issues Committee's case paper.

1231. Is not the difficulty that the exports of one decade are the inessentials of the previous decade?——That may well be; but the point here is the export potential. If that is the claim the Board of Trade are, or should be, in a position to report on that, and, of course, the Capital Issues Committee will exercise their judgment on that claim.

1232. *Lord Harcourt*: You have just mentioned the question of consultation with other Departments, such as the Board of Trade. Should I be right in thinking that one of the reasons why the percentage of approvals by the Capital Issues Committee appears to be so high is that there is a preliminary sieve in the Board of Trade, and that a great number of manufacturers probably go and discuss their plans with the Board of Trade, and either get encouraged, or else are discouraged and told that they would probably get an unfavourable report from the Board of Trade if they were to apply to the Capital Issues Committee. Is there a form of preliminary sieve, which prevents applications ever coming to the Committee?——The first sieve is undoubtedly the reluctance of respectable applicants to be turned down. Nobody wants to go to all the trouble of framing an application, making preliminary arrangements in the market for finance, and so on, only to be turned down. I think the major preliminary sieve, which these figures reflect, is the fact that the Capital Issues Committee is there as a kind of negative sanction. There is, I think, a secondary sieve, as Lord Harcourt has described, that an applicant may quite often go to, for instance, the Board of Trade and in effect find out in advance whether the Board of Trade are going to support him, because it is known to be part of the practice of the Committee that they take advice from sponsoring Departments. Clearly, if the department concerned says that it will not support the application, the applicant knows that he must think again. So I think it is right to say that there are those two sieves operating behind these figures of consent.

1233. *Mr. Jones*: Apart from such preliminary machinery, it would appear from paragraph 6 that the Committee meet regularly once a week, and consider the applications, which are the subject, I should imagine, of a carefully prepared case paper. If we look at the information in paragraph 6 in relation to the statistical table under paragraph 21, it would appear that in 1956 the Capital Issues Committee were looking at an average of about 80 applications in one day, to borrow an average total of about £21 millions. I cannot conceive, unless there has been some preliminary consideration, how it would be possible to give effective consideration to those cases in so short a time. Does not that presuppose the sort of preliminary arrangements that Lord Harcourt has indicated?——*Sir Roger Makins*: I imagine that, on the precise procedure and the internal workings of the Capital Issues Committee, you will probably be asking them how they prepare the case. But I think it clearly follows from the papers that these cases are very carefully prepared by the applicants, normally on professional advice. They are then put up to the Committee with supporting documents, where necessary, from one or more of the Government departments interested. As regards the number of applications which are handled, it is a matter for the Committee to decide how they do it, but I think it will be clear to you that a large number of these applications would be seen to fall clearly within the guidance, and therefore would probably not present a great deal of difficulty to a body of men who have been dealing with these matters now for a considerable time.

1234. *Chairman*: I think Sir Robert Hall said that there would be a general idea in the Committee as to what resources should be available for investment. That does not mean that the Government would supply them with some overall figure of the amount of investment which they thought would be economically satisfactory in the year?——*Sir Robert Hall*: No, we do not. I think it is more that the Committee have an idea of whether the Government regard the position as one of relative freedom or relative tightness, rather than that they have any precise figures in front of them.

1235. What does "priority" mean, if you look at the second paragraph of the memorandum of December 1951? This is their basic principle:

> "It is clear that the Committee must scrutinise all applications by reference primarily to the contribution which they can make to the surmounting of our present difficulties. I would ask the Committee to accept this test as their basic criterion "—

that leaves the interpretation to them—

> "and to apply it in a vigorously critical spirit. Clear priority should be given to projects which are essentially and positively related to the rearmament programme, to the stimulation of exports to desirable markets, to the savings of imports, particularly from dollar sources, and to the relief of basic deficiencies, especially of raw materials. Other projects which, in the Committee's view, can contribute definitely to the general health of the economy by the technical development of industrial productions, and the more efficient and economical use of resources, should also receive favourable consideration."

When they have given effect to all the things which can be called priority claims, there seems to be an uncontrolled margin of other things which they can favour as well, except for the discouragement of inessential goods. How do they work this system?——*Sir Roger Makins*: This is general guidance. They exercise their judgment in relation to the applications, and these are referred to the Treasury in cases of doubt. The general instructions which are given here come to be defined in particular cases, and it becomes, with the course of time, clear what applications are most likely to be accepted.

1236. *Sir Oliver Franks*: The instructions to the Committee are clearly not of the nature of rules or regulations, and therefore the Committee is not seeking to apply rules or regulations to particular cases. Certain very general standards of judgment are set up in these official communications, and the Committee is interpreting those standards by the use of a very wide discretion, which it reinforces, if it needs to, from time to time, by reference to the Treasury. The Committee is really, if one uses an American phrase, "playing it by ear". It has not got either global figures, within which it tries to work out certain proportions or priorities, nor has it got rules to apply. Therefore, as it only seeks to apply general standards it only, so to speak, feels as it goes. Is that a fair summary?——I think your general remarks are right. They must speak for themselves as to how they actually operate, but I imagine that their *modus operandi* would be rather more precise than simply a question of feeling their way as they went along.

1237. I was taking the notion that their decisions would be determined by their feeling of whether the Government was letting up on capital investment or being tighter about it. They would not have figures but they would have, as it were, feelings, or an awareness of atmosphere and climate?——They would certainly be aware of the climate; but it would also be clear, both from the guidance issued to the Committee and the requests to the banks. The Committee has, so to speak, gone up and down with the tide; there was a certain relaxation in 1953 and 1954, followed by a tightening in 1955, 1956 and 1957. Not only would they be aware of the atmosphere but there are positive indications given to them in the variations in guidance which they have received.

1238. *Chairman*: This makes their position a very responsible one, because they have this, I think it is fair to say, only very general guidance. They are dealing with all large scale, or even medium scale, capital borrowing in the country, and the Treasury in practice has hardly ever overruled their decisions. Is that fairly put?——It is fairly put, except that they are strictly advisory. They themselves do not take the decision. The decision is taken in every case formally by the Treasury. I think it is very important to stress that. They are a body of men of proved experience, who have voluntarily undertaken to perform this task of scrutinising applications within the limits of the guidance which has been given to them by the Treasury. They take the responsibility for the advice which they give to the Treasury, but it is the Treasury which decides the case; in other words, the responsibility rests on the Treasury, and not on the Capital Issues Committee, for the ultimate decision.

1239. But would that mean that there is a separate reconsideration of each case by the Treasury, in the light of the advice that is given?——No. There is not formal consideration of each case; but consent to borrowing is given not by the Capital Issues Committee but in a letter from the Treasury.

1240. I appreciate that the letter issues from the Treasury, but I am really trying to get at this: accepting, as I do entirely, that they are an advisory committee, how much independent reconsideration of their advice takes place? I do not think that that is answered by saying that the actual letter issues from the Treasury, because I assumed it would?——*Sir Roger Makins*: I will ask Sir Edmund Compton to give you a detailed reply on that, but in general, as I have said, the Capital Issues Committee refer to the Treasury specifically any applications over £1 million, any applications in which there is a recommendation of refusal, and any case in which they have varied or limited the request to borrow. Those cases are always referred to the Treasury for consideration. —*Sir Edmund Compton*: I confirm that. The special scrutiny of refusals is done because refusals are Treasury decisions which subsequently may be the subject of a challenge, and therefore Treasury Ministers should know in advance about them. What we call in our jargon "magnitude" consents—that is the big cases where the recommendation is consent—are also reviewed because they are the cases which are responsible for the bulk in value of the volume of the borrowing that is being allowed. It would, I suppose, be possible for the Treasury to review every single case, but that is not thought necessary. The process of review consists of the Treasury having in front of it, if necessary, the case paper, and a summary of the purport and the amount of the Committee's recommendation. That is usually enough to enable the Treasury to see that it falls quite clearly on one side or the other side of the Treasury guidance to the Committee. The Committee has usually, we find, either recommended yes or no, according to whether, in their judgment, the application has, in the words of the most recent directive, a definite urgency under current requirements.

1241. *Lord Harcourt*: When you say that the Treasury does not review each case, I imagine that what in fact happens is that a recommendation must come into one of roughly four categories: obviously all right, all right subject to certain modifications, doubtful, and complete refusal. Probably the large bulk will be obviously all right, and those the Treasury would not bother to look at. In the other three cases they would look at the suggested amendments, or consider carefully the doubtful case, and obviously give very careful consideration to something which the Committee recommend should be rejected totally?——That is so; and I would add to that that the great majority of the recommendations that we get from the Committee are a straight yes or no. The number of cases in which the Committee are themselves in doubt about where it would fall under their terms of reference, and therefore come to the Treasury in effect before making a recommendation, is very small.

1242. *Chairman*: Do they give you reasons for yes or no?——Usually, at any rate at the first stage, the recommendation is simply that the application, in their view, has or has not a definite urgency under current requirements.

1243. Does the applicant, whose application is referred to you on the ground that the Committee are not in favour, get any means of representing anything to you?——No.

1244. There is nothing like an appeal, or anything like that?——*Sir Edmund Compton*: No. The applicant who is refused gets a letter simply stating that his application is refused, without reason.—*Sir Roger Makins*: He can come round, and sometimes does, and ask why.

1245. Does he know that his application is threatened with refusal, and is being referred to the Treasury?——This, again, is a question of actual practice, but my understanding is that applicants do sometimes come round to the Treasury and ask, if their applications have been turned down, why it has been done.

1246. *Sir Oliver Franks*: Only if they have received a refusal. I was wondering if there was anything in the nature of an appeal from the process; it really seems that there is not?——*Sir Edmund Compton*: As a matter of procedure, in the normal case the Treasury has acted on a recommendation of the Capital Issues Committee within, I would say, 48 hours of receiving that recommendation.—*Sir Roger Makins*: I suppose I would say that there is not an appeal from the process, because the decision is the decision of the Treasury, and therefore the appeal, if it were made, would rather be against the Treasury than against the advice of the Committee.

1247. *Sir Oliver Franks*: It is clear that the general constitutional position is that this is an advisory committee advising a Government department, which, in the light of the advice received, decides. The department sets up a committee of distinguished and experienced people, many of whom have been on the job a long time. So far it looks as if that decision was being farmed out, so to speak. It looks as if the Treasury were asking this body of independent citizens to take decisions, subject to guidance, in a certain field, and that impression is reinforced because the committee is not advising, as most advisory committees do, on policy. It is, in fact, executive in nature. It is recommending on particular decisions, in the light of policy which it receives, so that its actual operation is like that of a tribunal. It has a wide discretion in terms of the standard which it applies, but case by case it comes to decisions. That, it seems to me, makes the whole thing rather a hybrid. You have the basic position of advisory committee and deciding department, but then you have this actual functioning added on of independent people taking particular views on particular cases. I should have thought that exactly the same question which arises in other fields where you have that position arises here, which is: when the public receives decisions, whether in a constitutional form from the Treasury as now, or from the Committee, if it were modified, are they or are they not entitled to know why the decision is what it is? I think the ordinary person, when he knows that his case is being dealt with by the Capital Issues Committee, feels as if it was before people who are taking a decision. No doubt that decision is capable of review, appealable, if you like; but they are, he feels, taking a decision. And yet in form that is not so; in form they are merely advising the Treasury. It seems to me that the rather curious structure of the process and the absence of reasons given at any stage make it seem arbitrary in a way which is not necessarily in the best interests either of the people whose proposals are being considered or the Government which decides upon them. It courts mystery where mystery is a hindrance rather than a help. I wonder what views you have about that?——In the first place, I think it is not really the case in any strict sense that the Committee is executive. It is neither a tribunal nor is it executive, it is purely advisory. I suppose it is the case that an applicant who is turned down may in some cases feel that he should have had the opportunity of elaborating his case or of presenting further material, or even being heard. If an applicant is turned down his recourse is not to go to the Capital Issues Committee but to come to the Treasury. It has not actually happened to me, but I understand it does happen; he will be received, and he will no doubt discuss his case, and he will be told that the reason why his application was turned down was because it did not fall within the policy guidance which has been given to the Committee. He would not be received in any unhelpful way, and he would either understand clearly what the decision was, or else he would go away and perhaps re-submit his application in some other form.

1248. I appreciate that, but that is really saying that he is in the same position as are other citizens when in the ordinary course of administration departments take decisions. He is free to pursue the informal methods of approaching the department and finding out, and usually he will be able to find out, why what has been decided was decided. I think the case is a little different here, because it would not strike the ordinary person that what was being followed was the ordinary administrative procedure. It is not just that the department considers a case and decides and informs. Here you have this rather elaborate apparatus of independent and experienced persons considering and reporting on the case. You have quite a lot of the appearance of an impartial decision by independent persons. It is perfectly true that the form at bottom is that they only advise, but, nevertheless, when the advisers are these independent and experienced people, the advice itself takes on a certain degree of independence. When that happens you begin to have a relation between the preliminary view of the advisory committee and the ultimate decision of the department which might, I think perhaps does, make the kind of decision that is ultimately made not completely assimilable to the ordinary administrative decision. You begin to get into an area when one is thinking of other matters and other departments where it has become customary to give reasons. That is why I raised the question, because in practice I think the apparent arbitrariness of the decisions, the way in which they are apparently changed within three or four months, is often not readily understood by very large numbers of people who are interested in the decisions as pattern-making for things that they themselves have in mind. When they look at the process of decision as they see it from the outside, what strikes them is not the ultimate constitutional position but this other fact of the relative independence of these private citizens of experience who are passing judgment upon their cases?——Like so many other British institutions the Capital Issues Committee has developed with time. You may say that it is in a special position and that it is not exactly parallelled elsewhere, and that may be true. As you have said, there may be a question of principle involved here, and I am not denying that there may be. But as an arrangement this appears to have worked over a period of years, I will not say without incurring criticism because, of course, it has incurred criticism on particular grounds and from particular aspects, but on the whole with a comparative freedom from such criticism as Parliamentary criticism and the like. It is perhaps relevant to look at the alternatives that might be considered, if the Capital Issues Committee either did not exist or had not taken the form that it has taken. I wonder whether an applicant for consent to borrow for purposes within the general ambit of general policy, of which he is aware, might not well prefer to have his application considered, in the way that it is considered now, by a body of men of proved responsibility and experience in that particular field rather than, for example, to have the thing go direct to a Government department and have it either approved or rejected there. In other words, I am suggesting that this institution or arrangement, even though it may not fall strictly within the general category of committees or institutions, is one which, nevertheless, performs a function which is useful not only to the administration but also to the applicant.

1249. I think that that very probably is the case; but in proportion as the applicant may feel more comfortable if his case is first passed upon by a committee like the existing Capital Issues Committee, and if what they recommend then goes for a decision in the Treasury, then it seems to me that the procedure has become one that has a good many of the aspects of independent consideration, and that, I think, raises, when the Treasury comes to its decision, the question of principle, whether or not reasons should be given. On the whole it is normal, when this sort of arrangement exists, particularly when particular decisions are at issue rather than general advice on policy, that one at least thinks whether the reasons should or should not be given. It seems to me that, if one has a hybrid of this kind, advisory in character and yet based on the independent views of men of experience, it does begin to be important to know whether as a result of this impartial, objective and independent process a reason ought to be given. That reason would have to be given by the Treasury on the existing set-up, because on the existing set-up the Treasury

decides; but are not the reasons for different decisions arrived at after this procedure? With the ordinary administrative decisions, for example, the procedure is rather different?——Yes. I do not know whether this is true in every case, but I take it that the reason for the acceptance or rejection of a particular application is that it does or does not fall within the general policy guidance which the Committee have, which is known. If you are then going on to say that we must explain why it does not fall within the policy guidance, that is a question in many cases of judgment rather than of precise interpretation of rules.

1250. I am aware of that, but I am really wondering whether that is not something that a person who wants to raise capital in the ways that come within the jurisdiction of this advisory committee is not entitled to be told, and whether it is not a cause of some difficulty and uncertainty in the world outside that the precise nature of the judgment reached is never disclosed?——That depends on the degree of uncertainty in the outside world which is in practice created, and that I do not think I am in a position to judge.

1251. *Chairman*: Before we leave this, I think there are two aspects of the working of the Committee to which questions have been directed. One is whether it is an adequate way of dealing with the proposals of the individual who wishes to raise money for certain purposes, perhaps very wide purposes. The other one is no less important, and that is whether the Committee contributes effectively to the control of investment. Is the Treasury satisfied as regards both those aspects?——Yes. We consider that they are adequate, and that it has been effective. From there, I suppose, it is open to anyone to go on to say that there are arrangements which would, if you like, be more adequate and more effective; but up to the present time the Treasury's position is as you have stated it.

1252. *Professor Cairncross*: The object of the machinery you have created is to kill certain business projects. What steps do you take in the Treasury to inform yourselves of the kind of projects that have been killed, about the number of them and whether there are among them some that are worthy? Speaking now not only of the Capital Issues Committee but also of the controls that are exercised through the issuing of guidance to the banks, do you in fact take any steps to judge how effective the machinery is, or do you merely judge by the kind of cases that come before the Capital Issues Committee, and by hearsay or public protest in Parliament?——I think it is the latter. I am not aware of any procedure or method by which we attempt to get that information.

1253. Do you go to the departments who are issuing advice to potential applicants, and try to discover from them the kind of case that is discussed and not pursued?——I do not think we in the Treasury do that. If an applicant goes to another department, then it is that department's responsibility; if they were in any doubt they would refer it to the Treasury.

1254. I am not now discussing cases but the means by which you conclude that the mechanism is satisfactory or not. Are there any tests that you can possibly apply, any information you can collect, that would allow you to form a judgment on that?——We rely on the general operation of the control and the results which it produces.

1255. Let me take, for instance, the case of the banks. Bank advances have not risen appreciably in the last five years in this country, contrary to the experience of many other countries, but the amount of credit which is made available to industry by the banks is, surely, a fairly small fraction of the total amount of credit outstanding between companies, or between persons and companies, or between persons. Banks are only a small fraction of the whole machinery by which credit is advanced from one customer to another. Have you any conception of what the fraction is, of what is the amount of pressure you exercise by stepping on bank advances?——*Sir Robert Hall*: No, we have no precise conception at all.

1256. Do you attempt to arrive at any judgment of the effects of the guidance issued to the banks, as to the type of business which is suffering, the volume of business that is restricted or new businesses which are hindered?——*Sir Robert Hall*: As to the type, I think Sir Roger has already answered that. The Treasury is generally aware of what is going on. If anybody is particularly aggrieved we hear about it. We have various methods which give a sort of qualitative sample. As to the volume I think that we judge broadly by the total trend of investment.—*Sir Edmund Compton*: On bank advances I think it would be right to say that in terms of amounts and direction the chief indication by which we go is the published figures of the quarterly distribution of bank advances. These show the variations in the trend of advances. For example, over the last two years the Personal and Professional category has gone down, and there has been an increase in the Engineering category.

1257. *Professor Cairncross*: If you take the Personal and Professional category, that might to a large extent be offset by insurance companies. There are a large number of financial intermediaries who are prepared to advance short-term credit in default of the banks. But to come back to the point that you are dealing with here, bank credit is a relatively small fraction of the total amount of outstanding credit, including trade credit and consumer credit in the country, and a variation of £50 m. to £100 m. in this direction might be completely offset in some other direction.—*Professor Sayers*: Why are the banks singled out for this attention?——The question was, what we know; the banks are good enough to tell us. The quarterly distribution of bank advances is published by them.

1258. It is only the banks who receive these requests, is it not, from the Chancellor, to restrict and refrain from lending to this, that or the other person?——In October, 1955, and I think I am right in saying in July, 1955, the Chancellor in making his request for restriction of credit made it in terms of asking all those who provide and control sources of finance to take up this restrictive attitude. In other words, there was a request which was directed in general terms to all sources of finance. That was said as an indication which would be applicable to, say, insurance companies in addition to the requests to the banking system that are set out here in this paper. But the main reason for the requests to the banks is that bank lending in the ordinary course of business is specifically exempted from the capital issues control. It was complementary to that exemption that the banks were asked to observe the same principles as were applied to lending subject to capital issues control.

1259. *Lord Harcourt*: I seem to recollect that, although these directives are addressed to the bankers, they are in fact also communicated to every other possible source of credit. I think the insurance companies do receive these directives, do they not; I am sure the accepting houses do?——*Sir Edmund Compton*: Yes, the accepting houses do.—*Lord Harcourt*: And I rather think, although addressed to the banks, they have actually been passed on through the British Insurance Association.

1260. *Professor Cairncross*: Is there not a difference between the different financial institutions, in that in some cases what you may call guidance becomes a directive while in some cases it may disappear altogether? If a bank pays no attention to a Government suggestion there are certain penalties that may be inflicted on it, but these penalties do not apply in the case of other financial intermediaries. Is that not so?——Borrowing from other financial intermediaries becomes the subject of control if there is an issue of security and the amount is over £10,000. Borrowing from a bank is exempt. That was the original reason, and I think is the continuing reason, for a parallel request to lenders at the same time as guidance is being given to the C.I.C.

1261. *Professor Sayers*: This is substantially a question of the efficacy of the control. In many cases the borrowing of sums for various purposes from financial intermediaries where no security is issued escapes the control of borrowing legislation. Some of this borrowing is from banks, and that is subject to the requests from the Chancellor which may be enforced in various ways and on the results of which you appear to keep some watch. There is a great deal of other lending and borrowing going on, that does not come under the Capital Issues Committee at all, and that at points competes with what is being done by the banks. Large sums are involved, and there is no question of a reference to the Capital Issues Committee. There is no question of the Government making things unpleasant, as for a bank that is not playing straight on

the control. Why is that large field left untouched, except for very general remarks from the Chancellor which have no sanctions behind them, and yet the Capital Issues Committee procedure is maintained and the requests to the banks are made?——The suggestion is that a great volume of borrowing is going on, apart from borrowing from the banks. The main instance of that borrowing not subject to control is, I suppose, the taking of deposits.

1262. *Professor Cairncross*: There is an enormous amount of credit outstanding from one company to another?——*Sir Robert Hall*: Surely you distinguish between that kind of credit and that issued by the banks? One is much more fully money than the other, is it not? —*Professor Cairncross*: Of that I am not sure. It has the same effect.—*Sir Robert Hall*: If one company gets credit from another, it is true that that is an increase in the quantity of credit, but there are limitations on the use of that kind of credit of a quite different kind from the limitations on the use of bank credit.

1263. *Chairman*: What limitation had you in mind?——If I get a loan from a bank I can draw cheques on it, and it can continue to move round. If I get a credit from my grocer it is much more difficult for that bit of paper to go into circulation.

1264. Such credit is much more particularly tied to the particular transaction, you mean?——Yes.

1265. Are these statistics in paragraph 21 published in this form and available generally, or are they supplied for our purposes?——*Sir Edmund Compton*: They are provided for your purposes, but we are about to publish some statistics on this subject. The difficulty is that the statistics themselves, as you can see, are incomplete, in that they represent consents actually given and that those consents are not necessarily all taken up or all taken up in full, or all taken up within a particular period. It is the custom to seek consent well in advance.

1266. Is there any check on the amounts that do fall by the wayside for one reason or another?——No.

1267. In some cases, consent is given subject to finding a place agreed with the Bank of England in the queue, as it were; might you not easily fall by the wayside there?——Yes, and consents are normally valid for six months and thereafter, they may or may not be renewed. If they are not renewed then there is no machinery for spotting whether the consent has been used or not.

1268. Can you categorise in these statistics the various broad heads of the purposes for which these borrowings have been allowed?——That is the form in which we are now attempting to make a regular series of figures for publication.

1269. *Professor Sayers*: In view of the nature of these statistics, a commentary would be very valuable, in fact, one might almost say essential?——*Sir Edmund Compton*: By "commentary" you mean a description of the different types or different purposes of applications in categories? —*Professor Sayers*: I mean by "commentary" a little more than annotation. The volume of the commentary may vary greatly.

1270. *Chairman*: If one was to form any outside view as to the effectiveness of this machinery for selective control one really would need some form of categorisation, both of those which have been allowed and those which have been rejected. I do not see how otherwise one knows how the thing is working?——*Sir Roger Makins*: We do not know in precise terms how the thing is working, for the reasons which have been given. We do not follow up to see what happens, in the event, to each application. As far as the categorisation is concerned, as Sir Edmund Compton said, an attempt is being made to produce a breakdown of these figures, which will be put before you.

1271. *Sir Oliver Franks*: We have been discussing the area of borrowing which the Capital Issues Committee looks at, and said something about all the other borrowing which may go on which does not attract much attention because it is not falling within the rules. Now a proportion of the decisions of the Capital Issues Committee has to do with capital investment. Other decisions have to do with the issues of shares from reserves, bonus shares, and we can forget about them. Now obviously a great deal of capital investment takes place of the sort that Mr. Jones referred to earlier, when companies, out of their own resources which they have saved up, go in for capital development without having to ask anybody's leave at all. Then there is another field which, as I say, appeared in the recent discussion (though there may be a difference of opinion about its size) which is such capital development as companies may undertake, having got credit for that purpose from sources other than the banks, and otherwise than by means of an issue that would go before the Capital Issues Committee. Can we have any idea, however rough, of the proportion of decisions which relate to capital investment with which the Capital Issues Committee deals in relation to the overall figure for capital investment for commerce and industry? Are they dealing with two-thirds, a half, one-quarter, one-tenth?——*Sir Robert Hall*: I think we ought to be able to give you figures of that.—*Sir Roger Makins*: We cannot give you a figure here and now with any assurance.—*Sir Oliver Franks*: That again is relevant to the effectiveness of the work that the Committee is doing. If it turned out that much the larger proportion of the capital investment which is undertaken by commerce and industry falls outside the purview of the Capital Issues Committee, then the question of why the particular people who are picked on arises, and one would be forced to ask in that case whether it is a matter simply of administrative convenience, that you can get at these and you cannot so readily get at the others. The same type of question would arise, as Professor Cairncross and Professor Sayers were asking from the lending angle. Could that be done? —*Chairman*: I think that is most important.

1272. *Mr. Jones*: Taking the figures in paragraph 21 if the applications granted resulted in full in issues, you would have had new issues of round about £1,000m. in 1956. To the extent that there were not issues, if only 90 per cent. by value of the applications granted were taken up, then it becomes £900m. Let us assume for the sake of examining this question that the full amount authorised is taken up, and that applications going to the Capital Issues Committee result in new issues of £1,000m. in a year; would not that be roughly between 5 per cent. and 6 per cent. of the gross national product?——*Sir Robert Hall*: It would be a little more than 5 or 6 per cent. if all this was in one year.

1273. Then let me put it in another way. Supposing you took into account your gross national product and your imports, would it then be somewhere in the region of about 5 per cent., making provision for meeting your exports out of your gross national product?——5 per cent. is near enough.

1274. Is not gross capital formation in the region of 14 or 15 per cent.? If that is so would you not have a situation where you have uncontrolled capital development including, I agree, renewals, and repair of depreciation, of one and a half times the amount of money that is really controlled and directed, or restricted?——I think there are several reasons against that. The principal one is that a great deal of the total capital investment involved in the 15 per cent. or so of the gross national product is investment under the direct control of the Government; investment by nationalised industries, by Government bodies, by local authorities. So the £1,000m. that you are referring to must be looked at in regard to the private sector of investment rather than the total investment of the country. Investment by the private sector is only about half the total investment of the country.

1275. You are saying, in effect, that you must add to this 5 or 6 per cent. the amount of money that is spent in development by the public corporations; by the whole public sector and by local authorities?——By local authorities and the central Government; although I should be a little surprised if this figure of the order of £900m. did result in a year in that much investment, because that would suggest that more was going to the Capital Issues Committee than I would think does go. The self-finance of companies out of profits, which is not caught by the Capital Issues Committee, must be a substantial part of the total: but we will try to give you an estimate. I can see that your point is really a development of the point that has already been put.

1276. *Professor Cairncross*: I hope you will distinguish between issues for use abroad and issues for use in this country?——I do not know how good the figures are going to be. Please do not put too much hope on these figures.

11 *September* 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B. [*Continued*

1277. *Sir Reginald Verdon Smith*: Sir Roger described this C.I.C. arrangement as being peculiarly British in character. I am wondering whether the Treasury have any knowledge whether any similar institution or any parallel method of watching or guiding the process of private company issues exists in any other country, and, if so, whether there are any comparable advantages or disadvantages in relation either to adequacy or to efficacy?——*Sir Roger Makins*: I have no knowledge.

1278. *Lord Harcourt*: I would like to return to the question which Sir Oliver Franks raised about the pros and cons of giving reasons when an application is refused. As Sir Edmund rightly said, applications are not made by people who think they are going to be turned down. Nobody wants an application turned down. Applications are normally made by responsible corporations, by boards of directors and executives, advised in most of the cases, I think, by financial houses or accountants or lawyers who have specialised in this sort of thing; and yet every now and then an application is turned down flat, for no reason. The result of that is, I think, that there is an unnecessary amount of bewilderment caused in a highly specialised and presumably intelligent group of people, who ought to be able to understand the directives and to follow the wishes and desires of the Chancellor as well as the general economic trend of the country. It therefore seems to me that this question of giving specific reasons, and explaining how and where an application has fallen short or in what way it has contravened any instruction, is one which really should be given attention. I do not know if Sir Roger would like to speak any more about it?——*Sir Roger Makins*: I do not know that I really want to add to what I have already said on this point. I can see that there are cases in which this practice may be unwelcome to the applicants——*Lord Harcourt*: Bewildering, is rather the word—I think more bewildering than anything else.—*Sir Roger Makins*: —but it would involve an important change in the way in which the Committee functions. It is a criticism which has been directed at the exercise of the control from time to time, and, of course, it has been taken into account: but I can really only say that it has not been thought practical or desirable to change it.—*Sir Robert Hall*: I find myself very much in sympathy with the way Sir Oliver Franks put it earlier. I think there is a fundamental difficulty in this field due to the fact that the word "inessential", which appears in the directives, is a word which is not capable at any time of precise interpretation. I do not think that it follows from that that it has no meaning or content at all: broadly speaking, at any moment there is a kind of national or political feeling that some things are more important than others, though they are not expressed in economic or precise terms. My own feeling is that you will always get these "fringe" difficulties when something has to be interpreted which is inherently incapable of a very precise definition. However, I think that it would be wrong to conclude from that that because it is not precise it has no meaning at all. In some cases one can make it precise. There were references in 1951 to metal usage; everybody could understand that; and everyone understood that exports were important in 1951, just as everyone understood that metals were short because of the over-riding effect of the defence programme, plus exports. But I think that if you are trying to operate a concept like "inessential" at all you must, in the end, do it in a way like this, taking a set of experienced and well-thought-of people. If you sat down and tried to write down what you meant by "inessential" at any time, I think you would have difficulty.

1279. *Chairman*: I do not think the criticism was about the idea of having a representative cross-section of people, with their current interpretation of a word like "inessential": the question was whether the Committee, having put their own interpretation on it in a particular case, could be asked to express their reasons for the interpretation?——Yes. It seems to me that what you have all been saying, in my view quite rightly, is that an applicant ought to know exactly where he is. It seems to me that it is inherent, in coming to operate a word like "inessential", that there will always be some element of difficulty in giving written precision to that.

1280. *Sir Reginald Verdon Smith*: Might I ask what Sir Roger thinks would be likely to happen if this apparatus were abandoned tomorrow?——*Sir Roger Makins*: I think it follows from the answers that we have given that we regard this as effective within its limits, without claiming a sort of global effectiveness for it, and consider that there would be an increase in the type of borrowing which now comes within the purview of the Capital Issues Committee.

1281. An increase on a scale which would be serious and dangerous?——*Sir Robert Hall*: I think we would have held the view in 1955 and 1956 that it would have been on that scale. It is always difficult when you are asked about a moment in time, as it were, tomorrow, when the capital market is rather difficult anyway, whether it would lead to those results; but I think we regard it as having been a useful instrument in the sense that there was less investment as a result of this Committee than there would have been if it had not been there at all.—*Sir Edmund Compton*: One could perhaps add to that that if it were dismantled now the check on what the Committee now consider the least urgent demands on the capital market would be removed, so presumably the pressure on the market would be increased. There is also a particular control that is now being operated through the Capital Issues Committee, namely control of bank borrowing for capital purposes. If that was abandoned, there would be an increase in borrowing for capital purposes from the banks. Then there is the capital issues control as the sanction behind the orderly marketing arrangements. As the paper mentions the consent of the Bank of England is required for the timing of an issue of over a certain amount. That is a stipulation in the Treasury consent. So the question of orderly marketing arises as well as the question of control over the volume of applications.

1282. *Sir Oliver Franks*: Surely the marshalling of issues to go out on the market can be and is undertaken by the Bank of England? Whether or not the Capital Issues Committee existed, it would make those decisions. The two may fit in together; but is not the Bank of England perfectly capable of arranging the order in which areas are put into the market?——I think that, if it were not thought that this provision was really essential, it would not be made a condition in the case of issues of magnitude. It is not there as a matter of form: it is there because it is considered to be necessary.

1283. *Professor Sayers*: Is it not a fact that the Bank of England took steps to secure orderly marketing before there was ever capital issues control?——*Sir Robert Hall*: I think perhaps it is relevant to say here, arising from what Sir Edmund said, that the Capital Issues Committee represents one of the means by which a particular Government policy is exercised. If the policy remained and the Capital Issues Committee were disbanded, then some other means would have to be found of exercising the control.

Chairman: We will not keep you longer, but when we meet you again in the future we may want to go back on certain aspects, especially after the opportunity of perusing the papers. At any rate we shall have to go back to what we left unfinished yesterday.

(*Adjourned until Thursday*, 17*th October*, 1957, *at* 10.30 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

SIXTH DAY

Thursday, 17th October, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	PROFESSOR R. S. SAYERS, F.B.A.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	SIR JOHN WOODS, G.C.B., M.V.O.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	MR. R. T. ARMSTRONG, *Secretary*
W. E. JONES, ESQ., O.B.E.	MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

1284. *Chairman*: Sir Roger, there are one or two things to follow up from last time we saw you. Could you tell us where these matters stand?——*Sir Roger Makins*: A point arises on the National Savings paper, which I think is on the agenda for this morning, on which we have prepared a statement which Sir Edmund Compton will make. Then there is a point which was raised on the investment and depreciation of public corporations; on that we have prepared a short paper which we will circulate to you shortly. Then there is a question, which I think was raised by Professor Sayers, on the Parliamentary control of the fiduciary issue; on that we have a paper in preparation which will be ready in two or three days. Finally there is the paper on debt management which we mentioned last time; this is in course of preparation, and I hope next week to give you a date when that will be ready. Those are the points on which we have progressed.

1285. May we take Sir Edmund's statement about National Savings now?——*Sir Edmund Compton*: When you heard us on the 10th September, Professor Cairncross raised the question of the discrepancy between the estimates given in the National Income Blue Book of total personal savings and the partial analysis of changes in identifiable assets, and asked what steps were being taken to improve the position.

The figure of personal savings is derived as a residual from the two very large aggregates of total personal income and total personal expenditure. Even small errors in either of the aggregates will therefore produce a much larger proportion of error in the figure of personal savings. The direct approach to an estimate of personal savings cannot be complete because there are various items about which nothing is known at the present time. Table 25 in the Blue Book, the one entitled "Capital Account of the Personal Sector", sets out the changes in certain identifiable assets; but it is recognised that there are serious gaps still to be filled, the most important of these being the change in personal holdings of Stock Exchange securities. Other items are changes in total outstanding borrowing from sources other than the building societies and the banks, e.g. mortgages on house property from insurance companies, hire purchase, and transactions in existing fixed assets between the personal sector and other sectors of the economy. Those are the gaps and it is hoped gradually to cover more of these fields, but we are advised that to do so will need the introduction of a new statistical series which may require considerable negotiation with the various financial institutions concerned.

The alternative approach, which I think Professor Cairncross also mentioned, is the approach by way of sample surveys. There were those carried out by the Oxford Institute of Statistics in 1952, 1953 and 1954, and the survey on the same lines done by the Central Statistical Office itself in 1955; but the results of these surveys have not, we think, been very satisfactory. At the present time the Central Statistical Office, in consultation with the other departments, is considering ways in which surveys of this kind might be improved.

This is only an interim report on the alternative methods of filling these gaps, but that is the position today.

1286. *Professor Cairncross*: You will agree, I think, that it is a little unsatisfactory when so much hangs on exact information, or failing exact information a clear indication as to trends, to have two sets of figures so divergent? It is obviously important to arrive at better information on this rather important point?——Certainly. This has in my experience been the most troublesome gap in the national income series for a long time now. That is why special efforts are being made at the present time to fill it.

1287. Take one illustration of what I should have thought might conceivably have been tackled as a priority. Last year there were restrictions on hire purchase. We do not know whether this made people save more, or whether it was not of any great consequence in the spending/saving relationship. Would it be possible to conduct *ad hoc* inquiries into matters of that kind?——That is possibly an example of the direct inquiry to correct what is still a gap in the series. I would rather not say more than that, because that is really a point on which, if you wished for further evidence, I would suggest the Central Statistical Office should give it.—*Sir Robert Hall*: I think Sir Edmund has made it clear that we would like to improve the statistics, and I do not think there is any difference in objective between what Professor Cairncross has said and what we have said. You may well think we should have pushed on even faster than we have done, but we certainly do not want to give the impression that we ourselves are not anxious to improve the statistical apparatus available to us.

1288. *Professor Cairncross*: I was looking back to the situation at the end of the war, when many people were saying how important it might be to conduct surveys on spending and saving by inquiry. Eleven years have elapsed since then. We may be dissatisfied with the techniques that have been suggested, but not much has been done.——*Chairman*: Not only is there a gap, but it is on a very important point; I think we are on common ground?——Certainly. Another gap of which we have been very conscious is the difficulty of getting good stocks figures and forecasting movement in stocks, where some progress has been made in the last year or two.

1289. *Chairman*: We had your opening statement, Sir Roger, which we said we would read over when we saw it in print. There are one or two points some of us would like to follow up——*Professor Sayers*: Early in the statement you spoke of the relations between the Bank and the Treasury in deciding on steps to be taken, and

said: "the ultimate decisions rest with the Treasury". I believe that the Bank of England Act gives the authorities certain powers to issue directions to the banks, but I believe that the power rests in form upon the initiative of the Bank of England. Would you confirm that that is so and, if so, whether you are satisfied that none the less the Treasury is in a position to take the ultimate decision on a matter that might involve the issue of a directive?——*Sir Roger Makins*: This rests of course on section 4 (1) of the Bank of England Act which says: "the Treasury may from time to time give such directions to the Bank as, after consultation with the Governor of the Bank, they think necessary in the public interest". That section has not so far been invoked. I am not seeking to interpret it in a legal sense, but it surely must mean that the ultimate decision rests with the Treasury.

1290. *Sir Oliver Franks*: I thought that, if it came to a question (as in practice it so far has not) of issuing a directive to the commercial banks, the people who had formally to sanction of issuing that directive were the members of the Court of the Bank of England. The directive to the clearing banks, as I understood it, would not be prepared in, or issued by the Treasury in the name of the Chancellor of the Exchequer; it would be prepared in the Bank of England and issued from the Bank of England. Is that wrong?——Are you not thinking of section 4 (3), which relates specifically to the directions which the Bank may give to any bank for the purpose of securing that effect is given to either a request for information or recommendations to bankers from the Bank of England?

1291. *Chairman*: Must that not be approved by the Treasury under the terms of the section?——Yes: "if so authorised by the Treasury".

1292. Have you ever been up against this problem, as a question of your powers, whether the Treasury can give the Bank of England under the first subsection a direction to give a direction under the third subsection to the commercial banks?——The question of applying this section has never arisen, and we have not, as far as I know, at any time considered the issue of a direction to the Bank of England. It would depend on the circumstances, if such circumstances ever arose, how this section, if it were invoked, should be applied. The Chancellor, as I have stated, has from time to time met the banks with the Bank of England, has discussed particular circumstances with them, and has issued requests to them.

1293. But that has not lain in the field of exercise of the statutory powers?——No.

1294. You have a power, as I understand it, in the Treasury, to direct the Bank of England, after consultation with the Bank. You have later in another subsection of the same section, a power in the Bank, with the approval of the Treasury, to direct the clearing banks. I was wondering whether the chain was intended to be complete; is the Chancellor able to set the Bank of England, as it were, in motion on the banks, or was there deliberately meant to be a break in the chain?——I think the only light which can be thrown upon that is the debate which took place in Parliament when this Act was passed, at which certain things were said.—*Sir Edmund Compton*: When the Bank of England Bill was before the Select Committee, my recollection is that, when they took evidence, Lord Catto put it on record that in effect the Bank could not be directed to think something. At any rate, as far as the then Governor's understanding of the meaning of the Bill was concerned, that was the position, and that was not challenged, as far as I know, but was accepted at the time.

1295. *Lord Harcourt*: You mean that there is not a two-stage continuous process; the effect of it is that the Treasury may not direct the Bank to make a direction?——I can only speak of what was put on record when the Bill was passed through Parliament, and what was then put on record by the then Governor of the Bank of England. I cannot take it further because neither of these two sections has been put into operation.

1296. *Professor Sayers*: Has not the present Governor in the last fortnight in a public speech at Ipswich said: "Here Parliament has laid the responsibility for initiating these statutory powers squarely on the Bank of England"?——I think that the Governor was making this distinction between 4 (1) and section 4 (3). He says that in connection with the Government's "overriding duty to ensure conformity of monetary policy with their general policy" section 4 (1), subject to consultation with the Bank, "empowers the Treasury to give directions to the Bank". Later he says: "The relationship of the 'authorities' to the commercial banks is a special and somewhat different matter. Here Parliament has laid the responsibility for initiating the use of statutory powers squarely on the Bank of England", and then he quotes section 4 (3).

1297. *Chairman*: That looks as if there was an interpretation in the Bank, beginning with Lord Catto and continuing with Mr. Cobbold, and you have not had to consider whether there is any difference between you, as it has not arisen?——*Sir Roger Makins*: It is the Government's overriding duty to ensure conformity of monetary policy with their general policy, and this has been recognised. I think that it is also recognised that there is a distinction between these two subsections, both in what I have said and what the Governor said in his speech.

1298. Mr. Cobbold used the words: "It lies with the Bank to initiate any action with regard to the commercial banks". I think that means that he regards 4 (3) as meaning that such action cannot be started by a direction of the Treasury to the Bank of England; it must start with the Bank of England.—*Sir Oliver Franks*: The impression in the clearing banks is that the clearing banks could be directed only if the then existing Court of the Bank of England so voted and decided; that, while all the broad facts about overriding power are as you say, it would formally be for the Bank, after listening to the Chancellor, to take its own decision. No doubt there might be consequences one way and another, but there is this intrusion of another set of wills in the process.—*Sir John Woods*: It seems that there is a received interpretation so far as the Bank of England is concerned. So far, at any rate, it has not been in the Treasury's mind to challenge that interpretation?——There may be such a received doctrine or interpretation, but it has not been formally stated, and therefore there is, so to speak, nothing to challenge.

1299. *Professor Sayers*: This is a point that may become more serious in future. If the Bank of England took one view as to what the commercial banks should be told or directed to do under statutory powers and the Treasury took another view, are you satisfied that the Treasury view would nevertheless prevail?——I do not want to evade the question; but it is very difficult to say that one would be satisfied as to the answer to what is a hypothetical question.

1300. *Chairman*: We may have to come back to this at some date. I do not see why you should have to answer at the moment, but I think that the Committee will have to face the problem. Suppose that the Attorney General told the Government that in his view there was no power under the Bank Act for the Chancellor to direct the Bank of England to give any particular direction to the commercial banks, but the Bank of England had of its own initiative to ask for approval of such a direction; would you from the point of view of the Treasury be satisfied that that was a satisfactory position, or would you think that some amendment or alteration of your powers was needed in the public interest?——If the Government of the day found that they had not the powers which they felt they should have, then it would be for them to decide whether they would seek to obtain such powers.

1301. They could consider making an amendment to the Bank Act; but I was wondering if we were going to get a view from you as to whether it would be desirable in the interests of monetary management to obtain such a power, if it is lacking. Or do you think that is too hypothetical?——I do not see why you should answer at the moment, but I think it is a thing we shall come up against.—*Sir Oliver Franks*: This is not a question simply of the effectiveness with which policy can be carried out stage by stage in the economic organisation of the country. There is also a question which goes beyond mechanics, and, I suppose, in the end reflects on the kind of society that we might want. Would this not be a question of an extension of *dirigisme*, and views could

differ on how far things should be controlled and planned from one centre, or how far you need a number of centres each with a degree of initiative, which is the present picture according to the interpretation in the City?——*Sir Roger Makins*: That is why I said that such a question would be a matter for the Government of the day to consider if the situation arose.—*Sir Edmund Compton*: There are two hypotheses behind that question. The first is that compulsory powers should be used; and, that having been decided, the second is that there was a complete cleavage of opinion as to what was wanted, between the Government on the one band and the Bank of England on the other; a Bank of England, moreover, which had been appointed by the Government.

1302. *Professor Cairncross*: How far does the interpretation of the word "bank" extend here? The legislation is drafted, if I remember rightly, in terms which leave the definition of a bank a little vague. If it were necessary, for instance, to issue a directive to the finance houses, would that come from the Treasury or from the Bank of England? Can you qualify the term "bank" in the Act.—*Chairman*: Is it not that a bank for the purpose of the Act is any institution that the Treasury certifies or declares to be a bank?——*Sir Edmund Compton*: Not quite. A bank is "such person, carrying on a banking undertaking, as may be declared by order of the Treasury to be a bank for the purposes of the section." Before he becomes vulnerable to be named by the Treasury, there is the question of legal interpretation as to whether he is carrying on a banking undertaking.

1303. *Professor Cairncross*: There are certain financial institutions known to be banks, which receive their marching orders from the Bank of England and not any other agency; are there not other financial institutions, not commonly regarded as banks, that might conceivably in future be asked to take directions from the Bank of England, if you declared that they were banks under the terms of the Act (I am thinking of finance houses)?——Under the voluntary code, which is perhaps the best way to describe the procedure now, it is open to the Bank of England to ask for the co-operation of any institution. They are not bound legally to confine themselves to a particular class of institution. But under the hypothesis that one was using the compulsory powers of the Bank of England Act, then directions would have to be confined to persons carrying on a banking undertaking. I suppose that persons who thought they were not carrying on a banking undertaking might claim exemption on that account.

1304. *Sir John Woods*: Are the hire purchase finance houses at the moment legally banks for this purpose or not?——The question has not arisen. Not having applied this, we have not had to face the question of defining the bodies whom the Treasury should declare to be persons to whom directions should apply.

1305. *Professor Sayers*: Is there not a point of immediate practical importance? Might you not have certain undertakings, considering among themselves that they could make a good case in the Courts that they were not banking undertakings, who would feel that they need not co-operate in any requests made by the Government or the Bank of England at present? Does not the obscurity of the legal position raise at any rate the possibility that these firms would be uncooperative in a voluntary control?——*Sir Roger Makins*: The question, which is obviously to the point, of the position of certain institutions which might not consider themselves to be within the ordinary, accepted definition of the term "bank", is before the authorities and is under consideration.

1306. *Professor Sayers*: Has consideration been given to defining a bank for these purposes as any institution which advertises for deposits?——*Sir Edmund Compton*: That is a possible interpretation of the word bank, but not one which we believe would be likely to survive legal challenge.

1307. Has the Treasury yet arrived at a definition which it believes would survive legal challenge?——No, because we have not been in the position of contemplating action under the Bank of England Act.

1308. Does that mean that you have not contemplated any amendment at all? The Treasury and the Bank of England at present request the clearing banks to take certain, sometimes pretty drastic, action that is contrary to the commercial interest of those banks. They accept the position, and do not put the authorities in the position of having to issue directions to them. One of the effects of their compliance is to put business in the way of other firms that do not receive these requests or, if they receive them, might take the line that they could snap their fingers, because there was no adequate legal power to compel them. Is not that a position in which some amendment of legal powers ought to be considered?——*Sir Roger Makins*: I can only repeat that this is a point which is under consideration by the Government at the present time. I do not think I can go further than that.

1309. *Chairman*: Would that mean that what is under consideration is whether to extend or amend the definition of "banker" in the Bank Act?——*Sir Roger Makins*: It has not been considered in that way. It has been considered in another way.—*Chairman*: Can you tell us in what way?——*Sir Roger Makins*: I could not tell you on the record.

1310. *Professor Cairncross*: There are a number of foreign banks with branches in London. Would they receive instructions from the Bank of England, or are they expected to conform with Government policy through co-operation?——That is really a question affecting the good relations of the Bank of England with those particular banks. I think you should address that question to the Governor when you next have him before you.* The requests are framed in general terms, but I would think, for example, that the branches of foreign banks in London are certainly not in the same position as finance houses.

1311. Are branches of foreign banks compelled under the terms of the Act to comply with the directions of the Bank of England?——*Sir Edmund Compton*: As a matter of current practice we operate a system of requests for co-operation. For example, the request to the bankers in the Chancellor's statement on 19th September was transmitted to the different associations that make up the banking system of this country, and the overseas banks operating in London received it in common with the clearing banks and the members of the British Bankers' Association. But I think Professor Cairncross is asking whether there lay behind that request the sanction the Governor referred to when speaking at Ipswich. We do not know, because we have never been called upon to apply this part of the Bank of England Act, and therefore to decide whether one of those banks should be named a person to whom the directions should apply under section 4. It just has not yet happened.

1312. *Chairman*: There is undoubtedly a difference between a request which takes the form: "I would like you to do this and if you do not, I will see you do" and a request which consists of saying: "I would very much like you to do this". We are trying to see what the real nature of it is.—*Professor Cairncross*: As far as I know, under all the nationalisation Acts there are powers of direction, and as far as I know these powers have not been used in any case. In practice what matters is the working relationship. But there must be, underlying such working relationships some legal basis. We are trying to establish the legal relationship between the branches of foreign banks and the Treasury.—*Lord Harcourt*: As I understand it, the difficult here really goes rather deeper than the Bank of England Act. I believe that the definition of a "banker" or a "banking undertaking" is something which has so far defied all legal interpretation; it has never been quite decided. At the time of the Bank of England Bill nobody had ever interpreted the word "banker" or "banking undertaking", and nobody in 1946 was prepared to attempt to undertake that. This is really a much more fundamental problem than the mere Bank Act, I think?——*Sir Robert Hall*: I think it is a common feature of much more legislation than this that you cannot say exactly how it is going to work until you have to use it, because you do not know exactly what the Courts are going to do until you ask them—*Sir Edmund Compton*: The thought behind subsection 6 was no doubt the only definition we have of a bank; that is to say the circular one, that a bank is someone carrying on the business of banking. On the other hand, the application of this section would arise on a particular case. It would be a question of giving a direction and naming a particular person as the recipient

* See Appendix to Minutes of Evidence.

of the direction; and it would then be possible as a matter of practice to identify, with or without the help of the Courts, whether that particular person was in fact doing that business.

1313. *Professor Sayers*: Later in your statement, after having spoken of the relations between the Treasury and the Bank, you give us a different formula in referring to movements of Bank Rate. You say that a change in Bank Rate is "the Bank's decision, taken, in practice, after consultation with the Chancellor of the Exchequer and with his approval." There is a change of wording from the use of the word "Treasury" to the use of the term "Chancellor of the Exchequer". I take it that this means that what happens is that the Governor of the Bank consults with the Chancellor personally, and whether or not anyone else in the Treasury know what is happening depends entirely upon the discretion of the Chancellor of the Exchequer personally. Is that so?——*Sir Roger Makins*: Certainly. It applies to that case; and it applies in general to any discussion or consultation between the Governor of the Bank of England and the Chancellor of the Exchequer. The Chancellor of the Exchequer will give instructions to the Treasury, or take the advice of the Treasury on any matter arising out of any discussion with the Governor, as he so decides.

1314. As a matter of actual practice, does the Chancellor seek the advice of his officials on these occasions?——The relationship between the Chancellor of the Exchequer and the Governor of the Bank of England, between the Bank of England and the Treasury as a whole, is, inevitably and necessarily from the nature of their responsibilities, a very close one. There is a very intimate contact, not just at the top level but at all levels, between the officials of the Treasury and the officials of the Bank of England.

1315. *Sir John Woods*: May I go back for a moment to the question of Bank Rate? Was I right in understanding you to mean that in a case like that the first contact between the Court of the Bank of England and the Treasury would be a discussion between the Chancellor personally and the Governor personally? You yourself, or Sir Edmund, for example, would not see the Governor about the same time?——I can only speak for the practice of a comparatively short time, but the first contact would normally be with the Chancellor; it might be with me; it would not be with anybody else.

1316. *Sir Oliver Franks*: In these decisions the political head of the Treasury must be involved; his chief adviser in the Treasury must be involved; his chief adviser in the Bank of England must be involved. The centre for decision is the Chancellor of the Exchequer. He may see his two principal advisers together or separately. Probably practice over the last eleven years has in fact varied from time to time: sometimes one adviser will be seen at one time and another at another, and then the Chancellor will make his own mind up; sometimes there will be a triangular conversation. When a Chancellor of the Exchequer decides how he will make his mind up and through what forms of consultation, it is likely that he has regard to traditions, both in the Treasury and in the Bank, which live on even though formal relations are changed, and that therefore, for example, a right, which I think before the war seemed natural and almost inevitable in usage, for the Governor of the Bank of England to go and see the Chancellor personally and alone if he so wished probably would still continue. Is the answer probably that the responsibility really rests on the Chancellor of Exchequer of the day, how he arranges these very personal conversations with his principal advisers, and that practice varies?——Certainly that is so. Any relationship of the type which exists between the Treasury and the Bank of England is not subject to a set of rules or prescribed procedure. It is, as I have described it, an intimate day to day working relationship at the top level and all the way down. As Sir Oliver Franks has said, the actual way in which that relationship is applied will depend on the decision or method of working of the Chancellor of the day and of the other persons involved.

1317. If I might take a hypothetical illustration, would it be within the responsible decision of the Chancellor of the Exchequer whether, after he had seen the Governor of the Bank of England, he made a decision which related to what the Bank of England would do or decide without further consultation with his own officials? If the Chancellor of the Exchequer chose to take that responsibility he could; if he chose not to (as no doubt would normally be his choice) he would then consult with his own advisers in the Treasury. In this realm we are dealing, in fact, with how people behave given the responsibilities they carry?——That is right. Naturally the Chancellor of the Exchequer has the responsibility, and it is his decision as to how that responsibility should be discharged.

1318. *Professor Sayers*: My question related not to any rules of procedure but to what has in fact happened in the six or seven instances in the last seven years. May we have any information on that?——I find some difficulty in trying to describe in detail how a particular decision may be arrived at, because all the elements which go to forming a decision are not in certain cases within officials' knowledge. I think it would only be unproductive to try and go beyond what I have in fact said: that these decisions are the responsibility of the Chancellor of the Exchequer, and that in discharging those responsibilities he elects how he will do it and on what advice.

1319. *Chairman*: I see that it is very difficult actually to demonstrate any particular cases, especially dealing with the past years. You stand on the fact that a Bank Rate decision has to obtain the approval of the Chancellor of the Exchequer, and it really depends on the way any particular Chancellor works his institutions as to whom he consults. Is that your position?——Yes, I cannot very well say more than that.

1320. *Professor Cairncross*: May one go this much further? Suppose that there is a disagreement of view between the Treasury and the Bank of England, which there must be on occasion; the Chancellor could not very well come to a conclusion without first consulting in some detail the Bank of England, if it held a different view from the Treasury. On the other hand, he would be in a much easier position if he found that the Bank of England had reached a certain view, and he was prepared to accept it without further consultation; he would not feel necessarily the same obligation to consult with his own officials as with the Bank of England?——I cannot really answer for what a particular Chancellor of the Exchequer might feel at a particular moment. All of us round this table have had experience of how decisions are reached in Government; these decisions are normally reached after full consultation with all those who are concerned.

1321. There are decisions in monetary policy and decisions in fiscal policy, both of which apply in the same direction: in one case responsibility for action largely rests on the Bank of England; in the other on the Treasury. It is fairly easy for the Chancellor to be kept informed in the one case by the officials who are handling budget matters, and in the other case by officials who are handling monetary matters. We are anxious to know whether these two sets of problems are ever discussed jointly as a common problem and with both sets of advisers simultaneously?——I can only say that there is a number of occasions on which the Chancellor and some advisers sit down with the Governor and some advisers and discuss current problems.

1322. *Sir Oliver Franks*: The last sentence of this paragraph of your statement says that "this relationship, and the responsibilities to which it gives rise, call for close and continuous contact and co-operation between the Treasury and the Bank, and this . . . has been the rule at all levels in both organisations". In most Government Departments the policy which the Department has to carry out is not completely contained in a body of regulations. Administration consists of applying rules to cases. Policy is contained in aims, purposes and programmes, and administrative officers of the Department are responsible for the interpretation of policy as they decide to act. They make policy by interpretation within the broad framework for which the Department as a whole is responsible. At each appropriate level of administration decisions which involve policy are being taken quite normally in and between Government Departments, and it is possible to talk about policy, each side knowing fairly well what the general policy of its Department is and what freedom of initiative in decision is appropriate for the meeting. Now are the Treasury and the Bank of England organised

in precisely this way? A great many institutions in this country are organised, unlike most Government Departments, so that in truth all decisions in policy are taken at the top, and people at lower levels of the institution may properly be described as executives rather than administrators. If the Bank in its organisation came nearer to the one or the other type of organisation, it would clearly throw either less or infinitely more responsibility on the head officials on the one hand of the Bank, and on the other of the Treasury. If the different levels of the Bank were for the most part executive in what they did, it would mean that policy discussions generally took place at the top, and the way in which the highest decisions are taken would become merely the question of the relationships and personal reactions of not more than four or six people. Could you comment on the interpretation we ought to give to the "contact and co-operation between the two organisations at all levels" in the light of this broad distinction. I am sure it is "close and continuous". The point is, of what kind is it?——*Sir Roger Makins*: Generally speaking it is of the kind which exists between two Departments of an administration. I cannot say how exactly the Bank of England operates within departments; that is a matter for the Governor. I can only say that these contacts and discussions of the innumerable points which arise exist and are operated on a day to day basis, and that they take place on different levels. There is the contact between the Chancellor and the Governor or Deputy Governor, and between the Governors and top officials of the Bank and myself, the Second Secretaries and Third Secretaries of the Treasury, both on the internal side and on the external side. For example, Sir Edmund Compton is in daily contact with the Chief Cashier of the Bank of England, and so on.——*Sir Edmund Compton*: I should like to add to that. I am not quite sure that Sir Oliver Franks's general description of how policy is made in the administration of Government quite fits with this particular area. Speaking for the part that is an undoubted responsibility of the Treasury, the fiscal side, I would have said that policy is formed at the top and handed down to a considerably greater extent than is the case in, say, a Department which is formulating policy on expenditure or administering a social service. The natural point to take is the Budget. In fact policy-making on the Budget is done in a very small and high circle. It is perhaps important to say that it is not only in the Bank but also in the Treasury that this rather specialised kind of policy-forming applies. Having said that, I believe that with the Bank our contacts below Governor level are both policy and operational contacts. Perhaps the major part of those contacts is operational, but then a lot of policy consists in the way in which you carry out operations. You are forming policy as you operate. I find it difficult to distinguish between the two in speaking of, say, the daily contact that I have to have with the Chief Cashier, and I believe that in evidence before you he might well say the same.

1323. *Mr. Jones*: Economic circumstances enter to a very large extent into the question of the Bank Rate. Could we be told what the position would have been had it not been for the 1946 Act? Before the 1946 Act, what would have been the attitude and position of the Chancellor of the Exchequer in regard to the raising of the Bank Rate by the Bank of England, and what consultations if any would have taken place under those circumstances between the Treasury and the Bank? What difference has the 1946 Act made in relation to this position?——I would say none. The process of consultation between the Treasury, the Chancellor and the Bank on the adjustment of the Bank Rate both up and down is not determined by reference to the Bank of England Act, 1946, at all, but really by reference to the economic and financial situation in which we find ourselves at the time.

1324. *Chairman*: Even before 1946 by tradition the Bank of England would not have altered the Bank Rate without previously informing the Chancellor and obtaining his approval, would they?——*Sir John Woods*: I am quite sure that they would not have dreamt of altering the Bank Rate at any time without consultation with the Chancellor of the Exchequer.——*Chairman*: That was my understanding. Is that right?——There would certainly be consultation. The point at which I was hesitating was whether the Chancellor of the Exchequer of the day could have said: "I was, of course, consulted, and approved"; which was what Mr. Butler said after one of the earlier changes of Bank Rate.

1325. *Mr. Jones*: Is not the association of the Bank with the Chancellor a much more intimate and closely bound association in consequence of the nationalisation of the Bank of England than it was before?——I would have said that the contact was much more close, but not for that reason; perhaps because of the realisation that fiscal and monetary measures are complementary, and that the two should be related. For example, the Bank Rate changes have on occasion been announced on the same day and as part of a set of measures to deal with the economic situation, the Bank Rate being one element in the measures that were being taken. A recent example of that was the statement of 19th September.

1326. *Lord Harcourt*: Would you say that the effect of the 1946 Act was merely to formalise an intimate relationship which already existed, or has that relationship been specifically altered since the passing of the Act?——The Governor referred to "the Government's overriding duty to ensure conformity of monetary policy with their general policy"; I would say that that situation had developed by 1946, and the Act gave it formal recognition.

1327. *Mr. Jones*: But the management of the National Debt would become a substantially graver preoccupation for the Treasury in the event of an increase in the Bank Rate. In those circumstances, whilst the final decision rests with the Bank of England after consultation with the Chancellor, is it possible to reach the conclusion in this committee that the Bank Rate can be raised without a good deal of discussion between the Bank and the Treasury as well as the Chancellor, or in conjunction with the Chancellor?——*Sir Roger Makins*: There is this distinction in terms of procedure between the decision to raise the Bank Rate and other decisions, but I hope I have said enough to make it clear that all major decisions of policy—and after all that is a major decision—are normally reached in the same way as other major decisions of policy are normally reached; that is to say, by the responsible Minister after a great deal of discussion with the officials and the authorities concerned.

1328. Would it be fair to say that the final responsibility for the movement of the Bank Rate is the Bank's responsibility, after consultation with the Chancellor?——*Sir Roger Makins*: It is the Bank's decision, taken after consultation with the Chancellor of the Exchequer and with his approval.—*Chairman*: That can only mean that, if he did not approve, there would be no effect given to the Bank's decision. Is that a fair reading of those words?——*Sir Roger Makins*: It requires the Chancellor's concurrence.—*Mr. Jones*: He is the final arbiter.

1329. *Chairman*: I think that we have probably exhausted our questions on that statement for the time being. Now may we turn to the paper on monetary policy and the control of economic conditions?* I am very grateful, personally, for the paper. I find a great deal of information and interest in it. I think I say that for the other members of the Committee too.——Thank you very much, Mr. Chairman. We have tried in this paper to give you and your colleagues something to grip hold of. I wonder if I might ask leave just to make two or three points before you begin your examination? First of all I should like to say that I have asked Sir Robert Hall, with your permission, to be the witness in chief on this paper.

Secondly, this paper was completed and sent in before decisions had been taken leading to the announcement by the Chancellor of the Exchequer of the new measures on 19th September to protect the external and internal value of the pound. To that extent the paper is dated.

Thirdly, you will have seen that throughout this paper we have quoted freely from contemporary official documents, White Papers, Economic Surveys, speeches and statements by successive Chancellors of the Exchequer. Government policy and the reasons for which it was adopted are, of course, set out in those documents and statements. It is clear, I think, that we as officials are not in a position to put glosses on them. We can explain and discuss the problem and the policy which was adopted to meet it, but we are clearly unable to give you what I

* Memoranda of Evidence Part II No. 6.

might call the rough workings, even if we knew them all, which lead to the formulation of that policy. I do not mean by that that we shall not do our best in oral evidence, as we have done in our written paper, to give you all the assistance in our power, both by way of information and by way of analysis of the economic factors which were operating at the time the decisions were taken. I am sure we can do this without infringing on the limits which our position imposes upon us. I apologise for making what is an obvious point, but I felt I should do so for the record.

Finally, when you come to the third section of this paper there may be some questions which you want to ask which will probably be more readily answered when you have before you the paper on debt management which we have in preparation, and for which I hope to give you a date next week.

1330. Thank you. Sir Robert, there is one general question I want to ask you. I think it runs through the main theme of, at any rate, the first part of the paper. In paragraph 4 you take as your opening text a quotation from paragraph 282 of the report of the Macmillan Committee:

"The endeavour of domestic management . . . "

—of the currency, that would be—

" . . . should be to promote the stability of output and of employment at a high level by influencing the regular flow of savings into investment at home and abroad so far as is compatible with the international situation."

What puzzled me on reading the paper was why that particular sentence from the Macmillan Committee was chosen. One would get the impression that it was meant to state the overriding objective of the monetary policy that has been employed. Would that be so?—*Sir Robert Hall*: It was not meant at all to summarise the conclusions of the Macmillan Committee. It was just that, historically, that was a reference to something which was not, I think, at the time an important objective in monetary management but which is picked up in the later history. If it produced in the minds of your committee the impression that we thought that that summarised the recommendations of the Macmillan Committee, I am sorry; it was not intended to do so.

1331. Is not the point of that quotation that, in order to attain the stability of output and employment at a high level, you must seek to have a regular flow of savings into investment at home and abroad?——Yes.

1332. As I read the Macmillan Committee things may have changed since then. Their understanding of the objectives of domestic currency management is at paragraph 280. They say: "The major objectives of a sound monetary policy—for example, the maintenance of the parity of the foreign exchanges without unnecessary disturbance to domestic business, the avoidance of the Credit Cycle, and the stability of the price level—cannot be attained except by the exercise of knowledge" and so on. It would help me in understanding the theme of the paper if we took those three things which they give as examples of the major objectives of a sound monetary policy and saw where they stood in the application of monetary policy since 1945 in this country. The first one they give is "the maintenance of the parity of the foreign exchanges without unnecessary disturbance to domestic business." They were envisaging the maintenance of the gold standard and they rejected any idea of the alteration of the parity or devaluation. Where do we stand today with regard to that objective, with a system different from that which they envisaged?——It is still an objective of policy to maintain the present parity of the exchange.

1333. We are, I understand, internationally obliged to maintain a certain fixed parity, and, as far as the present Government goes, we recently announced in the firmest tones that we do not intend to see it altered. But it is a double phrase there; it adds: "without unnecessary disturbance to domestic business". How is our new system affected by that?——I think the new system has endeavoured to combine the two objectives of a high level of domestic activity, which is I suppose much the same as "without unnecessary disturbance to domestic business", with the maintenance of the parity of the exchanges.

1334. Is the force of "disturbance" that you must seek to maintain the parity without allowing large swings in the domestic activity?——Yes. I think the following words, "avoidance of the Credit Cycle", are really the major meaning of "without unnecessary disturbance to domestic business".

1335. *Professor Sayers*: I wonder if Sir Robert would put it that, as it has happened in the postwar period, the authorities have believed that this qualification would not involve them in any departure from the policy that would have been followed had there been no such qualification; that is to say, that a policy of maintaining the international value of the currency has not involved any imposition on the economy of undue fluctuations in domestic activity?——I think it would be going rather far to agree entirely with that, because the history of the period clearly relates partly to the objectives internally, partly at least to the requirements of the external position. But the Government has endeavoured to do them both at the same time, except in 1949, when there was a change in the parity.

1336. *Professor Cairncross*: Some of the action that the Government has taken, notably that on September 19th last, caused a certain amount of disturbance to domestic business. Would the disturbance have been greater had the Government been prepared to see a different policy pursued in relation to the rate of exchange?——If you are talking about the disturbance to the domestic scene, it is clear that any positive action taken by the Government is meant to affect the level of activity, and to that extent you could say that it was a disturbance. But it has tried to minimise the disturbance, except where it feels that we have gone too far in one direction, and have to come back in the other.

1337. It depends on the business you are engaged in. If you were engaged in selling goods on hire purchase, or in commercial banking, you would not escape some inconvenience. You are speaking of disturbance to the level of output. The other form of disturbance is not one that is altogether negligible, is it?——I was speaking of disturbance primarily in terms of the Chairman's question; "avoidance of the Credit Cycle".

1338. *Chairman*: What I want to get at, if I can, is whether we are facing, under our present system, the same kind of problems which the Macmillan Committee were addressing themselves to there; in other words, have we got a system which is more likely to insulate domestic business from being disturbed by virtue of our present fixed position with regard to the exchange than the system which they were contemplating?——I do not think that they were contemplating a system in which the credit cycle has been largely eliminated by Government policy. I am afraid I have not exactly got the point of the question.

1339. They were laying down certain objectives of monetary policy, and one of them was to eliminate so far as one could variations in the credit cycle or disturbance of domestic business arising out of the necessity to maintain the foreign exchange at stable level. We have adopted a different system with regard to foreign exchange from that which they contemplated at the time. I wanted your view as to whether our system is more successful than their system, or less successful, in obtaining that measure of insulation?——I think that we have in recent years been more insulated from the external effects that you refer to than we were in pre-war periods. You ask: "have we succeeded?" This being a continuous operation we never know how continuously we have succeeded, or are going to succeed. I do not think that we have disposed of the problem.

1340. *Sir Oliver Franks*: It seems to me that roughly up to the time of the Macmillan Committee most people thought that the ebb and flow of employment, in an economy came by nature, and there was little that human experience and knowledge, as manifested in Government, could do about it except pick up the pieces. By the time of the Macmillan Committee and its report, that view had begun to change. I think it was still assumed that the come and go of demand was something that belonged to the course of nature and happened to us, but it was recognised that Government had a responsibility to aim at, and succeed in, cutting the peaks of the period of heavy demand, and more particularly making the valleys of depression

shallower. There were remedial things that it could do to make the up and down of the trade cycle less marked, and therefore less disturbing in its social consequences. From that point of view this quotation from the Macmillan Report is saying that one of the objects to be achieved by monetary policy is this relative evening out of the "come and go" of economic conditions in the country, whilst still assuming that the "come and go" happens to us by nature. The distinguishing feature of the postwar period, which I think is borne out by your quotations, is that Governments have assumed and decreed that slumps shall not occur. They are committed to the maintenance of full employment year in, year out. They are, therefore, asserting that what until before the war was assumed to be part of the course of nature is now in the control of Government and man. What at the time of the Macmillan Committee was an objective which they should try to realise by controlling the incidence of the trade cycle becomes postwar something rather different: a presupposition of Government, in the light of which you operate your various economic and fiscal policies. The assumption is that precisely this "come and go" in any major way of cyclical fluctuation has been legislated out of existence. Is it fair to summarise it like this: at the time of the Macmillan Committee evening out the fluctuations of the trade cycle was a major objective of monetary policy; since the war we have assumed that it is in the power of Governments totally to eliminate these fluctuations; we have decreed full employment, no slumps; and therefore the purposes for which monetary policy is used are altered, and must be reviewed in the light of the former objective having become an enduring presupposition?——I think that is a very fair statement. As you say, before the Macmillan Committee it was generally thought that trade cycles were inherent in the nature of things, and Governments did not take the responsibility for maintaining the level of employment because they did not think that they could. It seemed to us that it was interesting to pick up this historical reference to the changing attitude. In a postwar period Governments have claimed that they should and could maintain the level of employment which in the pre-war period they did not do. It has become a major objective of policy to maintain the level of employment which implies that you are able to do it.

1341. *Chairman*: Is not the weight of the quotation from the Macmillan Committee that you should do it by influencing the flow of savings into investment?——*Sir Robert Hall*: Yes. Mr. Keynes was a member of the committee, and his thesis, that by keeping savings and investment in balance you could have a stabilising effect on the level of activity, was, I think, behind that sentence. Of course, a great deal of work has been done in this field since the time of the Macmillan Committee. It would not be put in quite the same way, but it is, I think, interesting in the light of the subsequent development that you have got this.—*Sir Oliver Franks*: Rather like St. John the Baptist.—*Sir Robert Hall*: Yes. It is not supposed to be significant of the paper as a whole. We still had cyclical behaviour in the period between the Macmillan Committee and 1939.

1342. *Professor Sayers*: Could I pursue this reference to St. John the Baptist? There are certain differences in the method of baptism. The big difference between 1930 and now, which is highly relevant to the qualification that the Chairman mentioned, is that there are now exchange restrictions applied in the main to capital transactions and these restrictions can in emergency be extended. Does that difference give the authorities more elbow room in allowing for stabilisation of domestic conditions consistently with maintaining the exchange parity? I am thinking of a comparison of 1929 and 1957. In 1929 the balance of payments was, on the face of it, in fairly good shape, although there was serious distortion in the structure of prices and so on; what forced the authorities to take action in the monetary field was an outflow of capital. Bank Rate was put up to 5½ per cent. and then to 6½ per cent., not to impose deflation at home, but to deal with the outflow of capital. In 1957 the balance of payments was in fairly good shape, but there was a big outflow of capital which put a strain on the exchanges. To protect the parity Bank Rate went from 5 per cent. to 7 per cent. Is the apparent similarity between these two cases misleading? Was there a mixture of motives in 1957 that there was not in 1929, or have we really no more elbow room in 1957 than we had in 1929?——My reading of the statement which was issued at the time of the recent movement of the Bank Rate was that there was a mixture of motives, because most of the statement is about the problem of the internal price level.

1343. Suppose that there had been an outflow of capital and the Government had taken the view that the internal situation was not getting out of hand; would the situation have been dealt with differently, and if so in what way? This is a matter of elbow room that we now either have or have not as the result of this difference in the exchange arrangements. What difference would that have made?——You are supposing that the Government is not worried by either the current balance of payments or the pressure on resources internally, but is faced with an outflow of reserves which is threatening the maintenance of the parity, and you are asking whether the Government would deal with it by putting up the Bank Rate. I do not know the answer.

1344. Could it avoid putting up the Bank Rate in such circumstances?——I think that would depend on the other measures which it might be prepared to adopt. You are putting me into the hypothetical field, and I can do nothing but guess; but I would think it very probable that they would have put up the Bank Rate, because the other measures, being largely in the field of direct control, are much weaker than they were in the early postwar period.

1345. *Professor Sayers*: That throws important light on how far the international situation may rule us.—*Professor Cairncross*: The quotations in paragraphs 4 and 5 both begin with a reference to external demand. The first reference is to what can be done "so far as is compatible with the international situation", and the second reference is to "consider external no less than internal demand". Has the situation there changed appreciably? Is it as important today to lay stress on what happens to external demand as it was at the time of the Macmillan Committee?——We pay a good deal of attention to the balance of payments, and one of the factors in that is the level of external demand.

1346. We are still dependent on the success of other Governments in stabilising demand in their countries?——Yes. This is very complicated, but it is probably much easier to pursue a policy of stability in one country if the same policies are being pursued in others.

1347. Have we been faced in the last twelve years, or even the last seventeen years, with the need to take action in circumstances in which external demand was dropping?——Not in the postwar period.

1348. But in 1931 we had been faced with that situation?——Yes. There are several qualifications. The effect of a drop in external demand is usually associated with a sharp improvement in our terms of trade, as it was in 1931, so that you have some latitude arising from that. On the other hand the capital movements to which Professor Sayers has referred might operate in the other direction.

1349. Would it be true to say that the proportion of exports to total economic activity in this country is higher today than it was in 1931?——Speaking without the figures my impression is that there has been a large expansion. You will remember that in the immediate postwar period it was said that we had to raise our exports to 60 per cent. above the 1939 level. I cannot remember what the relation was between the 1939 and the 1931 level, but I think you are right.

1350. There is, therefore, an element of vulnerability in the situation, whatever may be our attitude?——Yes. A number of United Nations studies have been made on the question of the proper action to be taken internationally if the world were threatened with a recession.

1351. Would it also be true to say that the Macmillan Committee was preoccupied with the problem of reconciling external and internal pressures in a way in which at the moment we have not been quite so exercised?——Yes, I agree, but we are still worried about external troubles.

1352. *Sir Oliver Franks*: One or two questions arise on the form in which these opening paragraphs are set

out. The second paragraph says: "Monetary management is predominantly an instrument of general economic policy", and then concludes by saying that, since this is so, "it is necessary to state the broad purposes which have been sought by the Government." To understand what monetary measures are and can do requires an understanding of general economic policy to some extent, because that is the context within which they have to be evaluated. You cannot understand general economic policy unless the broad purposes which the Government is pursuing at any time are also grasped. That, I think, is borne out by the nature of the quotations. We find that a variety of things are wanted, standards of living, high level of employment, economic growth, and so forth; and finally there is a reference to fiscal, monetary and social policies required to achieve these results. Is it the view of the witnesses today that, if we are to understand what monetary policy is, and what its methods can hope to effect, it is necessary to grasp what the broad social and economic aims of Government policies for the whole economy are, and that therefore it is necessary to grasp what difference there may be, as is brought out here, in those broad aims postwar and pre-war?——The point to which we were addressing ourselves in the early paragraphs is a fairly simple one, that you cannot judge monetary policy unless you know what you are trying to use it for.

1353. Although perhaps it is rather simple, it is also very important. You are saying that this Committee, in your view, cannot hope to understand what monetary policy is, or what the efficacy of the several measures which go under that name is or can be, unless they pay at least some attention to those broader considerations which you then set out?——Yes, certainly. I am trying to avoid giving an expression of opinion as to exactly how widely you should interpret that.

1354. Certainly that is something which the Committee later on will have to try to make up its mind about; but the method by which this important paper is introduced does involve what I have said, does it not?——Yes, certainly, to the extent that I think you must go widely in order to understand what the objectives and instruments were.

1355. Leaving aside for the moment what this Committee may ultimately think, it is apparently what the Treasury thinks in trying to explain to us its view on monetary measures in the way that they have been used in the last five years. When the Treasury wants to set all this out and wishes to make its method of approach intelligible, this is what it says by way of introduction to make it intelligible. Surely, therefore, these, as you say, simple points that I am stressing are of fundamental importance?——I do not think you ought to press the point quite so far, because, as Sir Roger has explained, we are somewhat restricted to using material which has appeared. This White Paper on Employment Policy did appear, and it was a convenient formulation of the thesis.

1356. Need you be so modest? If, for example, you bring out that one of the broad aims of Governmental policy since the war has been not merely to maintain a high level of employment and demand but that it has committed itself to the notion of a dynamic and growing economy, which is an entirely new departure for the Government, then it must follow from that that the tendency for demand to press up against the ceiling must be greater, because, in addition to whatever the level of consumption may be if you are continuously stimulating the economy to make it grow, you are pushing investment at the same time. Is that not so?——We make that point specifically later in the paper.

1357. If that is so, then is it not precisely the relation of monetary measures to these broad and ultimate aims of Government which, in the view of this paper, are the things in the light of which we can judge the efficacy or otherwise of particular monetary measures?——Yes, I agree.

1358. Does that not mean that these fundamental changes in the responsibilities which Governments have assumed since the war, as compared with the responsibilities which Governments were expected or were willing to assume before the war, alter in very important ways the subject matter on which monetary policies have to operate and the kind of success or the degree of failure which we ought to expect from them?——*Sir Roger Makins*: In writing this paper we were not trying to make a political point, or to initiate a political discussion. We are saying that this is the framework laid down by the Government of the day within which the monetary measures have had to be taken, but we are not trying to pass any judgment.

1359. *Chairman*: That is the only approach you could have, if I may say so. But, accepting Sir Oliver's analysis, which seems to me to be the right one, I am not at all clear what is the relation in your analysis between what used to be called sound money and the objectives of monetary policy. If I understand your theme, monetary policy has been used since 1951 mainly for two purposes: to endeavour to adjust demand to supply, and to achieve (and this involves using an adjective) a satisfactory balance of payments. Those are the two main indices by which you implement your monetary policy. Where does sound money as an objective stand?——*Sir Robert Hall*: We tried to deal with that in the last part of paragraph 10 and in paragraph 11 of the paper, and by the quotation from paragraph 26 of the White Paper on the Economic Implications of Full Employment. In paragraph 10, we say:

"And during the whole post-war period it has been recognised that high employment is likely to be associated with upward pressure on costs and prices."

That is to say, there may well be a conflict between the objective of high employment and the objective of sound money. The word "dilemma" is used in the quotation from the White Paper.

1360. Paragraph 10 begins:—

"It will be seen therefore that the primary object of policy has been to combine a high stable level of employment with a satisfactory state of the balance of payments."

You may have a satisfactory state of the balance of payments, as I understand it, although you have a rapidly deteriorating relationship between money and prices in your own country?——Yes.

1361. If therefore your main stimulator of monetary policy is the state of the balance of payments, you are not checking yourself by the old conception of the internal purchasing power of money?——No.

1362. Then you go on:—

"Increasing stress has been laid on the need for a high level of investment to promote economic growth. And during the whole post-war period it has been recognised that high employment is likely to be associated with upward pressure on costs and prices."

There, as you say, you refer to the beginning of a dilemma, but I have no idea from this how the dilemma has been solved or surmounted?——We thought that, as a great deal of the historical discussion on monetary measures has been connected with problems of the price level, you might think it a little odd if so little attention was paid to it in the paper. The purpose of these paragraphs is to explain the dilemma which has increasingly emerged between various objectives which might be pursued as part of monetary policy.

1363. *Sir John Woods*: You do not in this paper claim, do you, to have solved the dilemma at all? It emerges on the historical side of it that at one stage you are pulled one way and at another stage another way. What has in fact happened seems to me to be a policy of stop and go?——I think it is stop and go on the balance of payments, to the extent that, when the balance of payments has been moving the way that we do not want, we have taken measures designed to reduce the pressure of internal demand on resources; but there has been a practically continuous rise in the price level over the period.

1364. The application of monetary measures has been stop and go according to what was happening?——In the light of what was happening to the balance of payments and of the judgment of the internal level of activity. But, as Sir Roger brought out in his opening remarks, this paper was finished and submitted before the statement on September 19th.

1365. *Professor Sayers*: Did I understand you to say that it is only gradually that this dilemma has emerged

and been recognised by the Government, and that through a large part of this period these two objectives, a high and stable level of employment, and the satisfactory state of the balance of payments, held the attention of the authorities on the whole to the exclusion of the behaviour of the level of prices?——I do not think that that is altogether fair. The problem of the movement of the price level has been continually stressed.

1366. In the discussion on monetary measures?——No, in the discussion of the general economic situation. There were two statements by the Government in 1947. There was the White Paper last year. There have been repeated references to the importance of not allowing full employment to push up prices, but in the Government's view, as we attempt to summarise it in paragraph 11, "there are special problems connected with the price level which involve other considerations in addition to that of the general level of activity."

1367. I read that as rather pushing aside the price problems from the sphere of monetary action. Was that intended?——I do not think that monetary policy has been addressed primarily to the price level.

1368. If I read the Chancellor's statement of 19th September correctly, he is now concerned with the value of money and internal pressure; is not that so?——Certainly.

1369. Is that a new development?——I prefer to say a shift in emphasis. I think that is clear not only from the statement but from the Chancellor's speeches.

1370. *Professor Cairncross*: May I ask about the objective of a high and stable level of employment. This is not put, as one might put it, in terms of a low and stable level of unemployment. Do you regard the two things as identical?—The phrase "a high and stable level of employment" has been so continuously used that it seemed a respectable expression to employ.

1371. As I understand the matter, the population of working age, which is usually correlated with the working population, has risen very little since 1951 and is now falling, but there are nearly one million more people at work. That reflects a substantial increase in employment in circumstances where one could not predict it. There has also been, presumably, a considerable increase in the degree of overtime working. Does "a high and stable level of employment" mean a continuance of a great deal of overtime working, and the re-emergence into employment of many people who have already retired, or are thinking of retiring?——I think that probably more stress has been given to the unemployment figures than to the absolute level of employment.

1372. Would you agree that there is a fairly broad belt of employment over which the figures may move without unemployment appearing to be more than a relatively small amount?——Yes. I am afraid I have not any figures here, but it is true that you get variations in the number of people drawn into employment. As internal pressure increases, the figure of total employed goes up, and as pressure recedes the figure of total employed falls away. There has not been a great deal of variation in the amount of overtime.

1373. I should have thought it was substantial in relation to total output. May I put it to you perhaps more forcibly this way? The level of people in employment may itself be a reflection of the pressure of demand that causes prices to go up. May the employment of these people not derive from the expectation of rising prices?——The question of how far the expectation of rising prices is behind the general demand for labour is certainly one that ought to be discussed. Our impression about the movement of people into and out of the employed population is that in times of high demand for labour businesses are prepared to make special arrangements, primarily for married women. The reason why they come on to the register or go off the register altogether seems to be connected with the local opportunities for full employment. Most married women will not apparently go more than a certain way for a job, so that they are only available where the condition of demand locally make it worth the while of employers to employ them.

1374. Do not these conditions of demand reflect high profits which are derived from the movement of prices as much as from the movement of output?——It depends how elastic supply is in the particular industry concerned. The fact that you had a larger volume of orders at what was already a profitable price level might well draw more people in without it being necessary for prices to rise.

1375. There was a good deal of alarm because output did not increase much between 1956 and 1957. At the same time I think it is observable that the size of the working population has begun to decline for the first time over the past year. When you are trying to decide whether the level of effective demand is adequate to maintain a high and stable level of employment, is this kind of circumstance taken into account? Do you aim to squeeze the last ounce out of employment or output, or are there times when you treat some of the employment as abnormal?——I think there are times when we treat some of the employment as abnormal. There is a fairly close correlation between the movement of the additional labour into and out of the labour force and the movement of the ratio between vacancies and unemployed, so that it would be very likely that, when we judged that we got the condition of over-full employment, we should also find that the labour force was somewhat abnormally swollen.

1376. *Chairman*: It seems to me that there are two quite different things. It is one thing to say: "Our general economic aim is to promote a high and stable level of employment, and an expanding economy; but we draw your attention to the fact that, if we do that, there will be a danger that there will be instability of prices, and prices will continually rise." It is quite a different thing to say: "We as a Government have an active monetary policy, but our objectives for that policy do not include the maintenance of sound money." The second seems to me to have been in effect the position of Governments up to quite recently. I thought you came near to agreeing with that?——I think that was the implication of the way that policy has been conducted. I think the Government's position always has been that sound money is a desirable objective and continually rising prices are a most unfortunate thing. But since, by and large, they have taken the view that conditions of full employment allowed the situation to be exploited by movements on prices, the stress has been on trying to persuade people not to take advantage of the situation, rather than on trying, as might have been argued in days when full employment was not an objective of policy, to say that the way to deal with it was through monetary action. I do not think that you can understand the period at all without recognising that there has been a dilemma.

1377. *Sir Oliver Franks*: Which until recently tended to be resolved one way, on the whole?——Certainly.

1378. *Mr. Jones*: In pursuing this aim of full employment, to what extent can we improve the economic position of this country and stem the tide of inflation by ensuring that a policy is pursued of directing as much of the activity generated by this full employment into export industries?——As we mention later in the paper, the policy followed in the early postwar period of putting direct pressure on industry to export is hardly used at all now. The policy has been to leave room in the total use of resources for the required amount of exports, but not to tell people that they must export, or, as was done in the late nineteen-forties, to fix voluntary export quotas with industry.

1379. We are considering a problem of demand and internal consumption. To what extent can monetary or any other policy arrest internal consumption to the advantage of the export industries and the export trade of Britain? If we were able to do that, what effect would it have upon price levels?——Both monetary and fiscal policy have been at least partly designed to stimulate exports, in the sense that the aggregate of home demand has never been completely enough to use up the whole output of industry. Our exports run, I suppose, at about £3,000 million a year. If we did not export that amount, there would not be anything like the level of internal demand to take up the residue, so that very broadly I think one can say that both fiscal and monetary policy can have a stimulating effect or the reverse on the tendency to export. But I do not think there is much connection between that and the price level.

1380. Suppose that we were in a position to increase the volume of our exports by 10 per cent., and to arrest internal consumption in order to make that possible; would that have any effect on prices?——Past experience suggest that it would, because it would reduce the standard of living, assuming that the reduction was off consumption, and the additional investment would lead to pressure for higher wages to compensate for the reduction in the standard of living.

1381. Suppose that the productivity of the country was raised by 10 per cent., and you had to maintain full employment; there could be no cutting back to build up a greater volume of production, greater productivity. What effect would that have upon price levels?——I think it is impossible to say. If productivity went up by 10 per cent., and was added to the total output available for consumption at home, the real standard of living would increase, but whether that would give you a more stable price level or not is uncertain.

1382. Any cutting back of essential investment would make any increases of necessary production much more modest. Would not that have a tendency not to curtail inflation?——If you define essential investment as investment necessary for the increase of output it would follow; but, of course, the question of how much investment is essential for a particular amount of growth is one which it is rather difficult to answer at any moment.

1383. Unless we take an example from the experience of other nations in this field?——There is a relation between investment and output, certainly; but the precise relationship is somewhat difficult to be sure about. My point was that when you talk of essential investment you still have to make up your mind exactly which investment is essential and which is not.

(Adjourned until 2.0 p.m.)

SIR ROGER MAKINS, SIR EDMUND COMPTON and SIR ROBERT HALL, further examined.

1384. *Sir Oliver Franks*: How far is this belief that the Government must take responsibility for growth of the economy shared among other countries in the western world? Has it been there ever since the war? What can be said about the genesis of it, because I think that that is one of the really relevant things in this picture?——*Sir Robert Hall*: In western Europe it was, to a large extent, a development from the O.E.E.C. organisation, which was set up in 1947. That really led to a considerable degree of comparison between one country's objectives and another's, and the Organisation itself devoted several of its reports to the question of growth. On several occasions it set something like targets for expansion over some period. Canada and Australia in different ways, and with slightly different philosophies, perhaps, have both devoted a good deal of attention to this; and in the United States I would say at a guess that, although the policy of the deliberate fostering of growth might not have found quite the place in official literature there as it has elsewhere, it has been almost a presupposition of a great deal of what they have done that they were, in fact, going to grow. The whole background of the Paley Report, and several other reports of that kind, was that the United States economy was going to grow, and that, at the very least, it was the Government's business to see that enough raw materials and basic commodities should be available for that degree of growth. It has also been a conscious objective of policy in a good many of the under-developed countries. I am not sufficiently familiar with conditions in South America to be able to express an opinion about that part of the world; but a lot of the accent of the U.N. economic work has been on the necessity of growth and of fostering conditions of growth. It has been widespread as an idea in the air through a great deal of the western economies.

1385. It was being suggested that the Government of the day, whoever it is, in this country tends to assume responsibility for full employment, that there should be no slumps, that there should be a growing economy, and so on. In the post-war period the facts have corresponded with that view; there has been a considerably high level of employment, there has not been a slump, and the economy has grown. Therefore, I think, most of us tend to feel that probably this is something within the responsibility of the Government, something which they can achieve. But it is possible that more is owed to history and accident than one realises. No doubt the first year or two after the war were full of rehabilitation and reconstruction, and that kept everyone busy. I suppose that the very heavy expenditure on armaments of all sorts, which has been characteristic of the last ten years, really springs from the situation disclosed in 1947 when it became clear that the Communists and the rest of the world could not agree about how the world should be run, and that the fears engendered by that situation, and successive difficulties since, have caused this enormous growth of unproductive expenditure which has employed millions and millions of people up and down the western world. It might be that, without this adventitious element coming in, the maintenance of these objectives of policy would not have been nearly so easy. Is that a fair comment, or would you want to qualify what I have said?——I think a great many of the economists who have been interested in these problems would not agree that it was necessarily a factor of growth that there should be abnormal Government expenditures of the kind that you have mentioned. There has been a possibly unjustified belief in the ability of Governments by one means or another to maintain expansionist policies. Many countries have taken a fairly simple view that the United States standard of output and living was so much higher than their own, and thought that they could go and do likewise. Whatever the analytical difficulties of a continuous increase in the standard of living, because of the tendency to a shift in employment toward services which are not productive, a great deal of the growth in output has been based on the growth in manufacturing industry, and I think they have just felt: "At any rate we have got a long way to go before we need worry about these problems".

1386. *Sir John Woods*: You say in paragraph 10 that "during the whole post-war period it has been recognised that high employment is likely to be associated with upward pressure on costs and prices". You said this morning that while that had been recognised, as, indeed, was pointed out in the Coalition White Paper, and again was emphasised in the 1956 White Paper, on the whole the policy has been overtaken by facts, and the recognition of the danger has not prevented continuing rises in prices. Then in paragraph 11 you dismiss the question of prices by saying: "The Government's view on this latter question has been that there are special problems connected with the price level which involve other considerations in addition to that of general level of activity". I am not clear what you mean by "special problems", or, indeed, what is the purpose of paragraph 11. Is it meant to dismiss the question of prices as irrelevant to our inquiry? I cannot believe you mean that?——I certainly did not mean that it was irrelevant to your inquiry. As I tried to explain this morning, it was because it seemed curious, in the context of a paper on monetary policy, to say so little about the relation between monetary policy and the price level. The argument is that, as I think emerged from our discussion this morning, by and large the Government has not used monetary policy as an instrument primarily to be used to secure stable prices.

1387. When you say there are "special problems", what sort of problems do you think that it involves? Does it involve major political considerations, or what?——I think it really follows, from the line which all Governments have taken, that they take the view that in conditions of full employment which everybody believes will be maintained profits will be high enough, and the bargaining power of labour will be strong enough, to result in a structure of costs which, in economic language, is indeterminate. If you take some of the earlier formulations of monetary policy, there would be a relation between the quantity of money on the one hand and the price level on the other. To take the very simplest and most elementary formulation, one would say that if you double the quantity of money you are likely to have a doubling of the price level. At any rate there will be some relation between policy on the one hand and the way the thing will happen

on the other. But I think it has been explicit in the Government view that in this condition there was no particular reason why the cost structure, between one year and another, should move by 3 per cent., 4 per cent. or 5 per cent., and that you could have everything in the short run going on as before with a variety of degrees of movement in the price level. In that condition of short run indeterminacy (I do not mean that in the long run there may not be other things coming in) the Government view has been, I think, that there has been what economists would call an institutional factor, or what might he called a social factor involved. That has been behind the continual pleas for restraint in the process of formation of personal incomes. By the "other considerations" involved, we meant considerations of this kind: the way people exploit or do not exploit a situation in which there is a degree of freedom as to the amount of exploitation of it.

1388. *Professor Cairncross*: Would you agree that, if the demand for output is intense, then the chances are greatly in favour of a rise in the level of wages and costs, and hence of prices?——Certainly, but I would not agree that you could deduce in advance, from a statement of the level of activity, just how much the movement would be, or the speed at which the movement would take place.

1389. *Professor Sayers*: Are you going so far as to say that over a period of years the rate of increase in prices would be determined by things other than monetary policy, and that it would have been the same whatever monetary policy had been followed?——Certainly not.

1390. *Sir John Woods*: I think Sir Robert was in effect saying rather that the Government had chosen not to attempt to influence prices by use of the monetary method; they preferred to use exhortation, and so on. ——*Professor Sayers*: That is to say a deliberately elastic monetary system was maintained because it was thought that no other system would be useful in checking the fall in the value of money?——I do not think that is quite right.

1391. You seemed to me to be arguing that the Government believed that the conditions of full employment and so on were propitious for a continuing and indeterminate rise in costs and in prices, and that, therefore, they did not follow what has been called a positive monetary policy. They simply let the monetary system respond to an increasing demand for money?——Yes.

1392. Does that mean that they believed that any alternative monetary system would have served no useful purpose?——No. All it means is that they considered that there was a dilemma in the use of the monetary system in connection with full employment. No opinion whatever was expressed on the point that you referred to.

1393. *Sir Oliver Franks*: Is not the issue, in Alice in Wonderland language, who is to be King? Have not successive Governments taken the view that the objectives of full employment, no slumps, and growth in the economy, are King, and that monetary policy is employed and its effect is to be judged in a particular context in which these are dominant aims of policy?——Yes. Whether those points were made explicit or not, I think they were implicit in what was done; and I think that that view is abundantly supported by the terms of the statement last month, where we all agreed that there was a change in emphasis.

1394. *Chairman*: There is one question, which I think is very relevant to our inquiry. If we are asked to investigate the system, we must find out what the system is for. I think you have said several times, in answer to questions on this, that you would deduce that monetary policy in these years has not been primarily directed towards anything like achieving sound money. I do not see the force of "primarily" in this connection. I would deduce that up to quite recently it has not been directed to that purpose at all. Would you accept that?——So far as I have understood Government policy in the period, they would not have gone quite so far as that; they would have said that they must avoid over-full employment, which would undoubtedly produce a continued upward movement in prices, whether people were restrained or not, because of the problem of the positive controls which have to be used if you are going to hold a price level against a continued flood of new money. I think that, to the extent that the avoidance or otherwise of over-full employment was an objective of policy, the Government would have felt that, if it did not create a climate which would give you sound money, at least it had not created a climate which made sound money impossible.

1395. Is not that anxiety to avoid over-full employment as directly relevant to the balance of payments question as to the internal price level?——It is relevant to both, and in our experience they have been closely correlated. We have never run into a position, which we thought we might run into, where we could not improve the balance of payments by pulling back a little from over-full employment.

1396. *Professor Cairncross*: All this hinges on the degree of freedom that you attribute to the movement of costs. You were saying that, when demand, and the pressure on labour in particular, becomes intense, you are liable to have a violent upward movement in prices and costs, which you do not want to have; that is to say, there is a secondary objective of avoiding a more than necessary rise in prices and wages. You were also arguing that there is a degree of freedom in the settlement of the level of costs, which may answer to treatment different from monetary or fiscal manipulation. But in practice, if you look back over the last six or seven years, would you not agree that the upward movement of prices and costs is directly correlated with the intensity of pressure on the labour market?——We have made such a correlation for the postwar period for this and other countries, and it was not significant. The nearest thing we got was that costs rose faster in the group of countries which were maintaining unemployment at a much lower level; you can broadly divide them into countries which ran it at between 1 and 2 per cent., and countries which ran it at between 4 and 5 per cent.

1397. *Professor Sayers*: If you are taking the whole postwar period, you are including such years as 1947, 1950 and 1951. If you only take the last six years does not the correlation come out very much more significantly? ——*Sir Robert Hall*: This must be ascertainable. My impression is that it does not, but we can find out for certain.—*Professor Cairncross*: I am basing my questions on the figures given by Mr. Roberts in his recent article, in which he directs himself to this question. His answer appears to imply some relationship between the degree of pressure on the labour market and the movement in wages and costs during that period.

1398. *Sir Oliver Franks*: It has been agreed in discussion that full employment, no slumps, and growth in the economy, are conscious aims of Government policy and have been since the war. Equally, I suppose there has been no conscious assumption of responsibility by Government about wage negotiation. On the contrary they have been anxious to maintain the position, as it were, holding the ring within which employers and employees negotiate on these matters across the table. If the Government do not have a positive policy in relation to the movement of wages, apart from influence, persuasion and exhortation, because they think it would be mistaken in these circumstances to have a positive policy, it becomes much more difficult to relate a set of instruments like those comprehended in monetary policy to a wage/cost situation, since ex hypothesi there is not a Government objective to which you are addressing yourself. May it be not accidental that these instruments which we have to examine have been used and have been judged by Governments since the war in relation to the main objectives and aims, which they consciously set before them as responsibilities and things to do? They do not set before themselves any positive objectives or aims about the movement of wages; may it be for this reason that the question of the relation of monetary policy to a stable price level has gone by default? Is that line of reflection false or instructive?——Instructive. It is certainly true that the Government has relied on the existing machinery for the settlement of wage disputes, and has consistently taken the view that they are to be settled by free negotiation between the parties and that the Government should lend its good offices rather than impose anything. The Government line has been that if money costs rise faster than the increment in the physical value

of output, then prices will rise; and they have therefore argued that all parties to the process of price fixing, employers and workers, should exercise restraint. I think it is fair to say that they have pinned their hopes on the belief that people could be got to act in what they regarded as a reasonable and, indeed, a necessary way, and that they have therefore not addressed themselves to the problem of other instruments by which the same result could be secured. You could find quite a number of speeches which really supported that view. I may have done nothing but paraphrase what you said, but I thought I would like to put it in my own words.

1399. *Professor Sayers*: Given that that has been the position on wage policy and industrial relations, is it not rather important to ascertain whether the rate of rise of costs and prices has been related to the amount of steam that there is in the boom at any time? If it is so related do we not then have to consider whether monetary weapons can be used to regulate the amount of steam?——Certainly.

1400. Could we be given a very short paper showing what has been the relation between the amount of steam in the boom and the rate of rise in prices and costs?——I will certainly have such a paper prepared. When it is done I should like to look at it. As you will be well aware, different people might well put different interpretations on the facts; I will do my best to meet you on this, but I do not want to put in something without considering what are the interpretations that might be placed on it.*

1401. *Chairman*: I rather understood you to say earlier that you had done some study on this subject, but had come to the conclusion, according to your interpretation, that there was no significant correlation. So you have some material?——Yes, we have.

1402. *Professor Cairncross*: Do you consider that the upward movement of wages and costs has proceeded at a steady rate and at the same rate, without much variation from country to country, in practically all western countries during the postwar period? This would be an entirely different view on the matter, but it is one which is also sometimes submitted?——I can tell you straight away that it has not proceeded at the same rate in all western countries, but our preliminary studies suggested that the degree of correlation was of a kind which would make it very difficult to say that it was significant.

1403. *Mr. Jones*: What about the other elements in the upward trend of prices, besides wages and costs?——We would have to eliminate them.

1404. This is not by any means a one-sided story, is it?——No. It has been held that there has been a self-generating series of movements which was not initiated from the wage side, although wage movements continued from it. The two other principal factors in the cost of living index, which is the significant one in this context, have been import prices, and taxes and subsidies. The White Paper on the Economic Implications of Full Employment gives the basic facts.

1405. *Professor Cairncross*: In paragraph 13, you say: "The main requirement for maintaining a high and stable level of employment and economic growth is that the total of domestic demand for goods and services should be in proper relationship." There is no reference here, nor in the succeeding paragraphs, to external demand, but I think you agreed this morning that the tempo of economic activity in the world is very much dependent on employment and activity in the United States and in other countries of the world. Do you attempt to forecast the movement of external demand?——In the sense that we attempt to estimate the volume of exports, we do. We make a study of the economic conditions in the principal overseas markets, and the Departments concerned, primarily the Board of Trade, go through the individual components of the export list, and come up with fairly close estimates of the volume of exports in each class.

1406. Would you agree that in prewar years this sentence would have been entirely differently phrased? Would it perhaps have said that the main requirement for maintaining a high and stable level of employment and for economic growth was that external demand for British goods and services should be stable and increasing?——*Sir Robert Hall*: Would they have put it in those terms in the prewar period?——*Professor Sayers*: In the 1920s, certainly.—*Professor Cairncross*: Would you not regard the main source of instability of employment in this country before the war as having originated outside the country?——*Sir Robert Hall*: The facts are not at present to my mind; but if we say that the level of employment was more or less stable between 1925 and 1929, the big downward dip which began in 1929 and reached its maximum in 1932 was initiated, according to the belief at the time, externally.

1407. Would it not also be true that the level of domestic demand after the war period was itself dependent on the success of the export industries in maintaining a high level of export earnings?——I feel inclined to agree, subject to correction.

1408. You would agree on the supreme importance of this even in present circumstances?——I think it follows from the whole analysis that we would be faced with a new position if we did not, in fact, make the exports which we planned for.

1409. Would you agree that the level of exports which you are planning for is dependent less on what happens in this country than on what happens in some other countries?——Yes; and, as we said this morning, there has been a fairly regular level of activity abroad. Part of the downturn in 1952 was due to a fall in exports which was not deliberately corrected by internal demand.

1410. *Chairman*: These forecasts are assessments which must be most delicate operations, and yet extremely important?——They are not delicate, in the sense that the probable errors are quite large; they are delicate, in the sense that a good deal turns on what you come up with.

1411. That is what I mean; and obviously we come across cases in your history where things have gone wrong from that point of view. But in the general approach of Government that you are outlining, their responsibility for the maintenance and development of the economy, these forecasts are a very important element?——Yes.

1412. At the end of paragraph 12 you say: "This is used to prepare regular assessments of that situation, and forecasts of how it is expected to develop." The statistics which you collect are inevitably dependent upon getting the material from a great range of the outside bodies in the country, and from organisations for the purpose which I know you have. When you get beyond the preparation of the statistics to the discussion of their interpretation, which is, perhaps, a more delicate operation than collection, how far is that an internal operation which depends on the Treasury, the Board of Trade and the Bank? Is there any machinery for getting assistance by discussion with leading persons outside?——My own experience is that there is no systematic consultation of the kind to which you have referred. We have regular and comprehensive reports from the regional officers of the Board of Trade and the Ministry of Labour, who spend a good deal of time discussing not only what is going on, but what people think about what is going on. People in positions like my own take what opportunities we can to exchange views with people who we think are experts in this field. An increasing amount is being published as the country becomes more accustomed to the idea of what we do. On the external side we get regular reports from overseas posts, and, particularly in Paris and Washington, we have people who are specially charged with the duty of reporting to us on the outlook as it is seen from there. But all this is quite different from any systematic arrangement.

There are a number of bodies, such as the Economic Planning Board, the National Joint Advisory Council, and the National Production Advisory Committee for Industry, where representatives of Government and industry meet. On the Planning Board there are discussions of the outlook from time to time. Though the Planning Board has three representatives from the Federation of British Industries and three nominated by the Council of the Trades Union Congress, I do not think that it is anything like so systematic as perhaps you had in mind.

1413. I was trying to explore the actual business of interpreting the great deal of material which you get first, and which appears in your statistics. That seems to me just the kind of thing upon which you may get very different readings. I expect you do, internally; some other readings from various sections outside the

* In the event the Treasury did not feel able to submit a paper in response to this request.

Government circle might be very valuable. I know other countries have set up institutions rather of this kind, though I do not know how they work, and I was wondering whether you felt the need for such a thing; whether there would be any advantage, or whether you think that with these various contacts which you indicated you are adequately equipped?——*Sir John Woods*: Would not the latest ideas of the National Institute of Economic and Social Research meet the case here?——In my private capacity, as distinct from my capacity as an official, I have been urging the establishment in this country of something rather like the institutes which the Chairman referred to, which are normally called *Konjunktur* Institutes, simply because I think it is a mistake to have no one to criticise you. I hope very much that the work which is now being embarked on by the National Institute, with the launching of which Sir John Woods had a good deal to do, will be fruitful and successful. There is one difficulty: the Government certainly ought to have, and in fact, I think, has, the best statistics available; to get the best use from this sort of thing you would need a basis of as much collaboration as is consistent with official secrecy.

1414. *Chairman*: Is that an insuperable difficulty?——*Sir Robert Hall*: I do not think it will be. We shall have to see. The Chancellor of the Exchequer went to the lunch which inaugurated this thing and gave it his best wishes.

1415. *Professor Cairncross*: Do you make contact with the economists in some of the large businesses and the banks, officially or unofficially?——Yes, we do.

1416. There are no statistics about the future; usually it is much more difficult to get something about what is going to happen than it is to get something about what has just happened. Are you getting anything on that?——Yes, I think we do get some help now. It has been a striking development in this country in the post-war period that big businesses and banks have begun to set up departments who think in these terms, and all speak the same language as one does oneself.

1417. *Sir Oliver Franks*: If for the reasons we were talking about the movement of prices and costs has been rather rapid, is it not true that this important element, which has come relatively low on the list of priorities for major Government action, has been responsible for two things? First, there has been a slowly, but in the last three years or so quite noticeably, growing distrust of the currency, not simply outside but inside. People have begun to think that holding money is not such a good thing to do. It takes a long while for a habit like that to form, but it has begun to form; and I suppose the rapidity of the rise in costs and prices in relation to the rise in production has been very largely responsible. Secondly, this sapping of domestic confidence in money has produced a lack of confidence abroad, which has led to the movements of money that we have seen in the last three or four months. As I understand it, the trading position in Britain has been quite good in those months; it is the banking position that has been bad, and the movements in the banking position have really been due, if one simplifies, to such causes as I have enumerated. It appears to me that when this relatively under-emphasised element in the economy had gone a certain length and the results became sufficiently noticeable, history caught up with us, in our usual way, not at home but in our external relations on the gold and dollar reserves. Is it, therefore, fair to read this last set of difficulties on the gold and dollar reserves in the light of a historic commentary on what we were discussing?——*Sir Robert Hall*: It is, I think, perfectly true that there has been a growing awareness of the weaknesses on the price side. I found myself very much in agreement with a recent discussion at the Economic Planning Board, where it was said that the new feature of the situation was not so much that prices were still rising but that people had at last begun to believe that they were going to go on rising. Always until now people have thought: "The Government will do something about it, if not now, tomorrow". I think that part of the run on the reserves in the last few months was associated with the belief that the deutschmark was going to be re-valued; to some extent it was speculation out of currencies, one of which was sterling, which was an easy one to go out of. I think it also reflected uncertainties about the long term position. Indeed one of the dilemmas in which the Government tends to be placed is that if we call attention, as we may well wish to do, to the seriousness of the thing from an internal point of view, we produce speculative movements against us which we do not want. But I think that, subject to the qualification about Germany, there is a good deal in what you say.—*Sir Roger Makins*: I would support what Sir Robert Hall says about that. The factors which you mentioned, I agree, are important, but I do not think they should be regarded as exclusive. Another factor, for example, is the drawing down of the sterling balances by other countries in the sterling area. The total judgment and degree of confidence which is shown externally in our position is made up of a combination of factors, and what is the controlling one in any particular circumstance or situation is very difficult to determine. The question of confidence is the most difficult of all.—*Sir Oliver Franks*: I accept that there are more elements in the situation than the two that I named; I should be more doubtful about accepting the view that it was difficult to identify the controlling ones.

1418. *Professor Cairncross*: Paragraph 15 raises the issue of predicting personal expenditure, which is said to move roughly with income. I thought some of the recent experience in the United States suggested that this could become one of the most incalculable of relationships?——*Sir Robert Hall*: It is true that there are these very odd movements of personal savings in recent years. We still do not know what actually happened about the jump between 1951 and 1952. This is very much telescoped as to the processes that go on.

1419. In the same paragraph: the expenditure intentions of public authorities, including the local authorities and not just the nationalised industries, are no doubt fairly accurately known in advance of action to raise or to restrict investment. But how accurately are they known when a change in the policy takes place? Does it take rather a long time?——There are time lags, certainly. We were quite pleased with the response from the middle of 1955 onwards, when investment in the public sector did respond. Of course, we have terrific arguments about stopping work in progress. But you are quite right to say that there is a problem involved in a change of policy; and, as you can see from the first sentence, if you take public authorities in the wide sense, realised expenditure does often differ from what were told it was going to be.

1420. I was interested in the qualification. I have observed these differences in trying to control even public expenditure. I take it that the biggest uncertainty probably surrounds private investment. It is very hard to say a year in advance what change is likely to occur in private investment, even with sample enquiries?——It is hard to get at it accurately. We have been working very hard on this, and we think we are doing a bit better on it. The Board of Trade has taken a lot of trouble to give us sample inquiries, and the Ministry of Works are pretty closely in touch with feeling in the building industry which is consistently more "bearish" than the facts of the situation warrant. They always say they are going to have a slump. We also try and get what we can from the production authorities in the capital goods industries, but it is a very complex process, involving some firm figures and some that you feel doubtful about; with some, in the end, it is one's own judgment from the feeling of the thing about how things will go.

1421. *Chairman*: Would you agree that of all these forms of expenditure that you list here investment in stocks is much the most difficult to predict?——Yes.

1422. *Professor Sayers*: You were saying this morning that there were great deficiencies in the statistics of savings, and telling us how you were trying to overcome those deficiencies. You say here that "personal current expenditure can be expected to move roughly with income"; is there any statistical basis for that which is at all reliable?——"Roughly" is a good saving word; but there is a correlation. By the end of the year we have a fairly good idea of what the aggregate of wages is likely to be in the following year, and we deduce a figure for other incomes, particularly the profit element, which has to be consistent with the whole forecast. If

the aggregate is up, say, by 5 per cent., I think that the aggregate of actual expenditure will be not too far away from 5 per cent. up; it is not likely to be minus 5 per cent. or plus 15 per cent.

1423. But there have been some odd things in the savings figures, as shown later in the paper; are you reasonably confident that they are not just accidents in the composition of the statistics?——When we get a marked and unexpected jump it makes us wonder a good deal about that bit of the statistics. On the other hand, where the series is reasonably regular we feel more confidence in them.

1424. *Professor Cairncross*: Is it not true, however, that the discontinuities you have on the savings side are not matched by similar discontinuities on the capital formation side? You had throughout the period a steady increase of capital formation, and in the proportion of resources engaged on capital formation. You only have to explain who did the saving, and your puzzlement, presumably, is how it was that private savings stepped in as Government savings stepped out?——Yes.

1425. In paragraph 16 you imply that you compare your forecast of demand with some forecast of production; later you explain that the higher the pressure of demand the faster the growth of production. Those things then become tangled up; you cannot tell what production will be until you know what the demand is, and one wonders how you do the operation? You have not two independent quantities but two that are inter-related?——The third sentence says: "The same is true in estimating supply possibilities", rather than supply realisations. The thought is that until the economy is at full capacity the out-turn will be primarily determined by the demand; as you approach full capacity the out-turn is determined by the capacity.

1426. Do you assume some normal increment in productivity from year to year?——We do a lot of things in trying to get at that. We have before us the record of the past, which is probably the best thing we have to go on; then we check that by sector analyses to see whether there will be a bottleneck in the cases where we know fairly closely. In most of the basic industries we know pretty well what the supply capacities actually are. We used to check it by imports and raw material supplies, though more recently they have been able to get the raw materials.

1427. That sort of bottleneck was never rigid. You were never faced with absolutely fixed factors?——Not fixed factors but you have to take them into account. For example, in 1947 we had a bottleneck which was very rigid.

1428. But, surely, less than was thought; just as in 1956 industry was remarkably efficient in finding substitutes for oil?——I agree that the further we get away from the end of the war, the greater degree of flexibility there has been in the world economic system as a whole. I think that there is nevertheless some validity in making this comparison between what people will try to buy and what the economy can produce for them to buy.

1429. Do you believe that, if you maintain a certain degree of pressure of demand on the economy, you can then rely on an annual increment of output of some fairly fixed dimension from year to year?——We would hesitate very much before we would make a statement like that. We try hard not to make such statements. We have a prejudice against taking what might be regarded as a view that there are rigid laws to which the economy has to conform.

1430. You will be aware that a number of economists hold the view that if you only make the pressure sufficient supply will rise more than enough to deal with the consequent inflation?——We do not take that view.

Chairman: I think perhaps we ought to break off now. We will continue from this point next week.

(Adjourned until Thursday, 24th October, 1957, at 10.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

SEVENTH DAY

Thursday, 24th October, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (Questions 1431 to 1525 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. B. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

1431. *Chairman*: Sir Roger, you have given us two supplementary papers, one on Parliamentary Control of the Fiduciary Issue and the other on Investment by Public Corporations*, which we will look at further, and see if there is anything we want to ask about them later.——*Sir Roger Makins*: We are preparing now two papers on the external aspects of the problems you are considering. The first will deal with the sterling area; the second deals in a more general way with the relationship between the internal and the external aspects. These will be ready as soon as possible.

1432. *Chairman*: Thank you. We go on with paragraph 16 of your paper on Monetary Policy and the Control of Economic Conditions†——*Mr. Jones*: I wonder whether the Treasury could give us a quantitative assessment of Treasury policy in this particular field. What do they expect to achieve by cutting back investment in certain fields?——*Sir Robert Hall*: At any particular moment we try to assess the total load on the system, looking at the likely level of consumption, the likely level of Government expenditure, the amount which we wish to go to the balance of payments and the amount which is likely to be taken by investment. Such assessments might lead to the view that the economy was either under too much pressure or under too little pressure. The first intention of cutting back investment would be to relieve some of the pressure, just as you might relieve the pressure in one of the other fields, to take some of the strain off the system.

1433. In 1954 there was an investment boom, that was encouraged by the Government and that continued until the early months of 1955. The economy should have been strengthened in consequence of that investment. But, following that, we had the dearer money policy which was operated at that particular time by the Government. Bank Rate went up from 3 to 4½ and ultimately to 5½ per cent. Instead of getting any advantage from the investment that had taken place in 1954, you not only cut back investment, but curtailed and stagnated productivity. To what extent is that going to help the solution of the problems with which we have to deal?——It is rather a complicated story. The tendency of the measures adopted in 1955 to cut back investment was, in accordance with the point that I was explaining in reply to the previous question, because of a judgment that the economy either was, or was in danger of being, overloaded. You cannot just push on with one thing at the expense of all the others. The problem is always to get what is judged to be a reasonable balance between the various kinds of load. It was judged that the investment boom that was taking place was overloading the economy and, among other things, having an adverse effect on the balance of payments.

1434. *Chairman*: What do you regard as the prime indicators of overload of the economy?——We have in the past used indicators falling into three groups. First, the movement of the balance of payments surplus: an overload tends to ease itself at the expense of the balance of payments, holding in things that you hoped would have been exported or drawing in things you hoped would not have been imported. That has always been a very important factor in our assessment. Secondly, the labour market: the movement of unemployment, of unfilled vacancies and of the total labour force, which we were discussing last time. Thirdly, the movement of the general economy: for example, we would think that, if the trend in output which had been rising at a particular rate was moderating, we could regard that as a sign of easing, and, up to the point of full capacity, we would regard a movement in the other direction as a sign that pressure was coming on. We look at one year in relation to the previous one. For example, we felt that the pressure throughout 1956 was somewhat less than the pressure in 1955 because industrial production was practically stable in that year, although investment had been fairly high. The economy looked as if it had more capacity; but, as it was not producing any more, it seemed to indicate that there was less pressure in the system.

1435 *Mr. Jones*: The proposal is to use monetary measures to strengthen the economy. If you build up investment, the purpose is to secure greater productivity. Under monetary controls you could build up productivity in all sorts of industries, whether valuable or a burden on the economy. Is it better to have an investment policy programme serving the essential industry of the country on the basis of the operation of direct controls, or do you consider that you can secure that end by monetary methods?——*Sir Robert Hall*: Those questions get us into the field of policy judgment, where, as Sir Roger has pointed out, civil servants are no more competent to speak than anybody else.—*Sir Roger Makins*: We have set out in these papers various elements which enter into the judgment at particular times on particular policies. The weight that you give at any particular time to any particular aspect or factor is a question of judgment. The judgment, the balance between those elements, is something which is the decision of the Government.

1436. This is not a question of Government policy, or of an attitude that a Government of the day may be pursuing, whatever the colour of that Government may be. We are talking to experts in this particular field about monetary activity and monetary functions. Arising out of the experience of the Treasury, we want, if we can, to learn from them which they consider would be the more effective in a certain set of circumstances. Is it not the economy of the country with which we are concerned? Is not that the sort of thing the Government expects us to report upon finally?——*Sir Robert Hall*: Your question is whether monetary policy, which selects projects by criteria of profitability, or by the choice of the system as a whole,

* Memoranda of Evidence Part II Nos. 5 and 4 respectively.
† Memoranda of Evidence Part II No. 6.

gives you a better or a worse distribution of investment than the adoption of some other criteria, which you have referred to conveniently as "essential" or "inessential". I think I must repeat, if I shall not weary you, what I tried to say when we were discussing the Capital Issues Committee. It is not a clear cut business to decide what is essential and what is not essential. If I could just give you two examples: when we look at the development of the economy we may think that the general objectives which are agreed on are going to be hindered by a shortage of a particular type of product, as it might be coal or steel; or during the Suez crisis we were very much afraid that there would be a shortage of oil. In a case like that I suppose that there would not be any disagreement as to the desirability of paying particular attention to this problem. It would follow from the fact that there was not very much disagreement about the need to carry on the economy of the country that special efforts should be made to get something the lack of which would cause a fall back in the economy. But when you get into a balanced situation, where the economy has a reasonable degree of flexibility and where you do not expect that pressure could come because of a shortage of one particular and easily identifiable factor or component, it becomes very difficult for anybody to say that this is essential and that that is inessential. Take the case of food: if you have nothing to eat and you are very short of money you may say that bread is essential; but as your income rises you begin to diversify your diet, and you would hardly say that things which would be regarded as great luxuries with a very backward standard of living were nevertheless inessential when you had already satisfied your demands for the more essential things. Essential is such a relative term that it does not seem to me to be quite as easy as I think your question implies to identify the essential and unessential.

1437. Suppose that a family are earning £X and they are spending £X plus; if they want to balance their domestic economy they consider how they should reduce to £X; the Micawber philosophy. Would not a sensible family cut out the things that were less essential to the wellbeing of their economy, to the advantage of the things that were essential? Could not that probable over-simplification as an illustration be applied to the economy of the nation?——Would you not find that different families cut different things? Some would give up cigarettes first and some would give them up almost last. If all families behaved in exactly the same way it would be simpler than it is in a community which has a great variety of families and a great variety of individuals. There is sometimes a simple situation in which you can, without much fear of being out of touch with public opinion, decide that some things ought to have priority over others, but when you have a balanced system, where you can get the same levels of output in a variety of different ways, you are faced with much more complex problems, which I am afraid I must take refuge in saying I regard as political. I cannot feel that an expert knows any more than anybody else about the way people are going to try to get the best use out of their resources.

1438. *Chairman*: At the top or bottom of the list—whichever way you like to put it—there are certain expenditures which everyone would regard as essential, but when you have to consider what can be contained in a limited list you get margins in which the clear idea of what is essential fades into a difference of choice between different people?——Yes, exactly.

1439. *Mr. Woodcock*: You said that indications of overloading were to be found in three groups of indicators; the balance of payments, demand for labour, and production. As regards the balance of payments you quickly discover whether you are in or out of balance?——Yes.

1440. The demand for labour is perhaps pretty well brought to your notice, although I have some reservation about that; everybody knows that at certain times people make demands on the labour exchange that probably they would not wish to have fulfilled, so perhaps that is not very accurate. But when you come to production surely you are a long way behind the events?——It is extremely difficult at any moment to say precisely what the productivity capacity of the economy is. One of the things we look at is the divergence from any trends there might be.

1441. How readily can you get that?——We get the index of production figures from two or three months late, and the national income figures, which we are now trying to do quarterly, between three and six months late. There is undoubtedly a time lag but I think that would not prevent us from being able at most times to say that there was a trend one way or the other.

1442. When you see that you are out of balance you do not from that know very much about the cause of your lack of balance. It may be the result of a worsening of the terms of trade which does not involve any alteration in the structure of demand in this country, or it may be due to an excess or an increase in the importation of goods for consumption or stocks. It is the same with demand for labour too. All these things are very general?——Certainly. I think the latter part of our paper shews that this is anything but an exact science. I am just trying to explain what we go on. That is the best we can do on the statistics. We try to keep in touch with what is going on in the field by getting extensive reports from the Ministry of Labour and the Board of Trade regional representatives. They are a rather more sensitive indicator because they talk to industries from day to day. But there are always considerable lags and uncertainties in the information.

1443. Might it be that the information you have and the way in which you get the information would almost inevitably drive a government to prefer a similarly general solution? Is the choice of a monetary solution not entirely a matter of judgment of qualities but based to a large extent on lack of information?——I think there is an element of that, though not quite in the sense you are using it. A detailed solution requires a good deal of detailed knowledge about the circumstances of particular industries or even of particular businesses. During the war the Government had extremely detailed information about practically everything that was going on in the economy. There was a complex system of controls and the Government did, in fact, take fairly detailed decisions. The basis of that was, I think, that the whole community had decided that what was essential was to win the war. Now, rightly or wrongly, the Governments of both parties in the post-war period have reduced very much the apparatus for finding out exactly what was going on in that way. Speaking from the point of view of an administrator whose Ministers will have to stand up in Parliament and defend what his officials have done, I think one would get very cold feet at the thought of taking individual decisions with neither the whole complex arrangement of civil servants all over the place to tell you what is going on nor the general agreement on what is the essential thing to do. There is an administrative difficulty as well as a theoretical or philosophical difficulty.

1444. It is said in the paper that monetary control would have its effect first mainly on investment. Surely it ought to be possible to make a decision as between investment and consumption without going into these refinements? How effective is monetary control in relation to that problem?——*Sir Oliver Franks*: This is a different point. The discussion so far has been on problems within the investment field. When we begin looking at the relation of the whole investment field to the whole field of consumption and asking questions about monetary policy in relation to that, the answers are clearly different. I think it is common ground that the first incidence of monetary policy will tend almost always to be on investment rather than on consumption? That is not a matter of policy or of balance of judgment, but simply a question of fact, and therefore of a different order from the things we have been discussing so far this morning?——Yes.

1445. *Mr. Woodcock*: But that bears on the use of monetary control?——I think your point is this: if monetary policy strikes first at investment, is that something in favour of or against monetary policy? I would regard that as a political decision.

1446. *Professor Sayers*: Would you not also say that, if the nation makes up its mind that it wants the axe to fall partly on consumption, there are other weapons to be brought into play, one of them obviously budget policy? In dealing with any particular conjuncture it is the whole complex body of weapons, monetary and others, that has to be considered?——Certainly.

1447. *Professor Cairncross*: In the past the assumption was that the variable element tended to be investment, and that something needed to be brought to bear on investment to stabilise it. Would you agree that in present circumstances the decision may be the different one of the level of investment compared with the level of consumption in a national income which is itself fairly stable?——Certainly.

1448. *Sir Oliver Franks*: It is important that we should know what we mean by the word "political". I do not think we mean party political. What we mean is something rather different, that there are certain decisions which involve values, perhaps social values, which when made are essentially matters of opinion rather than of administration, about which it is possible to differ without proof or disproof. If that is what we mean by "political" we are really using it as the adjective to the noun "policy". Is it not possible to do a little more about what we are calling political or policy decisions than simply to say that this is where the civil servant has to refrain from speaking? One can carry an analysis of the elements which go into policy decisions quite far without necessarily having to get to the point of saying which way the ingredients or the elements ought to be added up, which I think you feel, probably very properly, is not for people in the Government service to do?——*Sir Roger Makins*: This does not really permit of exact definition. Obviously there is a "grey" area here into which we will advance as far as we can.—*Sir Robert Hall*: I am grateful to you for explaining the sense in which we use the word "political". "Political" decisions for us are policy decisions which ought to be made by Ministers irrespective of the political complexion of a particular Minister.

1449. When we have said that, this question about the relative effectiveness of monetary controls as opposed to other instruments, e.g. direct controls and controls such as those now being exercised on the banks, is something very much within the purview of this Committee. May we hope therefore that on this the "grey" area will be extended for the purposes of discussion as far as possible, because it is clearly an important set of issues for us?——*Sir Roger Makins*: We will extend it as far as we can.

1450. *Professor Sayers*: Are you saying that in attempting to regulate the pressure on the economy the authorities use various weapons, among them fiscal and also monetary, and that they expect the monetary weapons to operate, in the first place at any rate, on the investment part of production, and that that has some advantage in that it is the investment part that tends most easily to run away, either upward or downward?——*Sir Robert Hall*: On the first part of your question our general ideas are set out in more detail in Part II of the paper, but I agree that it is broadly true that the substantial effect of monetary decisions is on investment. I would also agree that, if you want to run the economy as we have tried to run it, on a level base, investment is more likely to show substantial or significant swings than other components; of course, we may be deliberately affecting another component, but the uncontrollable element of swing would be more in that field.

1451. And your whole attention is concentrated on the amount of pressure for the use of resources? You are not thinking, at any rate primarily, of the behaviour of the price level?——I gave my complete views on that in our discussion last time on the 17th October.

1452. *Professor Cairncross*: In trying to operate on investment you presumably have in mind the simultaneous effect of investment on productivity and growth in the economy. How seriously would you take that? Would you agree that a large part of investment is in the form of assets that are identical with assets already existing, and so is not likely to have any marked effect on productivity, although it might have an effect on output?——That seems to be an over-simplification. It seems to imply that additional investment is a duplication of existing investment.

1453. Is that not so? Are not the houses and power stations that are put up today rather like those that were put up ten years ago?——Housing is a difficult field; but I think it is extremely hard to say that a new piece of industrial investment is either a duplication of an existing piece of investment or a new one. My own view is that a great deal of industrial investment would be regarded by those who are putting it in as an improvement on what it replaced; that is to say, they would regard it as having higher productivity. If you think, for example, of the steel mills that are going out of existence, surely the output in relation to the input would be much greater from the new steel mills than it was from the obsolete ones.

1454. Certainly that would be true; but if you were looking for mainsprings of higher productivity in the economy, would you agree that these frequently take the form of some effort on a small scale, involving a good deal of development work but not a great deal of investment in the initial stages? There might subsequently be a high level of investment in giving effect to these innovations, reproducing assets which have been tested and in use for a period of time, but without a prior stage of development the investment would not fructify in any substantial improvement in the productivity of the community. These earlier stages may be embarrassed if finance is cut off from the development, through restrictions on bank lending or in other ways. The incidence of particular devices of monetary policy on the two stages leading to higher productivity need not be the same. If you have a higher rate of interest, the chances are that your power stations will still be built, but if you have restrictions on lending and the availability of finance, certain forms of investment may never take place. Would you agree with that?——Yes. I think that the Government would not disagree with you. They kept an investment allowance on for research and development expenditure, which seemed to imply some attempt to maintain this.

1455. The investment allowance is only earned if you are already making a profit. If you are a business that is only in the initial stages and not making a profit, you do not get the investment allowance and you may be unable to raise the necessary capital. Does not a substantial part of the improvements in productivity result from the efforts of smaller firms, many of them new?——I have the impression that a great deal of innovation in this country comes from research and development by the very big firms.

1456. *Sir John Woods*: It sounds to me as if some of my colleagues may be of the opinion that Governments somehow have something against investment. I would have thought that nobody wants to cut investment. When we have had these recurrent bouts of fever since the war, it has been found inescapable in fact to do something about investment, whether by physical controls or by the use of monetary methods. We have had to cure the economic situation, usually arising from the balance of payments, and in order to do it we have had in the short run to do something which everybody agrees is disadvantageous in the longer run. Would you agree that that is a fair assessment of the dilemma?——I certainly agree that cutting back does not imply that we are against the whole activity that we are cutting back. In all this field we are trying to arrive at a balance by cutting the minimum possible off various places. I think everybody would agree that a high investment economy is in itself a desirable thing, and that, if we are forced to cut back investment, we are having some effect on the generally desirable objective of growth.

1457. Suppose that it is generally agreed that nobody wants to cut back investment more than they feel at the moment they simply must; one of the questions we are discussing is whether it is best to do it by monetary methods or by other methods, or by a combination. You were laying a good deal of stress on the purely administrative difficulty of doing it by selective methods. This is something on which I have had a good deal of experience. Considering the enormous complexity of British industry and the whole nexus between contract and sub-contract, and order and supply, it seems to me to be extraordinarily difficult for anybody to know enough to be able to exercise a proper judgment on that kind of thing. Apart from the absolute difficulty of it there is the timing difficulty, that you collect and sift and form a judgment on your information when it is very late in the day. In saying that, have I expressed approximately your own views?——Yes, certainly. I do not feel that it would be proper for me to express a view as between the

various instruments you might select, but I do feel that if you select one type of instrument you must think about the administrative difficulties. Indeed, it may be a choice of difficulties.

1458. *Chairman*: Has any investigation been done on this question of the relative contribution of the small or new concern to innovations, as opposed to the major organisations?——I am afraid I cannot give you references, but some work has been done in this field. Professor John Jewkes at Oxford is now engaged on an extensive study, mainly about innovation in the aircraft industry and the relative contributions of various types of enterprise.

1459. *Sir Oliver Franks*: Some types of major capital expenditure, for example in basic industry, while no doubt always an improvement (because you can do a little better next time) may very often be essentially matters of the expansion of output. For example, a new strip mill put up in this country now would no doubt be the newest and the best, and it would embody improvements, but you could say, I think, that it was put up mainly to increase the output of steel. At the other end of the scale you get people who have bright ideas. Sometimes a bright idea involves a real element of innovation, with research, discovery and application; sometimes it is some quick adaptation which somebody hits upon, and which finds an export market and the thing moves ahead very quickly indeed. That may happen in a large company or a small company. In a situation in which some cutting back had to be done, if one were principally dealing with problems of the first type, it seems to me that it is easier to find arguments for justifying selective methods. If, on the other hand, you are looking at the other kind of problem, which I think becomes more frequent as you reach the finishing end of industry, where bright ideas matter for sales, for exports and so on, then it seems to me that selection is very difficult, and apt to be a blunt instrument. The more generalised control, e.g. of monetary policy, tends to be rather easier to apply because of the nature of the facts. Does it appear to you to be true that there are in the total structure of the economy these different elements in the growth, one where the emphasis is really on output, one where the emphasis is really on the "bright idea", and that it would be difficult to look after everything by any one simple formula for cutting investment?——I agree entirely. When we try to take forward looks at the growth of the economy over some period, we feel that we are on much surer ground if we say that, unless there is some revolutionary change in the structure, the economy cannot grow unless its transport system and its basic supplies of power and materials grow. In fact, since the Government is responsible for many of the basic industries, it has to make decisions of that kind. But we should feel on extremely insecure ground if we made that kind of judgment at the other end of the field.

1460. *Professor Cairncross*: Most of the capital investment in this country is in the basic industries; transport, power and the big, heavy industries that make raw materials. The capital requirements of the later stages of industry and of services are usually comparatively limited. May it not be that you need in those stages a large number of small allotments of capital, all exposed to considerable risk, if you want to accelerate the process of improving productivity? In the other stages you are dealing with a few identifiable concerns, many of them under Government control and ownership, whose research and development activities can be supervised and studied; you know where you are and you can control their investment programmes by an alternative technique. But in limiting the financial resources that normally would be canalised into the finishing stages, you may be discriminating against these stages, and to that extent limiting the scope for improvements in productivity at those stages, although many of the more important exports of this country result from activities just there. There are elements in the private sector, say in electronics, that are engaged in development work, which do not need large amounts of capital, but do need capital that is exposed to very high rates of risk, and from which very big dividends, not to the firm, necessarily, but to the community, would result if their work produced commodities capable of export or for use in this country. Would you agree with that?——The Government's view has been that it must determine directly the balance of investment between the public and the private sector. On the other point it is, as you know, a matter that is much debated. Many people have criticised the effect of dividend limitation in encouraging self-finance and, by implication, discouraging the flow of funds to the smaller and more struggling enterprises that you have in mind. But I am afraid I do not regard myself as having any expert knowledge in the field. I think you could probably find people who know a good deal more about it than I do.

1461. We pay royalties to the United States on certain of their innovations which are used in this country, and they in turn pay royalties to firms in this country for some innovations here. Figures indicating out-payments and receipts, and the trend in these two, might show the extent to which we are enjoying a rate of spontaneous innovation in this country which would be in keeping with our position as a large exporting country, or draw attention to any increasing tendency to depend on work of this sort elsewhere. This would help us to know where the original work is being done, and what is happening as compared with abroad. Do you have such figures?——I am not aware of them; but the Bank may be able to help you on that.

1462. *Mr. Woodcock*: Do we have to conclude that monetary controls operate mainly on investment, and that in its operation on investment it cannot discriminate? ——It cannot discriminate otherwise than on grounds of who can raise money and who cannot.

1463. *Professor Cairncross*: Do you include in monetary controls here all those secondary instruments which have become more and more important, such as restrictions on hire purchase and on bank lending?—*Sir Oliver Franks*: Clearly what you were saying about discrimination being purely financial applies when you are talking about the Bank Rate. It does not apply in the same sense, and possibly does not apply at all, if you are talking about the direct limitation of advances or of hire purchase. It is a question of language; we have to decide, do we not, whether we are including this whole group among monetary measures, or whether we are only including classical measures like moving the Bank Rate?——*Sir Edmund Compton*: In this paper we treat these as measures supporting monetary policy properly so-called. In paragraph 40 of the paper we say that, because of the limitations of monetary policy properly so-called, it has been necessary to operate direct controls over people's ability to spend money in three ways; the capital issues control, the requests to the banks, and the hire purchase restrictions.

1464. The word "supporting" would suggest that there are certain measures which are the heart and core of the business, but that they may need supplementation by these other measures. The exact reverse might be true; it might be that the engines that were really powerful (whether or not they were good engines) were the control of capital issues, the restrictions on bank lending (voluntarily observed by the banks), and the restrictions on hire purchase, though they were supported because they were not strong enough, or because we were all classicists at heart, by moving the Bank Rate. In that case we would be using the word "support" the other way on. Are there not important considerations which would make one think that in relation to 1955 and 1956 what you have called the supporting measures were, in fact, the effective ones?——*Sir Robert Hall*: I think it follows from the latter part of the paper that we regarded it as necessary to support the broad general effect with particular reinforcements. You are quite right to draw our attention to the linguistic difficulties; it is just a convention what you call a direct, or an indirect or general, control. There is no hard and fast line between them.—*Sir Edmund Compton*: In speaking about these measures we use the word "reinforcements".

1465. Does that mean that the main weight was taken by the general measures, and only a minor but helping weight borne by these?——The reinforcements may win the battle. One does not know. It emerges perhaps later on, the extent to which the reinforcements came in, because the monetary weapons, in what has been called the pure sense, did not appear to do all that was required.

1466. In discussing monetary policy, we should know what group of measures we are including under the term. It seemed to me that most of the time we talked as if these restrictions on hire purchase and on bank advances were instances of monetary measures.—*Mr. Woodcock*: Let me put it this way. There is a number of instruments which are relevant to the problem that we are discussing. You can lump them all together as monetary instruments, but you can distinguish between those that are general in effect and those that are selected for a special purpose. —*Professor Sayers*: The choice of one group of measures rather than another within this whole field of monetary and supporting measures will have discriminating effects; it will cause the economy to contract or to expand in one direction rather than another. That is true even within the sphere which the Treasury has chosen to call monetary policy, the classical monetary weapons. Is it not our business to consider how the choice of technique, both within and outside the classical field, contributes to the results that are desired in the behaviour of the economy? ——*Sir Robert Hall*: I agree. We had some difficulty in deciding precisely what to call monetary measures and what to call supporting or direct measures, but we have tried to draw a distinction in the paper.

1467. You would not expect us to draw the same distinction in interpreting our terms of reference, I imagine? ——We try hard not to interfere with your interpretation of the terms of reference.

1468. *Mr. Jones*: As I understand it, the level of bank advances within the past twelve months has been somewhere in the region of £1,900 million. It would appear that in consequence of the present Government proposal advances are to be restrained to that particular level for the current period. What effect is that going to have upon companies and industrial concerns that have had an overdraft in the present year, and who may have as much economic reason, from the standpoint of the general good of the counry, for a further overdraft next year? Will no further credit be available to particular undertakings, no matter what their economic plight?——*Sir Edmund Compton*: The Chancellor said on 19th September that the situation required that the level of advances should be held for the coming twelve months at the average level for the last twelve months, and the banks have said that they will do their best to meet this requirement. There must be, one would think, selection, but it will be selection by the banks and not by the Government. In that respect, the situation is the same as the situation in July 1955, when the bankers were asked to make a positive and significant reduction in the level of their advances and the Chancellor specifically said that it would be for the bankers to decide how to give effect to that.—*Sir Roger Makins*: The bankers have given a general assurance that they will do their best; how they do it is a matter for them.

1469. *Sir Oliver Franks*: I believe that no previous request or information given to the banks has ever been withdrawn. They are all still in force and, therefore, the indications of priorities or urgencies, for exports, for agriculture at home and the like, still remain as categories of thought within which the banks will in fact exercise the decisions?——*Sir Robert Hall*: Yes.

1470. *Mr. Jones*: The banks will be working on the basis of their own varying global sums?——*Sir Edmund Compton*: Yes, but the distribution of the global sum between the various customers will be at the discretion of the banks. The instruction does not mean that a banker is obliged to give any individual customer exactly what he had before.

1471. *Chairman*: You do not regard the banks as operating under any legal instruction, such as the Bank of England Act provides?——It is a request, not a direction.

1472. Any one bank, so far as the request goes, may reduce or increase its total amount of accommodation? All that is asked is that the group of them should produce a certain result?——*Sir Roger Makins*: That is correct.

1473. *Professor Cairncross*: In paragraph 17 it is implied that a surplus of £300 to £350 millions is a suitable target for normal years, but that it should be higher in favourable conditions. I assume that it would be agreed that the last few years have been, on the whole, rather favourable; would the witnesses agree that the position in the last few years has been one in which the balance of payments has been almost universally unsatisfactory, judged by the criteria of paragraph 17?——Perhaps "unsatisfactory" is one of those words like "inessential". Clearly in the last three years the surplus has not reached the target; on the other hand we would say that the results last year and the first six months of this year, to take an example, were not unsatisfactory.

1474. Even though conditions could hardly have been, by any stretch of the imagination, more fortunate?——*Sir Robert Hall*: 1955 was definitely unsatisfactory, and the intention of the measures taken in the course of 1955 and 1956 was to make an improvement, but in interpreting the outcome of 1956 and 1957 to date you must remember that there was an impact on the situation which had not been foreseen. It would hardly be a fair criticism of the Treasury that they did not foresee in the early part of 1956 the developments which put a special strain on the balance of payments in the second part.

1475. *Mr. Woodcock*: The Treasury say that "the external capital account covers a wide range of different types of outward and inward investment", and "the movement of short-term funds", though we do not know much about them; they "defy precise measurement". Yet the object of policy is to influence these things; it is surely an unhappy position to know nothing about them, and yet seek to influence them. How do you know the effect of your policy on these short-term movements?——*Professor Cairncross*: I understand that figures are published in the United States showing balances held there on British account, but I do not recall any official publication of Her Majesty's Government in which these figures have been cited or even alluded to. This is information relevant to a discussion of the flow of capital to and fro. Is my statement of fact a correct one?——As far as I know they are not published.

1476. Is there any special effort, even in the Balance of Payments White Paper, to draw attention to the short or long term movements of capital into and out of the United Kingdom, apart perhaps from the recent White Paper on Commonwealth investment?——A good deal is said about overseas investment. We try to find out the kind of movements which are going on. There is an example in the Balance of Payments White Paper which has just been published, going back to the measures about what is generally called the Kuwait gap. Is that an example of the thing you have in mind?

1477. That is an example. It came as a considerable shock to economists to find that there was such a large amount of money passing through the Kuwait gap.——*Sir Roger Makins*: It was not only the economists who were shocked.—*Professor Cairncross*: It made it a little more difficult to take at their face value some assurances that have been given in the past that gaps have been plugged. Is it the view of the Treasury that there is nothing more of this kind that we need bother about? ——*Sir Robert Hall*: I think so; but we are hoping that you will be seeing Sir Leslie Rowan, who is much more expert in the details of this than we are. The Treasury certainly worries a good deal about short-term capital movements.

1478. *Sir Oliver Franks*: Must it not be true in general terms that the exchange controls of the whole sterling area have been dismantled to an extent which makes certainty on this subject almost impossible?——Yes.

1479. *Mr. Woodcock*: I would imagine that the Bank Rate of 7 per cent. was fixed with many considerations in mind; but one must have been some assessment of the effect on the movement of short-term funds. Yet you say you have no way of measuring what effect it has, so that you do not know the effectiveness of your monetary policy?——There are two points. There is, first, the possibility of measuring in advance the effect something is going to have; in all this field we have a great deal of difficulty in measuring in advance. We try to take measures which will bring the trend in the right direction, rather than which will produce a precise result. Then, on the second point, the effect after the event is capable of at any rate some degree of measurement, by the movement of the reserves. The figures to be published at the end of this month will throw a good deal of light on the effect of the recent measures.

1480. But the reserves are affected by many things, not only by movements of short-term funds. The determination to put the Bank Rate at 7 per cent. must have had regard to the possible effect on the movement of short-term funds; therefore you ought to know exactly what effect that has had; but the mere movement in your reserves will not do that?——No, but the movement of the reserves is analysed in a good deal of detail in the Balance of Payments White Paper. The more regular things, are picked out there.

1481. The White Paper is an annual publication. Surely it is important to know if you are continuing to hold the Bank Rate at 7 per cent. (which has tremendous internal implications) when the original purpose of fixing it at 7 per cent. has disappeared?——*Sir Robert Hall*: We have weekly figures available of what information there is. The Balance of Payments White Paper is published twice a year, but the work behind those publications is absolutely continuous.—*Sir Roger Makins*: We are thinking now not of what is published but of the information which is available from day to day and from week to week to officials.

1482. *Mr. Woodcock*: In your paper, which was written in August, you say: "Most of these flows defy precise measurement and cannot be forecast with anything approaching accuracy." Are you now saying that they can be forecast, though perhaps not with accuracy?——*Sir Robert Hall*: I am saying that we cannot forecast them with anything approaching accuracy, although we do in fact try to forecast them, and that after the event we also try to measure them.

1483. *Lord Harcourt*: You referred just now to the forthcoming publication of the reserves figure for October. That figure will be the result, perhaps, of an inflow of short-term capital, which we know was flowing in the opposite direction until comparatively recently. It may also be due to the closing of a certain number of bear positions, which is speculation pure and simple, which necessarily involves a movement of capital. Thirdly, and I would have thought possibly the largest factor of all, would be the variation of the leads and lags, the pure and simple mechanics of payment for trade. Are you by the time those figures are published able to analyse the different effects of those three main bodies of movement? Is not a final analysis of movements over the exchanges incredibly difficult?——Undoubtedly. The only distinctions that one can draw with a good deal of confidence are the identifiable capital movements and, over a considerable period no doubt, the trade effects, because the leads and lags must be eliminated if you take it over a long enough time. In any short period it is very difficult to work them out.

1484. When you alter the Bank Rate, therefore, you are not really trying to apply a specific remedy to a specific movement, but to apply a remedy which is calculated in the normal course of events and from past experience to produce an inflow of money?——Yes, to produce the return of capital in the direction in which you want it to go.

1485. *Professor Cairncross*: Questions were put about the probable effects of higher rates of interest, and we were given rather sceptical answers; the indication was that the movement of interest rates by itself would not have much effect on funds. I take it that the movement of interest rates would have more effect if it were likely to influence confidence in the value of the pound; there would be a psychological effect quite distinct from anything else?——This point is dealt with in paragraphs 44-47.

1486. *Chairman*: I suppose the effect of the end of 46 (*b*) is that you can no longer say that there is any automatic result. Both this paper and what we shall have from the Bank suggest that in recent years fears of exchange rate variation have been much more important than movements of interest rates?——Yes, I think it is fair to say that.

1487. Is there any analysis that will separate the one from the other?——No, I do not think you can separate it. You can do calculations about how much it costs to keep funds in one centre rather than another, but when you are dealing with speculative judgments about how things might go, the terms of the problem are such that you could not get a precise answer.

1488. *Professor Cairncross*: Would you believe that the movement of funds over the last month or two would have been so large if we were not committed in effect to making sterling convertible for non-residents by supporting the transferable rate?——I should prefer Sir Leslie Rowan to answer that.

1489. *Professor Sayers*: Having regard to all the difficulties of assessing the position, have you sufficient confidence in the balance of payments figures that are available to the Treasury to say at any time whether the balance of payments is satisfactory or is not satisfactory?——Yes, I think that we have enough confidence to make that assessment.

1490. Within a matter of fifty millions or so either way you are pretty sure of the state of the balance of payments apart from the speculative short-term movements of capital?——Yes; and broadly speaking experience bears that out. The higher the estimated surplus on the balance of payments, if you eliminate speculative upsets that can be identified, the less trouble in fact we have had.

1491. *Mr. Jones*: Would you regard as being anything like successfully watertight the exchange control that is being operated? There was a balance of payments surplus of £211 million in the twelve months ending 30th June, 1957, and the gap has not substantially widened since the end of June; but there has been a substantial drain upon our gold and dollar reserves. Does not this arise in consequence of the operation of the exchange control?——*Sir Roger Makins*: I think the answer is no; but there is a certain amount of technical background to these questions, and it would be, I think, more satisfactory if you addressed them to the representatives of the Overseas Finance Division. They will, of course, arise on the papers on the external side which are in preparation and will be before you before long.—*Sir Robert Hall*: On questions like "Is the exchange control satisfactory or not?" you could spend the whole morning, because the test of satisfactoriness, like the test of essentiality, is a complex of the objectives you are trying to achieve and the administrative methods which are open to you.

1492. *Mr. Jones*: It is often said that about one-half of the world's trade is done in sterling. A good deal of the vulnerability of our position has arisen in consequence of the drain on our gold and dollar reserves, which arises out of the movements of capital and the arrangements by which half the world's trade is financed in sterling. Could we have some quantitative assessment, either today or some time in the future, of the benefits which accrue to Britain in consequence of this service that we give to the traders of the world, by which we may judge whether it is a good thing or a bad thing to continue to be the world's banker?——We will take note that you would like that quantitative assessment in the paper which you will be getting on that subject.*

1493. *Sir Oliver Franks*: There may be non-quantitative considerations which are relevant. For instance, I have heard it argued that the maintenance of the sterling area in something like its present form is the other side of the Commonwealth coin, so to speak. If there are political aspects as well as purely economic and financial aspects, I hope that what you think about them will be said. If your judgement is not based on purely quantitative aspects, it is important, is it not, that we should not look at it from that aspect alone, if we are to arrive at a sensible judgement?——*Sir Roger Makins*: I accept that. Such questions are bound to arise, certainly on the second paper which we shall be producing for you. I would ask that we should not pursue this question today, because I think it arises more appropriately on the other paper.—*Sir Robert Hall*: From the point of view of this paper, it is an object of policy to achieve a satisfactory balance of payments surplus, and we try in our assessment of the situation and our recommendations about measures to think about that, and about the general effect on confidence effect. The wider question: "Is the sterling area a good thing?" is not one which can be easily discussed now.

1494. *Chairman*: There is another aspect of this question; could we stop doing this if we wanted to, and if so on what terms?——*Sir Roger Makins*: That is all part of the same thing.

1495. *Professor Cairncross*: You say in paragraph 19: "Expenditure by public authorities is within the direct

* See Qns. 2528 and following.

decision of the Government". This is of course the formal position, but it is not necessarily an accurate summary of the normal working relationship. The best way of controlling the expenditure of public authorities is not always to use direct means. Has any thought been given to what the reactions would be on public authorities' expenditure of forcing on them interest rates higher than the rates at which the Government can itself borrow?——*Sir Edmund Compton*: The policy has been consistently not to insulate them from the effect of interest rates. For that reason the local authorities have since October, 1955, been obliged to borrow on the basis of local authority market credit, whether they get their money from the Exchequer or elsewhere.

1496. That is true of the local authorities, but not of the public corporations. The Government appears to operate on their capital expenditure by direct limitations of various kinds; do they have access to capital on the same terms as the Government?——Yes.

1497. Has thought been given to varying that proposition? Should there not be some differential between the rate at which the Government borrows and the rate at which public corporations borrow from the Government?——That has not been considered. It has been thought that the only basis on which they could borrow, given the amounts they wish to borrow, was under present conditions on the credit of the Government. As they are borrowing on the credit of the Government, the rate of interest should be based on Government credit. Otherwise the obligations of these authorities guaranteed by the Government would be carrying a rate of interest that was out of line with Government securities.

1498. There are many ways of dealing with that situation; could you not charge them a commission?——The position is, as expressed in the last sentence of this paper, that the control is primarily exercised directly upon the amount that they raise; that is what the law provides for and that is primarily how it is done.

1499. *Sir Oliver Franks*: Would you say it has been done effectively over the last ten years?——*Sir Edmund Compton*: Effectively in the sense that the actual amount they raise is a matter for Government decision.—*Sir Oliver Franks*: That seems to be answering another question.

1500. *Professor Cairncross*: Their investment programmes have in the past been authorised by the Government. The discussions which led up to those programmes may have put the central Government at a disadvantage in relation to any one of the nationalised industries, because the knowledge you have about the affairs of a corporation is not likely to be as great as the knowledge you have in controlling Departments?——Whatever the defects in information nevertheless the decision has to be taken, and is taken; and it is, in fact, implemented by the consequent decision about how much money they can be authorised to use to carry out that work.

1501. In asking for authority are they influenced by market considerations just like any private corporation?——They know that they must pay the going rate, based on Government credit. The extent to which that does in fact make them ask for less than they would otherwise ask for I think is really a matter of opinion. I think it must vary to a considerable extent between different classes of authority. For example, I would have thought that the Electricity Authority, at the stage when it comes forward to borrow, must raise the amount of money that it needs at the time, because of the long-term nature of the commitments it has undertaken. On the other hand, the local authorities probably have more control over the amount that they need to raise, because of the shorter term nature of the capital expenditure they are engaged on and their ability, perhaps, to take longer over what they propose to do.

1502. *Sir John Woods*: May there not be another consideration; for example, the Electricity Authority can show that it has made a profit, whereas British Railways cannot?——That does not alter the terms on which they raise their money. The dominant consideration with an authority like the Electricity Authority is confidence in the growing demand for their product, rather than the knowledge that they can charge whatever they like for it.

1503. Do you think that the Transport Commission, bearing in mind the fact that they have not managed to balance their accounts taking one year with another, are at all restrained in their ideas of capital expenditure by the fact that they have not got a good profit rate?——*Sir Edmund Compton*: Yes, I think they are; on the other hand they would also justify the demand for fresh capital, as indeed they have done, on the consideration that they need to modernise in order to get themselves in a posture in which they can pay their way.—*Sir John Woods*: That is the answer I expected.

1504. *Professor Sayers*: In considering various parts of their modernisation programme British Railways are continually balancing the expected costs of running on the new method against the cost of running on the old method. If they are charged the going rate for the new capital provided to enable them to put in the new method, the new method becomes more expensive as the rate of interest rises. Has the rate of interest, as it has been rising to them during the last three years, resulted in any change in their plans, irrespective of any cut in the number of millions of pounds that the Government has imposed on them as allowable expenditure in any one year?——It would be difficult for me to say categorically that that has been entirely absent from their minds.

1505. This is relevant to the question of how public expenditure on investment is controlled now; I am asking, in effect: is expenditure controlled partly by the rate of interest as well as by Government fiat?——The rate of interest does enter into that calculation but the extent to which that happens must vary according to the type of authority. I think it is more material in the case of, say, a local authority than it would be with one of the nationalised industries.

1506. *Chairman*: The rate must enter into their calculation in the sense that it amounts to a part of the total expenditure. The point is whether, it having been taken into calculation, there is any observable result. Can you answer that?——I do not think that can be answered. In terms of the amounts that they have raised and are raising the dominant consideration for them has undoubtedly been the size of their programmes and the requests made to them or action taken with them to limit those amounts.

1507. *Professor Cairncross*: This is assuming that they are limited much more by the availability of finance than the expected return on the assets. If you look at the behaviour of large private corporations you might come to exactly the same conclusion; but that would be true only within rather broad limits. No private corporation is going to go on incurring liabilities without being fairly certain that it is going to get its money back. There is a second consideration: whether, if you are controlling large public corporations and have to intervene every second year to limit their programme in specific ways, rather than leave them to react to a higher rate of interest, that is going to involve a change in the relationships between these corporations and the Government. I should have thought that it was of importance and interest to you to know how far any change in interest rates affected the size of programmes they submitted for approval?——*Sir Robert Hall*: Changes in interest rates involve them in changes in costs; but they are very like a great many big corporations, in that the effects of changes in interest rates in recent years have been obscured by the other uncertainties in the calculation. They have almost all, except the railways, assumed that they would have no difficulty in selling their output at a pre-determined price. On general grounds I think it would be rather striking to discover that the actual changes in interest rates have modified their plans. The local authorities are in a different position, especially with house building where they have to think about the rents they can charge.

1508. And have not local authorities had to pay higher rates, whereas the public corporations on balance have not been paying appreciably higher rates?——There is not a sharp difference between local authorities' and public corporation rates. It is the difference between local authority credit and Government credit.

1509. But that has been a widening differential; the local authorities have been thrust on their own credit.

where previously they were able to make use of Government credit?——There is a distinction between the source and the rate. They still have access to the Government as a source of funds.

1510. *Sir Oliver Franks*: But one local authority is offering 7½ per cent. for the week. I do not know any nationalised undertaking which is having to raise money at 7½ per cent. or anywhere near, even for a short period. There must be a difference somewhere?——*Sir Edmund Compton*: I do not know what rate they are paying on their overdrafts, if they have any, at the present time, but I guess they are paying 7 per cent. That is in effect the equivalent to the short-term borrowing of a local authority in the market at the present time; there are certain local authorities who are borrowing short while they are waiting to borrow long-term in the market or from the Public Works Loans Board.

1511. *Professor Sayers*: But the public corporation does not have to wait its turn. The local authorities are paying these very high short rates as an alternative to coming flocking into the market and widening the differential between the local authorities' and Government credit. The fact that the local authorities have been forced off the market is widening the differential already. The mere fact that they prefer extensive short-term borrowing to forcing up the long-term rate still further does not affect the point that the local authorities are being forced to take less favourable terms than the public corporations. Have they not been hit during the last three years, to a degree to which the public corporations have not been?——The public corporations certainly have been treated as a branch of the Government in this sense: it was accepted in 1956 that they must either borrow on Government credit in the market or on Government credit terms from the Exchequer, and they were switched to the Exchequer, really on grounds of greater convenience of market management. The view was taken that it was more flexible to raise the money for the authorities by Government borrowing than by direct borrowing from the market by those authorities on Government credit. To that extent there is a difference between local authorities and public corporations.

1512. But this difference has been responsible for the widening in the gap between local authority rates and public corporation rates?——The gap is to be measured by the difference between Government credit and local authority credit. The difference at the moment is ¾ per cent. on the long-term rate.

1513. *Professor Cairncross*: Small authorities who go round and try to borrow money certainly pay more than ¾ per cent. more than the Government?——*Sir Robert Hall*: Certain local authorities are deferring long-term borrowing, though it might cost them rather more on short term.—*Professor Cairncross*: I was speaking of long-term borrowing.—*Sir Edmund Compton*: Perhaps you are thinking of one-year mortgages which we do not regard as long-term borrowing. It was part of the bargain, when the local authorities were given this freedom of access to the market, that they should have discretion to exercise their judgment in the market. Some of them are deliberately borrowing short in preference to borrowing long, as a matter of market judgment. It is a matter for their discretion how far they take that.

1514. *Mr. Jones*: Supposing a local authority is borrowing on a mortgage loan at 6¼ per cent.; would it not be getting the money at less than a public corporation, having regard to the fact that the rate of Treasury Bills is somewhere in the region of 6¼ per cent.?——It depends on the structure of market rates at any particular time. At present a short-term loan costs more than a long-term loan. An authority that wants to stay short for the time being has to pay a high rate of interest for the privilege of doing so.

1515. Would this borrowing be for two or three years?——It is a question for them, how long they take a mortgage of that kind.

1516. *Chairman*: Is this a fair summing up, that for all financing purposes the expenditure of these public corporations is in effect a branch of Government expenditure, but does not come under the same detailed controls as ordinary Government expenditure?——The Government is doing two things. It controls the amount they are going to borrow; and secondly, having given them authority to borrow, the Exchequer then proceeds to lend them that money, but on terms which oblige them to pay interest and repay the principal over a number of years. There are two separate functions of Government there: controlling the expenditure, where, I agree, the same detail of control cannot be exercised as compared with Government capital programmes; and lending the money, which is a function of the Treasury as a branch of Exchequer management.

1517. *Mr. Jones*: In paragraph 19, it is pointed out that imports can be controlled by licensing, and it says that we have moved away from this particular instrument because it has particular dangers of reciprocal action on the part of customers for our exports. If you deal with the situation by restricting credit and raising interest rates, can there be any different result in the long run?——*Sir Robert Hall*: No, but I think it gives us a freer adjustment in international trade if we do it in this way than if we go through the list and, as it appears to other countries, cut down in an arbitrary way between one import and another. We have been trying to get away from the system in which international trade is controlled by quotas and differential exchange rates.

1518. *Sir John Woods*: Would you not say that in terms of good international trading, any quantitative restriction of imports is perhaps the most unpopular and, indeed, most ungentlemanly behaviour, whereas monetary action which is taken may have the result of restricting, but is clearly taken to defend your country's currency?——I think there is a reason for that. If you are a trader in another country, at least you know where you are if the effect is got by a perfectly general instrument; you at least have the same chance as everybody else.

1519. *Lord Harcourt*: Would it not be right to say that quantitative restrictions invite specific retaliation, whereas the reduction of imports by general measures in defence of the currency is something which is understood all over the world, and does not attract retaliation?——The background of Government thinking on this has been that we must export a very substantial part of our output in order to live at all, and it is a very diversified kind of output, so that we should be particularly sensitive to retaliation.

1520. *Mr. Woodcock*: But cannot this phrase "difficulties for international economic relations" apply to monetary instruments as well?——They are not on all fours, I think, though I do not say that, if countries deflate or inflate violently, it does not upset international trade; it does.

1521. *Chairman*: Have monetary measures such as raising the Bank Rate led to your knowledge to protest on that score from the exporter whose trade has been reduced?——No. We might get the suggestion that we or other countries were pursuing too restrictive a policy, but they certainly would not object to our defending our balance of payments in this way; the argument would be whether we were right to defend it or not. On the other hand, if you go through a list and cut out particular things, you get complaints that you are being unfair to a particular class of trader or a particular country.

1522. *Professor Cairncross*: The point surely is that general measures might evoke general protest and specific measures might evoke specific protest. The kind of reaction you get abroad is that the United Kingdom is giving the whole world a restrictive tilt.—*Lord Harcourt*: Are not quantitative restrictions on imports against the Bretton Woods Agreement?——Yes.

1523. *Mr. Woodcock*: Have we also an international obligation not to deflate?——Not quite in those terms; it is "to maintain a high and stable level of employment".

1524. *Professor Cairncross*: Your reference to exports is not, I take it, intended to mean there are no ways in which exports can be encouraged, indirectly if not directly? There are various instruments open to the Government to operate so as to promote exports?——Yes. Indeed I think it is fair to say that in a period of credit restriction the Government has often indicated that it regards the furtherance of the export trade as essential or desirable.

1525. *Sir Oliver Franks*: Paragraph 18 says that the instruments available include direct intervention, fiscal

policy, and monetary policy. Paragraph 21 says that the problem for the Government is to select, from the various instruments available, a combination which is adequate to make the changes which are necessary. Is it reasonable to infer from that that these different measures are on all fours, and that it is a question of expediency, if necessary to be politically judged, what particular combination fits the circumstances from year to year or from six months to six months, and that the choice of instruments, whether direct intervention, fiscal policy or monetary policy is made without predisposition or prejudgement and with an open mind?——If you include the last three words as not inconsistent with what you have said, I agree.

(Adjourned until 2.00 p.m.)

SIR ROGER MAKINS, SIR EDMUND COMPTON and SIR ROBERT HALL further examined.

1526. *Chairman*: May we proceed to Part II?——*Sir Robert Hall*: May I say, Mr. Chairman, that we feel very diffident about this section, which deals to some extent with monetary theory. We are very conscious in the Treasury of the complexities of this subject, and we try not to identify ourselves with any particular school of thought or to seem dogmatic; but we gathered that you wanted to know the sort of background of our thinking in any recommendations that we might make, and we have submitted this, as I say with great diffidence, in the hope that it will help you.

1527. Thank you very much; I am sure it will. There is one question on paragraph 24: coming to this rather from the outside, as I do, I was struck by the importance you put there on persuading people to balance the terms on which they can raise money at the point in question against the prospect of being able to raise money at some unascertainable later date. Is there not the question also of simply discouraging people faced with the difficulties of raising money from going forward with a plan to raise it at all?——*Sir Robert Hall*: We live as it were from day to day, or from year to year, and our thought there was that there was no need to go into the question of whether they put off the decision for ever or took a new one altogether; the relevant thing was that they did or did not do it now.—*Sir Edmund Compton*: The starting point is that they want to raise it. If they do not want to raise money, the question does not arise.

1528. Projects can be abandoned as well as deferred? ——*Sir Robert Hall*: Yes, but we feel that you will never know whether they have been truly and finally abandoned, and that it is therefore safer and just as significant to say that they have been deferred. There is no implication as to when they will be taken up again, because each year is judged on its own merits.

1529. *Professor Sayers*: The relevant point for the immediate economic situation is that they are deferred; whether they are deferred to the Greek Kalends or until tomorrow is not relevant to the pressure on the market today?——No.

1530. *Sir John Woods*: Indeed, they may not know themselves; they may simply say that the conditions at present are such that they are not going to do it, at any rate now?——Yes.

1531. *Professor Sayers*: Of course there are times, for instance when you think that a slump is coming, when it is important to know just how admissible the schemes on the shelf are, but apart from that complication it is merely a matter of knowing what is going to be taken up today and what is not, is it not?——Exactly.

1532. *Professor Cairncross*: You draw a distinction between raising money and spending money. I take it you would also draw a distinction parallel to that, between incentives to hold money in one form or another and incentives to borrow or lend, which is something slightly different? There is a given supply of money in the system, which conforms to a certain degree of liquidity, but the firmness with which that money is held can vary. If the rate of interest goes up, and people are earning more interest on that money, they may hold it more firmly. Then the danger that the money will be applied to capital purposes or spent is diminished. As far as I understand some of the later paragraphs here, there seems to be a presumption that changes in liquidity take place primarily through changes either in the supply of money or in the supply of Treasury bills; but surely there is also a very real possibility of a substantial change on the demand side. If people lose confidence in money, for instance, they will try to get out of it, and even with a fixed supply of money you may find an increasing amount of inflation. I make this point because in fact the supply of money in terms of bank deposits has not varied very much over the past five or six years; and yet the level of prices has risen very appreciably?——Yes. I think we call attention to the changes which can take place in the desire to hold liquid balances.

1533. Do you have any views as to the limit? Do you believe the economy might be run in fact on a very small sum of money in relation to what exists now? Where do you get to the point where you think liquidity is about right?——It is a function of the rate of interest, to our way of thinking. We also think that there is not, except in quite abnormal circumstances, an indefinite extensibility of the active supply of money at the expense of the inactive. At any time there are minimum balances which every individual or corporation will wish to hold, and he will find serious inconvenience if he lets them drop below that level. We feel that you get down somewhere or other to some level which you must have on the average, because it is so inconvenient to have to realise an asset if you happen to want money.

1534. *Professor Sayers*: This irreducible level will depend in part on the availability of other highly liquid assets, or what we might call near-money. Has not the increasing availability over the last half century of these highly liquid assets made it possible for the national income to expand relatively to the supply of money quite considerably, without any appreciable rise being thereby engendered in the rate of interest, such as one would expect to see?——*Sir Robert Hall*: Yes.—*Sir Edmund Compton*: In the first half of 1955, when deposits were going down, commentators said that they thought the slack had been taken out of the system, as though they thought we were approaching that sort of level as a result, presumably, of the removal of savings from inactive deposits into securities. But I think we would all feel that what has happened since then has shown that all the slack had not been taken out of the system by that single operation.

1535. As one who was not one of those commentators, I wonder how far you did in fact subscribe to that theory that was then put forward?——*Sir Edmund Compton*: Our state of opinion at that time was reflected in the action that was taken in July, 1955. We took the view that not enough slack had been taken out of the system, and requested a reduction in the level of advances, taking the view that probably the increase in advances had generated active deposits.—*Sir Robert Hall*: I think our general state of mind was always a sceptical one, that it would be imprudent to be sure that anything was going to happen until there was some evidence that it had happened.

1536. If that slack had been taken up one would have expected a very sharp rise in the market rate of interest. Is it not more realistic to think of the active demand for money as being compressible very gradually as rates of interest rise?——*Sir Edmund Compton*: I think our view was that some slack had been taken up, and of course there was quite a marked rise in market rates of interest. In fact it was an example of the process described in paragraph 24 (a) here in the paper, of "other people or institutions who have money" being "persuaded to take securities in exchange for it"; but one goes on to say that though some slack may have been taken up, not enough was.

1537. Which do you regard as the more important, the compression of the demand for the money or the rise in the rate of interest that goes with it?——One of the objects of the rise in the rate of interest is to depress the demand for money, to persuade people to exchange money for securities; that is the savings side of the medal. The other side is the expected effect of the rate of interest to make people less ready to borrow money, or, if it is

money that they themselves bold, to defer spending that money.

1538. You have formulated the two sides of the medal in a rather different way from mine just now. Which do you regard as more important?——*Sir Robert Hall*: I think I would regard the depression of the demand for money, the change in expectations, as more important. I think that follows from what I said this morning about how, in the complex of uncertainties that are facing you, small changes in the rate of interest get lost.

1539. *Chairman*: I have been a little puzzled to give a concrete meaning to phrases such as "the creation of optimistic or pessimistic expectations about the course of prices." It sounds almost like propaganda. If you alter the Bank Rate, people will read into that either what you tell them or what deductions they may make from it. Have you something more in mind than that?——There is a long history of argument in monetary thought as to whether, for example, when the Bank Rate is put up, it causes a reduction in activity or a movement towards a slump, because people have to pay more for what they borrow or because they think that it is a storm signal. If it were the latter, the "creation of optimistic or pessimistic expectations" would be a very complex process; a man's expectations would depend partly on traditional knowledge handed down from his predecessors, that one had to look out when the Bank Rate went up, and partly on anything that he could glean as to the intentions of the central authorities. If it were the former, it would be a real thing, although it might have a propaganda element in it, in the sense that the central authorities might try to persuade people that bad times were coming.

1540. Does it all centre round the use of the Bank Rate, and whatever deductions, direct or indirect, are drawn from that?——In the past it undoubtedly did, and at present even if we did not accompany an increase in the Bank Rate with gloomy noises it would still be giving people a signal that it was time to think whether their plans, which had been based on the view that business was going to stay good, should be altered or not if perhaps business were going to become bad. We use the words "expectations" and "optimism" or "pessimism" because in a lot of this field you are dealing with plans which will not come to immediate fruition.

1541. A Government which wanted to restrain people from spending money could not just go about shaking its head and saying: "Bad times are coming". It must depend upon some relevant action, with the consequences attributed to it?——Yes, but the consequences attributed to it might be justified by the action that the authorities were taking, or they might just be a guess or a traditional method of behaviour.

1542. *Professor Sayers*: A hangover from periods of bad trade in the past?——There is certainly an element of that in it, though I would agree that if in fact nothing positive were done the use of pure changes in expectation would gradually lose its effectiveness. But I find it rather difficult to understand trade cycles in the past without reading into the cause of the action a change in expectations which seem to indicate something more than the actual change in the cost of money.

1543. *Chairman*: But is it not possible that with increasing public knowledge about the relevant factors and an increasing number of organisations to study them, Bank Rate, if we are concentrating on that, and its movements will be dealt with more on merits and by objective judgments about what is going to happen, than just regarded as a storm signal or a sign of the authorities knowing what is going to happen?——Yes. A little later in this section we point out that the general belief that the Government could and would eliminate violent fluctuations has affected the course of expectations. My own view is that the period round about 1954/55 is quite a significant period in British monetary history. To us at least it seemed that it was about then that the business belief that the Government was going to try to maintain a high level of activity rather modified the attitude of businessmen and institutions which had to some extent been conditioned by prewar experience.

1544. *Professor Cairncross*: But was not one of the great differences between the use of the Bank Rate within the last few years and its use in the more distant past that in the past it was assumed that the Rate could be raised almost without limit in order to make a restrictive policy effective, whereas in the last few years it has been fairly widely assumed that the Rate would not be increased indefinitely, and that 5½ per cent. could be regarded as a "crisis" rate? In that sense the increase in Bank Rate to 7 per cent. may alter expectations in relation to where they stood a year or two ago?——I think that there is an element of that, but that you would be oversimplifying it if you regarded the Bank Rate in isolation and apart from what was believed, both in the past and now, about Government intentions.

1545. *Professor Sayers*: Does not what you have been saying tend to minimise the importance of Bank Rate itself as a signal?——I think I have been saying that, if people believe that the level of activity is likely to be prevented from wide variations, then that reduces the importance of Bank Rate as a signal.

1546. *Chairman*: Does it not look as if Bank Rate might have to be judged in future strictly by the results it achieves, and not as a sign of superior wisdom on the part of the authorities or as a storm signal?——I would say that in the past it was judged in this way because in fact it was associated with the kind of movements which people thought it would be associated with. To the extent that people do not believe that it will be associated with such movements, that is a new factor in the situation; they have to recondition themselves to a new set of experiences.

1547. *Mr. Woodcock*: In paragraph 24 you refer to what has happened in the past. If we go as far back as the late twenties or the early thirties, what happened then? Money was as cheap as it possibly could be; did that have the effect of increasing borrowing?——Very slowly. It was certainly very strongly held in the thirties that if we got into a deep depression, expectations in themselves would not cause people to borrow; that is to say, people will not borrow money even at a nil interest rate, if they think they are going to lose it. It has been sometimes put that monetary policy is more like a string than a stick; it will hold people back but it will not necessarily push them on.

1548. *Professor Sayers*: Will it beat them off?——We are still in an experimental period.

1549. *Chairman*: In paragraph 28 you say that decisions on the central Government's own current expenditure are not influenced by monetary conditions themselves. Is that relevant to their borrowing activities?——Current expenditure is what is spent on goods and services and transfer payments. In the postwar period we have always had a surplus above the line. I think this means that the Government may say: "the economy needs to be contracted or expanded, therefore we will spend more or spend less"; it does not say: "interest rates have risen," or "bank accommodation is more difficult; therefore we will spend more or spend less on our current activities."

1550. *Professor Cairncross*: Whatever may happen to private customers, the central Government would not feel compelled to restrict its expenditure?——Certainly not its current expenditure.

1551. But the private customer might be expected to show some reaction to the incentive of higher rates of interest in limiting his current expenditure?——Yes.

1552. *Professor Sayers*: In the second sentence you say that monetary pressures may exercise marginal effects on current expenditure of other public authorities; is that phrase meant to cover the reaction of local authorities in considering their housing programmes, for instance?——We meant "current" to mean current and not capital.

1553. *Chairman*: Although the central Government's current expenditure is covered above the line, there would still have to be large periods of the year when short-term borrowing has to take place to finance it, would there not?——We should not so conduct our affairs that the regular outflow of Government payments would be affected by the cost of servicing the borrowing on floating debt which has to be done to even out the flow of Government expenditure.

1554. *Professor Sayers*: You would not defer the payment of Treasury officials from September until January because the Treasury Bill rate had gone up?——No.

1555. *Sir John Woods*: Are you quite sure Their Lordships would not be moved some time to send round a Treasury Circular on those lines, because the rate on Treasury Bills was over 6 per cent.?——*Sir Edmund Compton*: There would perhaps be an accidental connection. The conditions in which we were paying 6 per cent. on Treasury Bills would also be conditions in which we were enjoining economy in public expenditure, but because of the effect on the money supply, not because we felt it was crucial to cut down the cost of financing our seasonal deficit.

1556. *Professor Cairncross*: If total demand on the resources of the country is too great and has to be restricted, one of the large elements in demand is the use of resources by the central Government to meet its requirements. Is it not quite as proper that that should be restricted, in circumstances where you are cutting down, as that private consumption should be restricted.——*Sir Robert Hall*: Yes; but we should cut it back because of a direct decision that the country was spending too much, not an indirect decision that money was getting dearer.

1557. What is the difference? Monetary pressures express a disproportion between demand and supply. A rise in the rate of interest merely gives expression as a rule to this kind of pressure. But rates of interest may not be effective in those conditions, and your policy then might be not to make use of them. If you chose to deal with the pressure by restricting Government expenditure for current purposes, that would be as effective as any other method. Should one exclude this form of reaction, from the point of view of deciding what to do?——*Sir Robert Hall*: It seems to me that there is a valid distinction between a direct decision and an indirect decision. If we decide that we want to remove pressure, we cut down our own expenditure and make it more difficult for other people to spend. We do not start by making it more difficult for everybody to spend, and then go out and read the papers, and say: "It is more difficult to borrow money, therefore we have got to cut down Government expenditure "——*Chairman*: But a heavy additional charge for short-term borrowing must be relevant in considering at any rate the future level of current expenditure.

1558. *Professor Sayers*: Do individuals and firms behave in the same way as H.M. Government in this respect, and if so is there much point in putting the Treasury Bill rate up to 6½ per cent.? If H.M. Government is typical of the community in this, if people take no notice of the short-term rate of interest, but they conduct their affairs in just the same way, then why go to this expense in the debt management?——*Sir Robert Hall*: That depends on whether you have satisfied yourself that the private sector does not respond to these changes.—*Sir Edmund Compton*: There are perhaps two points here. First, a judgment that the money supply is too great and that some of it can be reduced by an increase in the Budget surplus (which is really the objective both of the Budget balance and of the injunctions to departments to economise). Secondly, there is the point that in so far as we are temporarily in deficit we must minimise the cost of our temporary accommodation. That we do in two ways: first, we economise on our balances and make full use of those before borrowing; and secondly we are always pressing Departments to manage their accounts so that they cut down their balances, collect the taxes, and generally minimise their drawings on the Exchequer at any particular time.

1559. *Professor Cairncross*: But a factor of critical importance is surely the large payments of interest that are taking place all the time. These payments clearly rise as interest rates go up; is it not then necessary either to raise additional sums in taxation, or cut the Budget surplus, or cut other forms of expenditure?——Of course that is an element in the Budget balance; it is an expense that must be paid. But the assessment of what the Budget surplus should be depends on the judgment of what surplus is required to balance supply and demand in the country, as stated in this paper; and this judgment in its turn, in each Budget, is influenced by the two methods of operating, the fiscal and the monetary.

1560. *Sir John Woods*: Are you then saying that, if the general balance of supply and demand in the economy is such that restrictive measures are needed, the Government for that reason alone will try to institute its own economy drive; that the same circumstances will have led to altered monetary conditions and the high interest rates; but that it is the first thing which leads to Government economy, and the fact that the Government is paying 6½ per cent. on its deficit borrowing is incidental?——Yes. On the second point, it has been said, and we would say again, that those higher rates are the price we have to pay for the impact of monetary policy on the system.

1561. *Mr. Jones*: Paragraph 30 suggests that monetary policy works essentially through the level of investment. In view of the long-term aims of the country in terms of economic growth, can you regard this as satisfactory? Are we not sacrificing the future to present expediency?——*Sir Robert Hall*: Investment increases your potentiality for the future, but cuts down your current level of consumption or activity. The problem is always to know what balance to strike between the two.

1562. But is not the first line of attack of monetary policy and a high Bank Rate upon investment? *Professor Sayers*: Is not the main attack of monetary policy rather on investment plans, on the expected rather than on the actual level of investment? It may affect actual investment at the time too, but it is unlikely to affect the full volume of investment, except insofar as that investment is causing a rise in prices and so eating into the consumption of the fixed income groups?——*Sir Roger Makins*: It seems to me that we are getting into some difficulty by the terms that we are using. "Cutting back" investment seems to imply that you are going to stop doing something which you are already doing, whereas the conception of these measures is much more that they slow down the rate of investment which is in contemplation.

1563. *Mr. Jones*: Do they not actually reduce investment below the current level, particularly in a situation of inflation?——*Sir Robert Hall*: If we are on a rising trend and we take measures to restrain it, the only thing we can be sure of is that it will not be as much as it would have been if we had not taken these measures. Whether the result is actually an increase or a decrease of assets depends on how far you push the measures.

1564. Suppose that the actual currency to be devoted to investment is cut to the level of a year when prices were 5 per cent. less; would not that mean a 5 per cent. cut in investment?——*Sir Robert Hall*: Yes, in that case it would.—*Sir Roger Makins*: But for the future it would depend on whether prices continued to rise at the assumed rate.

1565. *Sir John Woods*: In paragraph 30 you refer to the main area which can be influenced as being investment in both fixed and working capital, and you say that "such expenditures are frequently postponable". Should there not be some slight reservations for working capital and stocks? People who in the course of their business have to carry stocks may not be able to postpone very much; it depends on how well they are stocked at the time. Would you agree that this is a significant point because it may be that, in some areas at any rate, the earliest and most biting effect will be in respect of stocks?——*Sir Robert Hall*: I do not think that it is by any means invariably the case that firms have one particular level of stocks which they must carry. If they think that prices are going to rise, for instance, they may increase their orders; if they think that prices might fall they will decrease the amount of stocks. There is a postponable element in stocks. But I think there is an important distinction in this field between investment in stocks and investment in fixed capital.

1566. *Mr. Woodcock*: Paragraph 31, written in August, says: "It is now, however, taken for granted that the Government will do all in its power to prevent the advent of a general recession". Would you say that was true of October?——*Sir Roger Makins*: As a general proposition, yes.—*Sir Robert Hall*: I think Ministers have said that it is not their intention to create a general recession in the sense in which this word would have been used before 1939.

1567. I seem to remember some statements that they would push tightness to the point at which it succeeded in its object whatever its other results?——That depends on their judgment of how far they have to push it; they might have to push it further than their statement suggests.

1568. *Professor Cairncross*: In paragraphs 32 to 34, if I understand you aright, you are arguing that the money supply is pretty well geared to the size of the floating debt, subject to one or two qualifications: for example, it might happen that Treasury Bills were held more extensively outside the banking system than in the past, or it might, I suppose, happen that the banks varied the proportion in which they were anxious to lend to the private sector, as compared with the public sector?——*Sir Robert Hall*: Yes. The argument is that the banks are largely affected in their operations by their liquidity ratio, that the most important element in the liquidity ratio is the supply of Treasury Bills, and that therefore "a restriction of the supply of Treasury Bills available to the banks and the discount houses is a necessary condition, apart from direct requests, for bringing pressure to bear on the supply of money".

1569. It may be; but there are qualifications. For instance, the number of Treasury Bills held outside the banking system might increase?——We thought we had covered that by the words "available to the banks and the discount houses".

1570. In what sense are they available to these rather than to other holders? There is no type of Treasury Bill that is manufactured specially for use by banks in this country?——No; but if other organisations or persons take up Treasury Bills, that reduces the amount available to the banks, and presumably leads to increased competition for the existing supply.

1571. *Professor Sayers*: But the banks can influence the distribution of Treasury Bills between themselves on the one hand and private industry on the other by altering the terms on which they take deposits?——Yes.

1572. *Professor Cairncross*: Surely there have been quite extensive changes in practice, both in banking and on the side of the large commercial companies? The commercial bill has declined in importance, but quite a high proportion of Treasury Bills has lately been taken up outside the banking system. If that trend continued, you might dispose of a greater part of the floating debt that is now held by the banking system. Similarly there have been quite marked changes over the last few years in the disposition of large companies to hold balances or enter into debt to the banks. But these qualifications are not intended to question the central proposition that the floating debt is the principal element here. How widely would you draw your definition of floating debt? You speak only of Treasury Bills in this paragraph, but surely short-term Government maturities enter into the same category, and are held extensively by banks?——*Sir Edmund Compton*: Yes, but they do not put them into their liquidity ratio. The significance of the short-term securities is, I think, that if we operate on the supply of Treasury Bills they have a means of defeating us—*Professor Cairncross*: If you take the liquidity ratio too seriously?—*Sir Edmund Compton*: Yes.

1573. *Professor Sayers*: But short bonds are held by the discount market and put into the banks as security for the call money, and call money enters into the calculation of the liquidity ratio. So are not short bonds directly relevant to the liquidity ratio.——*Sir Edmund Compton*: Not the short bonds held by the banks. When we calculate what the bankers' liquidity is, we look at their floating debt assets, call money plus bills.

1574. *Chairman*: But if you were a banker and you were considering your liquidity, you could not ignore the fact that you had a holding of maturing bonds as well as your holding of call money, commercial bills and Treasury Bills?——No, indeed. Your short bonds would be part of your liquid reserve, but in terms of the conventional liquidity ratio they would not count.

1575. But that would depend upon the exact rigidity with which you regarded what you call the conventional liquidity ratio? Must there not be some play in that? ——Our experience is that the play that bankers allow themselves on that under the present system is small.

1576. *Professor Sayers*: Is it not this way round, that throughout all these years they have held such a large volume of short bonds that they have been prepared to leave only very small play in their liquid assets ratio, and therefore these bonds held by the banks are themselves significant? This is quite apart from my other point that the short bonds held by the discount market do enter into the banks' 30 per cent.; but the Chairman's point is surely valid and has affected the situation. If the banks did not have this reserve of short bonds they would have felt compelled to have their liquid assets ratio rise appreciably above 30 per cent. at times. Would there not be a bigger variation in the liquid assets ratio if they did not hold this amount of short bonds?——They must build it up sometimes; they must have a liquidity ratio of about 35 per cent. in December in order to be at 30 per cent. in mid-March. But it looks, from the experience of the last two or three years, as though they can so dispose their affairs in terms of forthcoming maturities and the like as to provide themselves with fresh liquid assets and maintain their conventional liquidity ratio at around 30 per cent., if they feel they are going to be in any danger of pressure. For example, they undoubtedly took account of the expected increase in National Savings takings by the Exchequer in 1956 in calculating what they would do about their short-term securities, in order to enable themselves to keep above the minimum by the end of that financial year.

1577. *Professor Sayers*: May I come back to my other point? It is suggested in this paragraph that the supply of Treasury Bills is the main basis for the supply of money. I accept that as a general proposition, but I suggest that this is an important qualification, that, if the supply of Treasury Bills was diminished and the supply of short bonds increased, that is to say, if you funded extensively into bonds, the discount houses could raise the proportion of bonds to Bills in their portfolios, and you would have just as much call money, and the banks could be holding just as many Treasury Bills as before. So would not the supply of liquid assets in the banks be just as much as before, although you had reduced the volume of Treasury Bills?——*Sir Robert Hall*: We do not dissent at all from the general proposition that the existence of a large volume of short maturities makes it much more difficult to bring pressure on the banking system.

1578. And for these two reasons; the qualifications become important when we come to considerations of debt management and of the desirability of the present levels of short bond holdings?—*Sir Edmund Compton*: For that reason, I am not sure that the point ought to go without making this qualification about it: the implication that funding is no good if it consists of turning Treasury Bills into short bonds seems to me to assume that there is no limit to the extent to which the discount market is able to switch as between bills and bonds. This is not a matter for the Treasury to dogmatise on, but I should think there are severe limits upon the extent to which they can do so.

1579. *Professor Cairncross*: We are told that the difficulty in devising a suitable monetary policy arises in part from the large amount of floating debt. Have you made comparisons between the money supply, the size of the floating debt and the national product now and before the war? It is odd to find that the money supply is no larger than six years ago, particularly if one finds that the increase in bank credit to industry has risen very little while trade credit has risen enormously, and stocks, particularly stocks held by industry, have gone very high indeed. The figures in paragraph 38 do not say whether, over the period since 1935, the floating debt has risen more in proportion to the money supply or in relation to the national income.—*Sir John Woods*: Some calculations made on material given by one of the joint stock banks relating to the relationship between money supply and the national income suggest that the ratio between the two things now is the same, within about 1 per cent., as it was in 1938.—*Chairman*: What would you say about that given fact?——*Sir Robert Hall*: I would say that money is doing a great deal more than it was in recent years.

1580. What vehicle of money is doing the additional work, notes or deposits?——Both; but bank deposits more in proportion than notes. If you take the years 1951 to 1956, the total of deposits in the London clearing banks has gone up by approximately £120 million, to over £6,000m. The currency in circulation to the public has gone up from £1,291m. to £1.765. If you take the two together, the money supply has gone from £7,453m. to £8,053m. So from 1951 to 1956 the money supply has

gone up from 100 to 108, and the national income has gone up in money value from 106 to 141. Within the increase of 8 per cent. in the money supply, there is a very small increase in bank deposits, and a larger increase in notes, though still not as large as the increase in the money value of the national income. Then, as we say in paragraph 38, the proportion of floating debt in the National Debt has increased by a third, and floating debt and marketable securities with less than five years to maturity taken together are now 34 per cent., compared with 16 per cent. in 1935. It was on these sorts of calculations that we supported our conclusion that the liquidity of the assets available to the system is greater than it was.

1581. *Professor Cairncross*: But the National Debt is lower in proportion to the national product than it was?——About the same.

1582. *Chairman*: In paragraph 34 you say: "a restriction of the supply of Treasury Bills available to the banks and discount houses is a necessary condition (apart from direct requests) for bringing pressure to bear on the supply of money". That, I appreciate, is a statement of the theory. Would you say, again apart from direct requests, that there has been any time since 1951 when a sufficient restriction had been achieved to bring effective pressure to bear on the supply of money?——*Sir Edmund Compton*: There have been two occasions when that came about for a short time. One was at the end of 1951, when the bankers' liquidity was affected by the Serial Funding operation; but I believe it is very much a moot point whether the reduction in advances which then took place was because the banks were pressing for reductions or because their customers were taking a view of the future and reducing their demands. The second period was the earlier part of 1955, when the bankers were up against the minimum liquidity ratio after the increase of Bank Rate to 4½ per cent., which was accompanied by a considerable transfer of large sums of money from deposits into Treasury Bills. The depositors got round to turning their deposits into short bonds. At other times the banks have, to varying degrees, restricted advances; but at those other times it must have been in respect of requests and not owing to actual liquidity pressure, though liquidity pressure was sometimes potential.

1583. The stability of the ratio at any one time would depend upon the trend which follows during the course of the succeeding months?——What followed after, when the apparent pressure on liquidity came about at the end of 1951, was a reduction in advances. What followed in the early months of 1955 was an increase in advances, and sales by the bankers of their investments.

1584. It looks as though they were in a position to slide out of the consequences even though a firm pressure on the liquidity ratio is achieved?——In terms of the monetary system, they did not slide out of the consequences, but responded to the pressure upon their liquidity. The sale of investments by bankers can operate to reduce the money supply in the same way as a reduction in advances. It was that operation which was claimed by commentators at the time to have taken some of the slack out of the monetary system.

1585. *Professor Sayers*: At the end of 1951 the liquidity ratio was reduced by the funding operation, and at the same time the banks were asked to be more cautious in granting advances. Supposing that they had not had their liquidity ratios reduced at the same time as this request for keeping down advances, would they have acted any differently in dealing with applications for advances? The reduction in the supply of Treasury Bills could only have brought pressure to bear on the supply of money if, as a result of the operation, the banks had reduced the amount of advances they were willing to supply even more than the Government request was leading them to do (assuming that their investments were unchanged). Was it the willingness of the banks to grant advances that was the limit of the quantity and not the demand of the customers?——To what extent they responded to the pressure on their liquidity and to what extent to the direct request I would find it difficult to say. The bankers themselves said, and I am in no position to contradict it, that a great deal of the reduction of advances that took place in the early months of 1952 was really due to a change of attitude on the part of their customers. When a banker was pressing a customer to reduce his overdraft he found that the customer was ready to do so, because looking ahead he was disposed to contract.

1586. So the suggestion that the reduction of the floating debt was an operative factor at that time is built on a very slender foundation?——*Sir Robert Hall*: The banks appeared to be under some pressure because of the change in the liquidity ratio, but we could not say with absolute confidence that that was a factor, because it was not put to the test.

1587. *Chairman*: What were the details in the early part of 1955?——*Sir Edmund Compton*: Liquidity fell to 30·0 per cent. in March, and 30·1 per cent. in June, and the bankers responded to that pressure by selling investments. In the same four months their advances went up by £289 million.

1588. *Professor Sayers*: Would you argue that, because they were being forced to sell investments, that in itself would make them more stingy in granting advances?——I imagine that they were not glad to sell investments, because owing to the effect of the increase in Bank Rate through the structure of interest rates, the value of their investments had gone down; so they were incurring losses.

1589. They incurred them in order to be able to go on advancing money, without reducing their liquidity ratio below what they considered a comfortable level. Do you think that the authorities were achieving their object by forcing the banks to be very uncomfortable about granting advances or by the banks' sale of securities forcing the interest rates up?——The Government were not satisfied with the money situation as it had developed by July, particularly with the increase in advances, which seemed to have added to activity; the proof that that result was not considered satisfactory was in the direct request that was made to the banks to reduce advances in spite of their sales of investments.

1590. The pressure on the supply of liquid assets was not, by itself, sufficient to induce contraction at the pace the authorities wanted?——*Sir Robert Hall*: That is quite clear from the statements made by the Chancellor of the Exchequer in succeeding months.

1591. *Chairman*: And your view was that the sales of investments must be thought of as primarily extinguishing idle deposits whereas the advances they substituted were actively used?——*Sir Edmund Compton*: That was the diagnosis.

1592. *Professor Cairncross*: You meant the effect to be for the banks to decrease their lending to the private sector and increase their lending to the public sector; advances were to be restricted in order to allow the banks to hold on to their investments, which all represented loans to the Government? But the net effect of the operation in 1955 was surely that the banks were successful in lending to the private sector at the expense of the public sector?——The banks were selling investments, but the Government was not receiving anything by the sales of these investments.

1593. *Professor Cairncross*: If the banks sold those investments somebody else had to bear the burden?——*Professor Sayers*: It would have the effect of raising the price at which the Government could raise further money. —*Professor Cairncross*: In other words, it was possible to interpret this as a method of protecting the gilt-edged market. That may, of course, not have been the view taken by the Treasury?——It is a suggestion. I do not think it occured to us, especially at a time when the price of gilt-edged securities had in fact fallen as the result of the application of what was then a high Bank Rate.

1594. *Professor Sayers*: The remedy that the Government adopted was to tell the banks to curtail advances to the private sector directly, apparently on the basis that the advances to the private sector were putting too much steam into the boom. Are there not two ways of doing it other than that which you followed; to raise interest rates so that they incurred much bigger losses on selling investments, or to make certain investments unmarketable?——To have made part of their liquid assets or investments unmarketable would have been in fact the inauguration of a completely new system. It would be the same thing as a compulsory liquidity ratio.

1595. Would it not have been following the compulsory funding policy of the autumn of 1951?——*Sir Edmund Compton*: That was not a compulsory operation.—*Professor Sayers*: That is a matter of words.—*Sir Edmund Compton*: The second alternative Professor Sayers mentioned was one under which it would have been made so uncomfortable for the banks to sell their securities that they would have been bound to reduce their advances. But the Government securities in the bankers' hands are short dated and coming so near to maturity that the interest rate would have had to be driven very high indeed in order to create a situation in which the banks would incur spectacular losses.

1596. Does not this episode underline the way in which this band of short securities held by the banks weakens the control that the authorities have over the liquid assets? ——I hope that comes out from the paper before the Committee. It was the view of some people at the time, though not of the Government, as history shows, that the Treasury could be almost indifferent to the way in which the bankers responded, so long as they did respond; that the effect would be to reduce the money supply, whether the bankers sold investments or reduced advances.

1597. But you would not agree with that?——That, in the situation in the summer of 1955, did not seem to produce the results we expected.

1598. *Professor Cairncross*: Where do you expect to come out in the end? It is not clear what would happen if you removed these restrictions on bank lending, but presumably you would expect the money supply to expand and the banks to make full use of it. Have you any idea where this would take you? How long do you expect the existing system of restrictions to last? Are we to contemplate the existing restrictions as part of the permanent armoury of weapons the Treasury wish to make use of in monetary policy, or something temporary and arising from a post-war situation?——*Sir Robert Hall*: We have not anything like firm views about those questions. We regard the situation as in a state of flux and transition. I think it is quite clear from what has been said already that we have been feeling uncomfortable about the whole position. The future outlook is, I think, very closely bound up with the future outlook of prices. As we have tried to bring out, the inability of the Government or the economy to arrest the rise in prices has made considerable changes in the underlying outlook both of business and of the holders of money. It is at present the policy of the Government to place much more emphasis on measures to produce stable prices than on measures to produce a particular level of output. To do away with direct requests to the banks in the present climate and to rely solely on liquidity ratios to control them would imply the ability to go in for long term funding operations on a very large scale.

1599. *Professor Sayers*: I am wondering how objectionable you feel that the control of bank advances is. We have been driven to the conclusion that there are technical features in the liquidity situation of the banking system that have been making it difficult for the Government to prevent the banks from expanding advances, and these difficulties have led the Government to say directly to the banks: "We do not want advances increased." If the continuance of that system of control of bank advances leads in course of time to all sorts of disadvantages that are not apparent in the first stage of the control, ought we not to aim at removing these features in the banking system, so that we can revert to a system in which the authorities check the expansion of advances by the banks by general measures to affect the money supply?——That would be one solution. I do not know whether I should be out of order in saying that the existence of this Committee reflects a good deal of preoccupation on the part of the Government. If we had firm answers to all these questions I think perhaps we should not all be here today. Theoretically there are a number of possible solutions; the solution Professor Sayers has put is only one of the possible ways out.

1600. *Professor Cairncross*: Given the present floating debt policy and rates of interest and so on, have you formed any judgment exactly what would be necessary in order to leave the banks with a fairly free hand in their lending policy? I take it that the floating debt is a rather higher proportion of national income than it was before the war, and I would agree there might be some fairly normal relationship between the money supply, including Treasury Bills for this purpose, and the national income. This is a matter in part of arithmetic and in part of judgment. Do you really believe banks are so far away from a situation in which they are controlled by liquidity and by current rates of interest?——We have had too short a time with them to know. I still think that the central point from which any really satisfactory answer would stem would be a judgment about the course of prices, because the interest rates at which you could fund would partly reflect expectations about the course of prices.

1601. Looking back to the 1920s, when the floating debt was exactly the same in character and if anything larger in proportion, I do not know that anyone then took the view that it was difficult to get at output through monetary policy. You had a money supply which settled down in relation to output and income fairly satisfactorily, at least in the sense that there was no inflation requiring special intervention?——Yes, but you had a big collapse in 1930.

1602. Let me put the point from the other angle, which I think Professor Sayers was trying to explore. There are obviously very serious inconveniences from the indefinite restriction of lending by commercial banks. The commercial banks may find themselves forced into a situation in which they are very little more than savings departments and are not performing the services to industry which they exist primarily, from one point of view at least, to perform. There are many new industrial developments in which it would be desirable to see the commercial banks participate, but so long as these restrictions are maintained, these developments have to look elsewhere. How seriously do you view this situation? Do you want commercial banks to become little more than agencies for the transfer of private savings?——*Sir Edmund Compton*: The first question is whether it is good for the economy that the bank lending should be restricted at all; in other words, whether there are disadvantages that would come from the restriction on bank lending in any form. Then the second question is whether a particular method of restricting bank lending has more disadvantages than another. It has been suggested quite often that it is the way in which the banks are restricted that causes the harm; that, if the banks respond to requests to restrict advances, that is disadvantageous to the system in a way which could be avoided altogether, if they reduced advances in response to pressure on their liquidity; that pressure on their liquidity would be natural whereas direct requests are unnatural. It is suggested that by direct requests, banks are placed at a disadvantage in relation to almost all other financial institutions, certainly in relation to insurance companies, building societies and other agencies of that kind; their competitive power, though not their service to specific borrowers, suffers.

1603. *Professor Sayers*: They have no incentive to attract deposits at present because they are not allowed to lend. Other people can attract deposits and lend?——In the situation as we had it, we had to restrict the money supply. The money supply consists of bank deposits and currency. The banks are, as it were, vulnerable; they can be restricted either by liquidity pressure or, failing that, by requests on advances; and so, because we can get at them, therefore we do. The suggestion has been that they alone in the money supply system are restricted, and that there are other areas which are really providers of money which are free from restriction.

1604. *Professor Cairncross*: They occupy a strategic role in relation to the creation of credit which other financial intermediaries do not have. They have a basis of cash in a way the insurance companies have not. They can erect a system of credit on that basis. Others erect a system of credit, but not of a similar kind. The banks may dwindle in relation to those other agencies, but they are selected by the government presumably on the grounds that they are more "get-at-able"?——*Chairman*: Should you not be very uneasy about that system?——I think that is so; it is part of the situation that requires examination and possibly further control. The excuses, if that is the right word, for proceeding as we do are first, that this is an experimental area, and, secondly, that in all this field overall control is not possible. For example we know well that on the investment front our control is mainly on those who raise money and only to a less

extent on those who have money of their own to spend; so here in this field of credit we have to exercise restriction where we can, in spite of some unfairness that may result.

1605. *Professor Sayers*: On the basis that you have to do it by word of mouth, so to speak, and cannot do it by the price mechanism?——Yes. It might be possible to conceive a system under which everything that was required was done by the rate of interest alone, but as a practical matter we have found it necessary so far to operate as far as we can directly on the quantity of money.

1606. *Professor Cairncross*: But you would agree that higher rates of interest will affect all forms of trade credit in a way in which they were not previously affected?——Yes.

1607. *Chairman*: I quite understand the view that the banks are readily available and you hit whatever head you can get at, so to speak; but is it not the fact that these particular restrictions are imposed upon them because they are regarded as having a particularly important part to play in the general working of the economy, more important possibly than others?——Certainly. I should have added that they are creators of money in a way that perhaps the other financial intermediaries are not.

1608. Is that the universally accepted view about banks?——It is certainly a view we hope you will examine.

1609. *Sir John Woods*: Is there not a danger that the longer you maintain these restrictions on lending by the banks the less important their position will eventually become, while the credit agencies who have so far remained outside the net will tend to become more and more important and grow in size? You can hit the banks' heads easily, because they are nearest; but is there not a risk that the smaller coconuts in the background will grow very large in their obscurity?——Yes. It is a question whether it could go to a point which would endanger the banking system or commercial credit. As we are at the present time, measured by such things as, say, the volume of hire purchase debt in relation to bank advances, the bankers are still far and away the predominant providers of credit.

1610. *Professor Cairncross*: When you look at the figures for trade credit the proportions come out very differently. There has not been a year since 1951 when, if you take the quoted companies engaged in manufacturing and distribution, the increase in advances by the banks has come anywhere near the increase in other credit. If you take the aggregates, you have totals of about £2,000m. for the outstanding creditors against about £300 millions for indebtedness to the banks. Have you any comment on that?——I am not sure what figures Professor Cairncross is using for this. At a later stage we are hoping the Committee will have before them statistical information about the financial assets of institutions; perhaps that is the stage at which one can make an overall assessment. I was looking at one particular area where, as a matter of practice, the banks feel, and perhaps resent the competition of the hire purchase finance companies.

1611. *Chairman*: This question is going to be of some importance in our general approach to the monetary system, and I would not like to think we had not the full views of the Treasury. If you say the proper time to discuss it is when the paper on financial intermediaries comes up, may we defer it till then, and then take it in detail?——If that is agreeable to you.

1612. *Professor Sayers*: The first sentence in paragraph 35 seems to indicate as the basis for funding that the rate of interest should always be expected to go down, but that it does not matter at all at what level it is, whether it is 50, 20, 10, 5 or 2½ per cent. Is that intended?——We find it very hard to state in a sentence what the conditions are in which people will buy our securities. We have made the generalisation that we tend to fund on a rising market, which is another way of putting what Professor Sayers was saying. That is probably what happens in the short term; at the particular time when sales are taking place certain investors have a feeling that some bottom or other has been touched and they feel that prices are likely to rise. There may be also the consideration that they cannot wait any longer; there are limits to the time people can hold their money idle, if it is their job to invest. But funding is a spasmodic affair; it tends to be an operation consisting of fairly short periods of sales at times when sentiment is good and investors feel, as I say, that some bottom has been touched and there is a rise to come. It could not be true that funding depends on a market that is rising all the time because otherwise we would never have funded except on a continual rise in prices, and that just has not been the case.

1613. But that still leaves me wondering if you maintain the position that the choice between holding money and holding securities when the rate of interest is 50 per cent. is identical with the choice when the rate is 2½ per cent.?——*Sir Robert Hall*: I do not think we could possibly be maintaining that.

1614. *Professor Sayers*: As the paragraph is worded it leaves the level of the rate of interest as something irrelevant.—*Professor Cairncross*: Is not the inference that it is the perpetual expectation of a fall in the rate which is important?——One question is whether you expect to make money by holding on to the security, because the value will rise in the future.

1615. But you also make money by the dividends you collect while you hold it. Surely those dividends are relevant; otherwise there would seem to be very little point in raising the rate of interest at all?——Yes, I think that is perfectly fair; and of course the second sentence would come in too; you might be willing to take a loss on the investment if you thought you had a very good alternative opportunity with the money.

1616. And equally you take a bigger risk of depreciation if you are getting 10 per cent. than if you are getting 2½ per cent. while you hold it?——I agree.

1617. *Professor Sayers*: It puts a very different complexion on this if the rate of interest is relevant. If the absolute level of the rate of interest is relevant in the determination of policy, do not the problems of control of the supply of money all become very much easier, if you are prepared to face the various consequences of a rise in the rate of interest?——Yes, I think that that is so, if you are thinking in terms just of the operation of monetary policy.

1618. As this paragraph stands it would be possible to argue that no raising of the rate of interest could help in getting control of the supply of money and therefore of the supply of bank advances. On the other hand if you accept the view that the higher the rate of interest the further funding can be carried in course of time, the easier it is to control the supply of bank advances without any arbitrary commandments to banks?——*Sir Edmund Compton*: I think it would be very rash of us to dogmatize. Professor Sayers is arguing that the higher the rate of interest the more funding we should do. We have to oppose to that our experience, that funding has actually occurred when rates have not been rising but falling.

1619. That has been the experience that you have had over a period of years when the rate of interest has in general been edging up and up, when one year is compared with another?——Over the last year or so that is not what rates of interest have been doing. On the whole, our experience of funding in these last three years has been that prices fall to a lower level and therefore rates rise; then funding occurs on a rising market, on rising prices and falling rates; then a setback occurs. Then that process is repeated again at some further date when market opportunities arise on which we can actually sell securities.

1620. That has been in a period of years following other years in which you have been complaining of inability to fund on a sufficient scale. You have, in fact, not been willing to jump the rate of interest up; you have edged it up, and whenever it has shown signs of going down you have been able to fund a little bit; not enough but a little bit. Is that not so? The policy of moving from one level to an altogether different level has not been tried?——Generally the authorities have operated on rates of interest by Bank Rate and its consequences, and have not done so by the pressure on the market of sales of securities.

1621. Has not the consequence of altering the interest rates in this way been that from the point of view of

funding you have had the worst of both worlds?——That really depends, firstly, upon what is regarded as a satisfactory volume of funding measured in terms of a reduction, or restraining an increase, in market Treasury Bills; and, secondly, on the character of the funding, that is to say, whether the securities issued in replacement for maturities were long, short or medium. In fact, with annual maturities of the order of £1,000 millions a year, as said in this paper, there have been in every year except 1954-55 market sales of securities of something of the order of £400 millions a year. There were special reasons for what otherwise might be regarded as a poor performance in that particular year. I think the extent to which funding opportunities were taken over the whole of this five year period is quite considerable. The proportion of long securities to short is another matter.

1622. Does not the volume of funding that needs to be done depend upon the structure of debt at which one should aim, having in mind the needs of monetary policy? By that criterion has not the amount and character of funding needing to be done gone far beyond anything that has been done in the last ten years?——That depends on an analysis, which I am not satisfied has been completed yet, whether funding is no good unless it consists of exchange into long dated securities beyond the reach of the bankers or the discount market.

1623. I was not suggesting it was no good; but has it not been inadequate in present circumstances?——The practice has been to go for the greatest possible quantity of funding; to respond to the preferences of the market, be it for short, medium or long, although with a bias on the side of the authorities for lengthening the dates as far as we conveniently could.

1624. *Chairman*: Could we have a definition of what is involved in funding; the other day I was left rather uncertain as to where the line was drawn?——Perhaps it would be better to speak of official sales of securities.

1625. I did not mean that; there must be a limit at which exchange of one maturity date for another involves such a small difference between maturities that you can hardly call it funding?——*Professor Sayers*: Every year the outstanding debt gets a bit shorter?——That is very material; the long term debt created during the war is now becoming medium to short term debt.

1626. *Professor Cairncross*: The structure of interest rates is obviously of great importance to you in debt management. Obviously short rates are to some extent directly within the control of the Government, and long rates could be influenced by your willingness to accept lower prices for your bonds. In practice you have elected to operate through the short rates, and to allow the long term rates to adjust themselves. You have done that on a falling market for bonds. You have been obliged to accept higher and higher long term rates as time has progressed, instead of making substantial adjustments and then seeing how the market would react, and in the course of these changes you have had to pay progressively higher rates, now very high, on your short term obligations, when these short term obligations amount to 35 per cent. of your total debt. You are paying very high rates for a substantial proportion of the outstanding debt and lower rates for the long term obligations, although the amount maturing each year is £1,000 millions. Would you find it possible, and possibly more appropriate, deliberately to accept higher rates on your long term obligations and keep down your short term rates?——It has been consistently the policy, where we can, to lengthen the date. In fact, when I look at the maturities that lie in front of us, I see a certain amount of light at the end of the tunnel; 1959-1960 is a blank year and then we get another in 1962-63. It is not a question of £1,000 millions a year indefinitely. Your suggestion was that we ought to be concentrating more on the longer term end so as to reduce the "near-liquidity" of the banks. It is material that a high proportion of the holders of the debt, and therefore of the potential investors, consists of the bankers and the discount market. There is a choice between issuing a security into which they will go and which if held by bankers will not count towards their liquidity ratio, and trying to pay them off and find another investor outside who will lend us money on a longer term. If we exclude the bankers and the discount market as potential investors from our funding operations, the amount of our funding is going to be very much less than if they are in. That applies in particular to the securities that we created for them in the Serial Funding operation of 1951.

1627. This answer postulates that you are not interested in reducing excessive liquidity. Surely they are in, and there is no question of saying what happens if they are out?——Liquidity is a matter of degree. The liquidity ratio of the banking system depends on holdings of liquid assets, largely Treasury Bills. Then there are near-liquid reserves, or liquidity which consists of their holdings of short dated securities. The primary objective has been to get at their liquid assets proper because it is in response to pressure on that liquidity that they take action to reduce their lending or holdings of investments.

1628. We have put to you that short bonds may have very much the same effect as Treasury Bills both because the discount market deals in short bonds as well as Treasury Bills and because the commercial banks can, if they wish, rid themselves of either. If the situation is one in which you have no special fears about the forthcoming maturities over the next five or six years, then the matter is different; but we were led to believe you were looking forward to a large flow of maturities over the next few years which limited your power to gain control over the banking system? Is that not so?——The maximum objective might well be to get rid not only of the banks' excess liquidity but their excess near-liquidity; but the objective also is to fund as much as we can. If we confined our sales of securities to the longer term, we should fund very much less than if we also responded to such investors' preference as there is for short-dated securities. If a banker converts or is ready to convert £100 millions of maturing Serial Funding Stock into five year stock, we are that much better off than if we insist on paying him back in cash, which we might well have to do if we could not find a longer term investor to replace him.

1629. No one would deny that. The suggestion was that you might find it more profitable to operate directly at the long end of the market in order to fund into longer term stocks, including, if you like, five years, which I should regard as a long term for this purpose, rather than to concentrate on operations at the short end of the market, sticking up the rate on Treasury Bills very high, and allowing that to percolate through to the other end of the market?——*Sir Edmund Compton*: There are other reasons for operating on interest rates by means of the Bank Rate. There is the primary purpose, the effect of it on the external position. There is, secondly, under the system as we have it, the immediate and direct response to the Bank Rate of the bankers, in putting up their deposit rates (which may mean people holding money as opposed to spending it) and their overdraft rates. Those immediate effects of the Bank Rate are part of the object of interest rate policy.—*Professor Cairncross*: They are all rather played down in the paper before us. The international effect, for instance, tends to be represented as being limited in its importance.

1630. *Chairman*: You were asked whether it would not improve your control of the money supply if you let the short bonds held by the banks run out, and offered a security by way of new borrowing so long that it was unattractive, or by ordinary practice impossible, for the banks to take up, so as to reduce their liquidity in the course of time and have a longer general run on your Government borrowing. I think your answer was that you really could not get enough of the new loan taken up unless you issued a security that was attractive to the banks?——Yes.

1631. *Professor Sayers*: Are you reverting to the argument of paragraph 35 that the absolute level of the rate will not influence the amount of long funding, that no matter at what level you pitch the longer rate you cannot sell more long bonds to the non-banking public?——Yes.

1632. Is that right? I thought Sir Robert Hall was prepared to qualify paragraph 35?——These things are never as absolute as all that. It is not as though you had so much a year coming into the market for investment, no more and no less, and it had to be dealt with there. The amount that is available for investment and the readiness of the holders of money to invest will vary. It is a question of amount and of timing.

1633. And, I suggest, also of price; I thought that was admitted?——Both the amount and the timing will be affected, mainly, I would think, by the expectations of investors about where the price is going to go.

1634. I cannot understand on this theory, which is the theory of paragraph 35, why the Government should issue any stock at all, any long stock, bearing any rate of interest higher than 1 per cent. But it has issued such stock in the last five years; why has it offered a higher rate than 1 per cent.? Can it be because it thought people would more readily take bonds at 3, 4 or 5 per cent. than at 1 per cent.?——I was saying that, within limits, the amount that would come forward for investment would depend upon the yield that was being offered. I would have thought that, if you offered 1 per cent., investors generally would just sit tight and not think it worth putting the money in.

1635. You now admit that the level of the rate of interest matters to the amount of long bonds you can sell?——I would like to get back to the point the Chairman originally put to me. The objective here is to fund in quantity as much as possible, and I was saying that we would not fund anything like as much if we failed to respond to such market preference as we can find for investment in our shorter dated securities.

1636. Why can you not do both at once, issuing some shorts for the financial houses and some longs for the general public?——That is just what we do.

1637. Why do you not offer to the general public such terms that they will take rather more than they have been taking of the long bonds?——The question of what rate attracts the investment is really the whole essence of market management. It is in fact how those who manage the Issue Department manage to sell as many bonds and securities as they do sell.

1638. And why they do not sell more than they do sell?——They sell as much as they can.

1639. *Chairman*: How are we to know what actual price they get for what they part with?——These are market operations, and the terms on which the departments deal are not disclosed.

1640. *Mr. Jones*: This year a substantial amount of conversion funding is to take place. Let us assume that only half the amount of the loans that come to maturity this year is converted. In circumstances like that would the Issue Department of the Bank of England take up that part of the conversion loan that was not taken up by the maturity holders? If they did, would they sell it at some time in the future at a market price substantially less than par? Would not that result in the Treasury being called upon to pay a higher rate of interest?——On a point of fact, we have not made a conversion issue. We have just announced that we are going to pay off the November maturity. But that is, in a way, a technicality because the bulk of that repayment has been financed by sales from the Department's holdings of other stock. When a Government issue is made the Issue Department underwrites it, in the sense of taking up whatever the public does not take up, which may well be the bulk of the issue that takes place; and then the Issue Department subsequently sells that among other securities (it has a whole range of holdings) according to the market opportunities for funding that occur and at the market price obtaining. This may well result in stock being sold at a price which is considerably lower than the price at which it was issued to the public and underwritten by the Issue Department. For instance, there was an issue of 3½ per cent. Funding Stock 1999–2004 in February of this year. It is no secret that the bulk of that was taken up by the Issue Department at the time.

1641. *Chairman*: And the effective yield to the person buying it in due course is larger than the ostensible yield at which the stock was issued?——The Issue Department are including that in the stocks they are ready to sell in response to market demand; at the present time any sale will be at 64⅝. That offers the investor a yield of 5¾ per cent.

1642. *Professor Sayers*: Has the facility with which this underwriting by the Issue Department takes place, and the authorities' mastery of the technique involved, perhaps tempted the authorities into trying to keep the yield on long bonds too low for substantial funding operations to take place? If, instead of underwriting the issue, you had priced the issue at a figure which would have induced the general public to take up the lot at once, you would have funded in a sense in which you have not yet done. The price ruling in the market would no doubt have been different today; it would probably have been lower although it might conceivably have been higher. What you have done is to use this facility to press funding in small amounts continuously; but opportunities have not been created by the authorities?——I would not have said that we impeded the rise in the long term interest rate. I would say that the authorities make full use of such market opportunities as occur. As to the amount, I would not say it was in small quantities; on occasion it is in quite large ones. But opportunities have not been created by depressing the price, by offering stock at a rate of interest markedly above the market. We have never done that.

1643. *Mr. Woodcock*: You have an enormous amount of money loaned to the Government one way and another at low rates; the whole of the deposits in the Post Office and Trustee Savings Banks, for instance. If you followed these suggestions would all that money be withdrawn and transferred?——That arises, if I may say so, on the consideration of what interest rate policy should be rather than on the consideration of whether interest rate policy should be effected by sales of securities below or above the market price. A Bank Rate change raises the question whether, as it pervades the structure, it will disturb the mass of money that is loaned to the Government in effect on demand. One's judgment is exercised according to one's view on whether the holders of small savings securities are, or are not, inclined to sacrifice the small savings advantages to the market advantages.

1644. *Mr. Woodcock*: Theoretically it may be on demand but really it is mostly pretty fixed.—*Professor Cairncross*: Is there not a high degree of inertia?——That is one of the considerations borne in mind by the Treasury in adjusting market rates of interest.

1645. Would it be possible for us to have some indication from you of the maturities to be expected over the next five years?——We can say what stocks are due for repayment in each of the years; I have a table in front of me now.

1646. *Chairman*: Not all due for repayment in a fixed year; there are some where you can call them between one year and another, are there not?——Yes, but at present rates of interest it can be assumed that we shall adopt the final date in each case.

1647. *Professor Sayers*: Information is available in a number of places of the amount of stock in existence that will mature at certain dates. That is presumably not the same as the amount of stock outside the Departments, which is the relevant figure for us. Can we see that?——I would like to think over that question. I am not sure that it is feasible to provide figures for the future, simply because stocks are bought and sold all the time, and we are not to know what the Departments' holdings of stock maturing in 1960 will be in 1960.

1648. *Professor Sayers*: But can you say what are the prospective maturities outside the Issue Department today? We know that those, as other maturities, will be affected by Government operations, for funding or anything else, between now and the dates of maturity.——We are very conscious that this is material to your inquiry, and I think we can go a considerable way to meeting you.

Chairman: I think we ought to stop now. We will continue tomorrow morning.

(Adjourned until Friday, 25th October, 1957, at 10.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

EIGHTH DAY

Friday, 25th October, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, Esq., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, Esq., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

1649. *Chairman*: I understand there is something you would like to say before we go on?——*Sir Roger Makins*: Mr. Chairman, I have been reflecting on the discussion which we had yesterday on paragraph 35 and paragraph 36 of our paper.* In this part of the paper we are setting out by way of analysis the various courses which are open to a government to follow in the execution of monetary policy. Yesterday we had some discussion on the merits of one of these policies. I rather wondered whether it would help if I were to try and summarise at this stage what our position is?

We do not deny that the rate of interest has some effect on people's willingness to buy government securities, and therefore that there is *some* rate of interest at which we can fund, at least for a time. We recognise this possibility indeed in the opening sentence of paragraph 36 of our paper, but this should be read in conjunction with the footnote to it, which throws some doubt on its practical application. If, for the sake of argument, we were to try and follow this policy we think that the rate of interest would have to be very high, and the operation would have to be on a very large scale; that it would indeed have to be pressed to whatever point was necessary to obtain control of bank liquidity, and that anything short of this, that is to say a partial policy, would not be likely to achieve better results than the present one. As we have stated to you, it has been an objective of our policy to fund, but this has not been the sole objective. Even if it had been, I think the Government would certainly have hesitated to take the extreme measures which in our view would be necessary to achieve it, involving, as we think it would, heavy loss to existing holders of long term securities, the impairment of the Government's credit, and the assumption of a greatly increased debt burden over a long period. Therefore we have concluded that, taking these wider considerations into account, the policy of relying on high interest rates to fund at any cost could not be contemplated, and we have followed the more moderate course of funding when opportunity offers.

We shall try to elaborate this point of view in the paper which we are preparing on debt management, and we shall certainly be ready for further detailed discussion on this question at that time.

1650. Thank you. This is a subject which we shall undoubtedly want to explore as fully as we can. Would it be convenient if we left any further detail on that particular point until we have read your paper?——We would be very glad to fall in with that suggestion.

1651. *Sir Oliver Franks*: On paragraph 38, may I ask whether the change in proportions of longer to shorter term debt, taken in conjunction with the statement which you have just made about funding, really means that it is unlikely that it will be possible on any really very large scale to reduce the volume of floating and near floating debt? It looks as if on your view we had to live with a large floating debt reinforced by heavy yearly maturities of relatively short bonds as one of the facts of life for the visible future. Is that overstating the position by much?——*Sir Roger Makins*: I would say not by much.——*Sir Edmund Compton*: I would not like to be completely pessimistic about the prospects of funding in the narrower sense. It depends on two factors; not only upon the availability of investors ready to buy the longer term securities, but also upon a non-market factor, that is the Exchequer surplus, and the extent to which we are able to pay out of revenue or out of our other Exchequer receipts, be it, say, the gold and dollar reserves or be it non-market borrowing from small savings. That comes in before one can form a judgment about how much can in effect be paid off, as opposed to being exchanged into longer term securities.

1652. This seems to me an absolutely fundamental point in the whole inquiry, and therefore where on balance you think the position lies is a point of the greatest importance. If, when all the factors which you think proper have been taken into account, you feel it would still be so expensive to get the rate of interest high enough on long term bonds to get major subscriptions and major movement out of floating debt and near-liquid short-term bonds, then the other side of that view is that the floating debt, perpetually reinforced as the short bonds mature, is with us as a severely limiting factor in relation to most of classical monetary policy for the foreseeable future. I am not seeking to get a response from the Treasury which is unreal in its precision; but where does the Treasury stand on this problem?——*Sir Robert Hall*: This is a fundamental question, but one on which I think it is impossible to give any firm answer, because an important factor in the development of the situation will be the development of the price level. The problem of long term funding cannot be the same against a context of continually rising prices as against a context of stable prices, which is the present objective of Government policy.

1653. *Mr. Woodcock*: It is not surely a question of funding existing debt, but of reducing liquidity, and that could be done by the Budget surplus?——*Sir Edmund Compton*: That is a very material factor in deciding whether this objective is or is not on. If you look at the Exchequer financing figures you will see how in the last three years the situation has been gradually turning more favourable to the Exchequer than it was in the previous three years. Net Exchequer requirements that had to be satisfied with borrowing of one form or another were: in 1955, £244 million; in 1956, £239 million, and in 1957, £1 million; there was an improvement of £238 million in the amount of the Exchequer requirements that had to be financed by borrowing in those last two years. That was due to the triple combination of the Budget

* Memoranda of Evidence Part II No. 6.

surplus, the overseas balance, and National Savings. National Savings was a form of non-market borrowing which further increased the amount of the surplus we had available to repay floating debt.

1654. *Chairman*: Have not these various factors been with us ever since monetary policy has been actively operated, since 1951? I read the paper as saying: "All through these years we have been doing our level best", as I am sure you have, "to reduce the volume of floating debt, but it is still of such a proportion that except on two occasions in the period" (which we mentioned yesterday) "the floating debt has been so large that the banks have really been able to escape from the effects of monetary control". Is that unfair?——That is entirely fair as regards what has happened so far.

1655. *Chairman*: You say: "There may be other factors which will make our control effective over the coming years, and we have done better in the last two years than the earlier ones"; but still at any one moment monetary policy has to make an assessment of what it can do or cannot do?—*Professor Sayers*: And, if I understand Sir Robert Hall correctly, the next few years are to be a continuance of the last seven, with the possible complication that the proportion of short term debt to long term debt will rise because people have begun to realise what is happening, and therefore long term debt will be even less marketable than before?——*Sir Robert Hall*: In any assessment of the situation the size of the Budget surplus and the net requirements of the Government are important factors, but you have to assess also the willingness of the public to hold the debt. It is that which makes any positive forecast doubly uncertain.

1656. And that may be different from what it has been during the last seven years?——Yes.

1657. *Sir Oliver Franks*: But if we assume that the broadest aims of Government policy in this field are to remain an economy at a very high level of demand, with growth whether and continuously fostered by the Government, I do not see why one should be too hesitant in assuming that the outcome of all these very difficult factors, which singly cannot be predicted with accuracy, should not be rather similar to what we already know from history. Is not the position, which I put to you in the form of a question on the fundamental issue, as it were diagnosed in the history of the last five years?——That raises again the question of the place in policy objectives of the problem of rising prices. That the Government pursued a policy of maintaining a high level of employment and fostering growth and regarded the problem of the price level as one to be solved by a change in the climate of opinion, and that prices have gone on rising, cannot be denied. But when you say: "if policy goes on in the same direction", there has been, as we have already noted, the statement of September 19th.

1658. *Chairman*: It also raises a different question in my mind. I want to put to you whether from the point of view of monetary control, the villain of the piece has either been the Treasury Bill or the volume of Treasury Bills. If you do not see any reasonable likelihood of being able to keep the volume of Treasury Bills in the future down to what is needed, must one not possibly reconsider the nature of the Treasury Bill itself, and ask whether there is not another instrument or a variation of that instrument, that would do your work better?——Yes. We point out in paragraph 40 that there have been other facets of monetary policy arising from the difficulties of orthodox methods of control. I understand that the Bank of England is submitting a paper to you on alternative methods.

1659. My mind was not on things different in their nature, like those you are referring to in paragraph 40: the question is whether the Treasury Bill is the only form of short-term Government borrowing which is capable of being used in these circumstances?—*Lord Harcourt*: Sir Edmund Compton said before that the revival of the Treasury Deposit Receipt had been considered but had been turned down as unsuitable. On the face of it it looks as if there is a very strong prima facie argument for the reintroduction of Treasury Deposit Receipts as opposed to the continuance of this very large volume of Treasury Bills. Might not the Treasury Deposit Receipt get us out of some of the difficulty which we appear to be in at the moment?——*Sir Edmund Compton*: This point will arise on the Bank of England paper, which has been referred to, on alternative methods of control.—*Sir Roger Makins*: On this question of alternative methods, we would rather not give off the cuff answers when we shall be giving you the most carefully considered papers.*

1660. But it is not a bad idea to bring points up; then we both know what we want to look into?——*Sir Roger Makins*: This is a point which will be amply covered.—*Sir Edmund Compton*: The only point to make meantime is that it would be an alternative form of borrowing from the banks, on a security that was not part of their liquid assets.

1661. *Professor Sayers*: Or from any group of financial institutions the Government chose to make liable?——I would not like to go too far into that. The point at which the need to borrow arises is the point at which the Government has a deficit which requires financing. That deficit arises, in effect, in the first instance by an increase in bank deposits.

1662. *Mr. Woodcock*: Without getting too closely into the various alternatives, could I follow this through a bit? If there were no difficulty about either funding debt or extinguishing debt, the Treasury would prefer to extinguish it?——*Sir Robert Hall*: Yes. That has been one of the objectives of our policy, because we have been aiming at working through the traditional methods.

1663. If it became an alternative between a very high rate of interest and very high taxation, you would have to balance one against the other?——*Sir Roger Makins*: Yes.—*Mr. Woodcock*: You might even come to the point, after considering the rate of interest required to enable funding to be undertaken on a sufficient scale and to encourage people to take long term bonds, that you would prefer a capital levy as a more favourable alternative.

1664. *Professor Sayers*: If things are allowed to go on in much the same way for the next ten years as for the last seven, the rise in prices will eventually bring up the money value of the national income to such a level that this big, and possibly growing, short term debt will not be uncomfortably large. Does not any inflation that goes far enough put the Government in a comfortable position in relation to the National Debt, sooner or later?——*Sir Robert Hall*: Yes, the combined effect through time of the real growth of the national income and changes in the price level must reduce the real burden of the National Debt.

1665. Meanwhile, if the authorities have been struggling to make things a little less bad, may not part of the price that has to be paid for avoiding the high long term rates be considerable damage to selected financial institutions, through requests, the fall in the price of gilt edged securities, and all sorts of things?——Yes, there are effects of that kind.

1666. *Professor Cairncross*: Is it not the position that at this moment the outstanding long bonds represent a lower proportion of the national income than they did before the war? If the National Debt bears roughly the same proportion in total to national income as it did before the war, and if the proportion of short term debt has risen rather markedly, then long-term loans outstanding bear a lower relationship already. But, although that is so, you take a rather pessimistic view about the demand for those long term bonds, given an adjustment in their price in relation to the price of shorts. This was the essence of the statement that you were making at the beginning of the morning. It seems to me a little paradoxical, unless something institutional has happened to alter the balance of demand, not just of supply, in the direction of a need for shorts as against longs, that there should be any permanent obstacle here to a changeover in the direction of funding. I agree with what you said about the need for some confidence in the stability of the value of money; you are obviously not going to get willingness to hold bonds, or money, or any form of debt whatever, if it is thought that the money contracts in which these debts are expressed will deteriorate in value. But would not any greater confidence about the price level translate itself automatically into greater possibilities of funding?——*Sir Edmund Compton*: One clear institutional change is the competition in the market of other long term

* See Memoranda of Evidence Part I No. 13 and Part II No. 1.

borrowers, such as the local authorities, the Commonwealth, and major industrial borrowers, all of whom are competitors for the money that is available for long term investment by the institutions.

1667. *Chairman*: Why is that a change institutionally as against before the war, or whatever date you choose?——It is a change from before the war in that local authorities, for example, were not, I think, major borrowers in the capital market at the time; certainly not on the scale which they are now.

1668. *Professor Sayers*: In relation to national income?——I was looking at it in relation to the government's long term borrowing; but taking the base date of 1935, I would not have thought that local authorities were borrowing at that time in relation to the national income on the scale they are attempting to do today.

1669. *Professor Cairncross*: The whole trend of the last fifty years has been for local authorities to borrow less in relation to national income. Take the rate of house building, for instance, before the war; it was quite comparable to what it has been in the last few years, and that was the principal purpose for which local authorities entered into debt.—*Professor Sayers*: Looking in other directions, surely external lending by this country has been so diminished in relation to the national income that the Government's competitors there are less?——I was looking at the volume of Commonwealth and Colonial Government borrowing long term in 1935, which was surely very small indeed in relation to the total demands on the capital market.

1670. *Professor Cairncross*: The situation is different according to whether you are looking at the current sources of funds coming from one direction or another (current surpluses on the Budget, current sources of funds to the local authorities and so on), or at outstanding debt obligations and who is holding these debts. Is there much doubt that the local authorities have not expanded their total debt to the extent that the central Government has expanded its debt since before the war?——I was asked about the institutional situation in the market that led to the limitation of Government long term borrowing there, and I was making the point that these non-Government borrowers are very heavy competitors.

1671. *Chairman*: Disproportionately heavy as compared with the pre-war period?——I would have thought so; certainly compared with the early post-war period.

1672. *Professor Cairncross*: Would you not agree that on the demand side of the market the rise of the big financial intermediaries, particularly the insurance companies, must have meant *prima facie* a demand for long term debt? Whether the insurance companies want to put the money into Government bonds may be a different matter; but, if before the war they had assumed the kind of place they now occupy in the capital market, would not that have made for a higher price in gilt edged?——I find it hard to regard that as a real question, because the actual volume of their demand in relation to the national income as it is now is quite out of line with the volume of their demand as it was then. The actual funds that are coming forward for investment at the present time are surely so very much greater than the funds coming forward for investment, say, in the mid-thirties.

1673. *Professor Cairncross*: This is the point we are putting to you. If you are looking at the institutional changes since the thirties, do they not appear in some directions at least to have been favourable to the Government, since they have meant the emergence of large institutions whose first instinct would be to buy long bonds, rather than to put their money in equities?——That is certainly so; but in parallel with that there are two other changes: the readiness of those same institutions to invest otherwise than in Government securities, and the emergence as competitors of the Government in the long term market of all the other classes of borrowers, including the major industrial borrowers.

1674. *Sir John Woods*: But would you not think that, assuming a greater confidence in the continuing stability of the value of money, a long term British Government bond, at a reasonably attractive rate of interest, would bring in not only institutions but also the private investor in a big way?——That is the major hope that the authorities have in their longer term funding policy, that that atmosphere of confidence will create the opportunities for longer term funding.

1675. You rather gave me the impression that even if there was this greater confidence in stability you would still feel doubtful about the possibilities of funding? Do you really feel such a lack of confidence in the possibilities of funding?——The conditions that you mentioned would be necessary before one got a major flow of investment into Government longer term securities.

1676. *Chairman*: The question is whether, apart from the difficulties about people believing in the future value of money, the institutional set-up today is unfavourable to the possibilities of long term bonds issued by the Government finding a good demand. We have not got any convincing answer on that point yet, because it does not seem that we are quite at one about the question whether the proportion of claims made by the local authorities or by other borrowers has turned against the Government's chances. Can you help us further?——I think there is that uncertainty. I am not sure that it is not a question that is not better answered by the potential investor. Apart from that, although we certainly have our hopes of longer term funding on a considerable scale when favourable conditions arise, we also have to face the fact that at any rate over the next three years we have got these very large maturities of short term debt. One must at least be doubtful whether anything like that amount of longer term funding could be done, remembering particularly that so much of this shorter term debt was specially created for that particular class of investor.

1677. *Professor Sayers*: But is it necessary to look at the possibility of all the maturities of the next few years being converted to longer term? If £1,000 million, or even £500 million, were switched from short term that would make an immense difference to the liquidity of the banking system, and the shorts that matured in succeeding years could quite comfortably be replaced by new shorts without the banking system getting out of hand. Is that not so? It surely is not necessary to think of the price that has got to be paid in order to get all these securities on to a long term basis?—*Chairman*: Would you like to defer that until we come to the debt management paper?——I think it would be advisable. I might just leave it with one postscript: I think a good deal of the discussion has been on the footing that, having regard to the last five years' experience, we should infer that experience will be the same in the next five. But, of the last five years, the last two have had quite a different pattern. Both as regards Exchequer requirements and as regards the repayment of floating debt the figures show a complete reversal of trend. Some substantial progress was made last year, and might well be continuing, in the reduction of the market floating debt, in contrast to what had happened in the previous years.

1678. *Sir Oliver Franks*: Does that mean, going back to the question I was asking before, that as you see the experience of the last five years we should be mistaken in our thinking if we made the assumption that it was not probable that this unwieldy floating debt over the next few years would prove manageable?——I think it would be unwise to make that assumption.

1679. Is that to say that in your view looking at the last five years has nothing to tell you about the next five years?——What the last five years has shown is that a material improvement in the situation can be made, and in fact was made, taking account of the lessons which we learned in the period of 1952-55, by a combination of measures: one is the Budget surplus, but that is from this point of view unpredictable; the second is the National Savings drive, which again meant a swing of over £100 million in the Exchequer's market financing requirements.

1680. *Professor Sayers*: Was that partly dependent on higher rates of interest?——Certainly. The third factor is, I would say, the success that these figures show in taking opportunities for funding, in spite of long periods of setback in which funding was not possible.

1681. *Sir Oliver Franks*: Granting that this is all true, as one looks at the history of the period, I am trying to see whether as administrators you feel that these lessons

of history contain or do not contain any element of prediction or guidance for the future. So far as I can see at the moment, whichever form I put that question to you in, you have to say on the whole that you do not think you can reply; therefore I infer that these things which are important in the analysis of the history yet offer no guide to what may come after. Is that a fair summary of your position?——Yes, it is. I would say from my point of view as an operator that the major doubt on our prospects for the future arises on the fact that there still exists this heavy block of maturing debt, over £3,000 million maturing in the next three years.

1682. Would it be fair to say from an administrative point of view all one can really say is that one has to deal with the future years as they come? There is no basis of policy on which one could frame a course of action?——I agree. I think that the most one can say is that, so far as one can judge by the record, say, of the past two years, the task is not a hopeless one, and that progress has so far been made.

1683. *Professor Sayers*: Has the change of trend in the last two years included any change in the amount of really long term bonds that the authorities have been able actually to sell to the investing public and the financial institutions?——We can speak to you in more detail when we come to the debt management paper, but experience on funding has been mixed. The opportunities for funding have occurred at all ends of the market, and have been taken as they occurred.

1684. Does it include a change in the trend of sales of long term bonds by the authorities?——I would rather have notice of that question, because it involves a certain amount of history. In relation to one particular period the answer would be yes, and in relation to another particular period the answer would be no.

1685. *Lord Harcourt*: I am perplexed about this apparent inability to sell long bonds, in view of the enormous growth in life insurance and pension funds in the post-war period. The British Insurance Association may be able to throw more light on the life offices' investment policy over the last seventeen years, and we should perhaps pursue this point with them, because they are the traditional and obvious holders of long-term securities, and have rapidly growing funds for investment. I would only like at this point to say that two things have occurred to me which perhaps may throw a little bit of light on the lack of willingness of the life offices to buy long-term bonds in the last seventeen years. The first point is that there was an agreement between the life offices and the Government during the war that they would put the whole of their net increase in funds into long-term Government debt as a war-time measure. That meant that in 1946 every life office had a disproportion of Government bonds in its portfolio. The second point may perhaps be that, with nationalisation of the basic industries, life offices which held railway ordinary shares, debentures and preference shares, electricity shares and so on, suddenly found themselves with a vast accretion of Government guaranteed bonds, all of which automatically went into their portfolios of Government stock, which again produced a further imbalance. For those reasons the life offices may not yet be back to a normal investment policy. Otherwise it would seem very perplexing that you should be unable to sell long bonds, when there should apparently be a large and growing demand for them?——Yes, I should not like it to be thought that we are never able to make official sales of long-dated securities; on occasions we have made sales. The doubt was whether such sales could be of such volume as to cover the replacement of this big block of maturities of short-term stocks, especially since some of it had been specially created for the requirements of the banks and the discount market.

1686. *Professor Cairncross*: In paragraph 39 (a) you say: "But the proportion of total capital expenditure financed through the Exchequer is much larger than it used to be, so that in spite of substantial budgetary surpluses," etc. You are referring in part to the additional capital expenditure of the nationalised undertakings; is the "so that" in place here? The nationalised undertakings might conceivably finance their own capital expenditure?——We are trying to deal here with the situation as it is, not the situation as it might be.

1687. Is there evidence that business, if you mean by "business" joint stock companies for this purpose, is in a more liquid state than it was before the war, as you state in paragraph 43?——*Sir Robert Hall*: The basis of the statement was partly that business ended the war in a substantially more liquid position than it entered it, so that, at least in the early part of this period, they were unusually liquid compared to their pre-war position, and partly what is said lower down about self-finance.

1688. *Professor Cairncross*: But you are not making the statement on figures showing the change in cash in joint stock balance sheets?——*Chairman*: Is the ratio of profits distributed to profits retained a very good index at the time when owing to rising prices the definition of profits is so uncertain? If profits are estimated with a historical basis, a large chunk of those would be retained simply in order to provide for the future? There really ought to be two statements of profit, so long as we retain the historical basis?——Yes, I see your point.

1689. *Professor Sayers*: The proportion of retained profits may rise very considerably as the liquidity of the firms goes down; it depends on what you are doing. Is that not so?——Yes.

1690. *Lord Harcourt*: But for those with expansion programmes and big replacement programmes liquidity has almost certainly fallen.—*Mr. Woodcock*: I do not think the question here was as much on liquidity as on resources. The resources may be highly frozen, but they are still there?——In the post-war period the corporate sector has for a number of years been a net lender; that is to say, the amounts that they had available in the aggregate were larger than their capital requirements. It has been falling a bit in the last few years.

1691. *Professor Cairncross*: There is a difference between the figures published by the C.S.O. and the figures examined by the National Institute for Economic and Social Research. The latter figures do not point so directly to a decline in the size of the capital market as do the former. The difference between the two groups of companies is that the national income figures include financial institutions which clearly would not be appropriate from the point of view of what we are discussing here. We should be glad of evidence on this since it is obviously very important?——Yes, I think it is very important. There are two points, I think: first, whether the company sector as a whole has been a net lender or net borrower (my impression is that it has been over a number of years a net lender), and, secondly, that inside the aggregate of the company sector there are very wide differences. It is because of those differences, the fact that one set of companies is in surplus and others have to borrow, that monetary policy influences the private sector as much as it does.

1692. May we ask for any further information from you on this that is at your disposal?——We will consider that, and see just how you are to get the information. It may arise in the course of your statistical inquiries. I take the point.

1693. *Sir Oliver Franks*: Clearly, in proportion as what is said in the last sentence of paragraph 43 is the case, the effect of monetary policy becomes more and more selective in its incidence on particular companies. One company is free to go on with its expansion merely because it has the liquid resources itself, and another company is not so, because to do so it would have to borrow. One of the benefits which is normally claimed for monetary policies is that they are general in their application, that they do not specify particular, perhaps narrow, categories of industry or commerce, and that within the general ground rules freedom of initiative is left. But if in fact these policies affect and can affect only a part, and perhaps not the larger part, of the whole field, then these arguments do not ring so well. Have the Treasury thought about this particular aspect of the application of monetary policy?——Professor Cairncross was exploring one aspect of this yesterday when he was arguing that the small new enterprise or the inventor, or the innovator, might be substantially worse off in these circumstances than the large existing one. You are widening that perhaps to say that there is an inherent probability that the firms which are in the expanding sections of the economy will be more affected than those which are not. It is inherent in monetary policy that you cannot say that people in a

different initial monetary position are in precisely the same position, just as people who are similar in all respects except their income are affected differently by the incidence of taxation. I do not deny there that there are the sort of implications that Professor Cairncross was mentioning.

1694 *Professor Sayers*: The selection of monetary weapons affects the rate of growth and productivity?——That follows, if monetary weapons affect investment and investment is an important element in productivity.

1695. But will the choice of monetary weapons affect the degree to which the growth of productivity is affected?——I do not think that is a necessary conclusion, because the expanding firms are probably expanding because they find it profitable. Growth in general has been made more difficult by the choice of monetary weapons, but if we assume that the incentives to grow are just as important and provided that the means of growth are available, I do not see that the relative positions are altered by the use of monetary policy.

1696. But if a restrictive or expansionist monetary policy is decided upon, it can be implemented in various ways; a choice of techniques is open to the authorities. One technique will affect the development of the economy differently from the way in which other techniques will; is that not so?——*Sir Robert Hall*: I cannot quarrel with the statement put in those formal terms.—*Sir Edmund Compton*: In operation we have had to recognise that. If I might put it as it struck me on Sir Oliver Franks's question, broadly we have thought that interest rates probably were of general application, to spending as well as raising of money; looking, for example, to the man who has money invested, a higher rate encourages him to save and discourages him from realising his securities. But the reinforcing measures detailed in paragraph 40 are self-evidently of partial application. The capital issues control bites on somebody who is raising money, not on somebody who has got it and can sell out in order to invest. That is recognised as a limitation of technique, but the defence for doing it that way despite the unfairness that might be thought to arise is that half a loaf is better than no bread: we are operating on margins, and if the objective is to reduce the total investment we must use the instrument that comes to hand. That is the defence we have used on the capital issues control, and indeed on the hire purchase restrictions, when the victims have naturally complained that they are responsible for only one per cent., or whatever it is, of the total of consumer demand.

1697. *Professor Cairncross*: You are now pointing out that higher rates of interest may deter someone who has money from spending it on capital account. Does that not imply a qualification to the end of paragraph 43?——I accept that as a general proposition, but the extent of the deterrent to someone to sell his securities must depend on what sort of securities he has. If they are National Savings securities which he can cash on demand, the deterrent is not there. Then there is the attraction of actually investing it, of putting it into bricks and mortar. If he thinks that that will pay him better, he will go ahead.

1698. *Mr. Jones*: How can you effectively and with fairness to those who have to make a contribution to the health of the economy work monetary policy when there are substantial resources held by companies as undistributed profits which enable them to make any demands they like upon manpower and resources? Is not the logic, particularly of the last sentence of paragraph 43, to give a quantitative assessment against monetary policy?——*Sir Robert Hall*: That would depend whether you took the view that the investment which resulted from the retention of profits by companies was as good as the investment which would result from their not retaining them. You are getting again into the field of policy judgments. Your question really is whether you get a better or a worse pattern of investment according to whether you have a good deal of self-finance or you adopt some other criterion.

1699. But I would think that it was a very good thing for Britain if we were using our resources to strengthen the economy and stabilise the value of money. Is it not absolutely essential, in the sort of economic policy that we are following, to do two things, both as individuals and as a national community: first, to save as much as we possibly can, and, second, to refrain from all sorts of extravagant purchasing and extravagant provision when we possibly can. What are you doing, in connection with the policy we are engaged upon, to select between the extravagant and the non-extravagant types of investment?——I am afraid I can only repeat what I said when we discussed the mechanism of the Capital Issues Committee. The question of what particular pattern of investment will contribute to that objective is a difficult one; it is extremely difficult, looking at it from the civil servant's point of view, to see such a clearcut answer as I think you have in mind.

1700. *Mr. Woodcock*: I understand the difficulties you feel about entering into discussions, like this, which have party political implications. But I think Mr. Jones would like to know your view on the efficacy of monetary weapons as distinct from more direct controls in creating a broad type of economy. There may be arguments, as to whether it would strengthen it or not, which you could follow up?——Professor Cairncross, Professor Sayers and Sir Oliver Franks have all been exploring the question whether monetary policy falls upon the economy in a way which is particularly adverse to some elements in the community rather than others, and I think your point is very much the same. But the problem of what is meant by "adverse" and "essential" and "non-essential" is in the end a political rather than a technical problem. Suppose that we said that monetary policy held investment down well below a level that might be possible, and that would be consistent with stable prices; you would then have a proposition, which I think would command fairly wide assent, that it was wasteful. But once you get away from the aggregate of the resources to the distribution of them between various possibly conflicting policy objectives, it is difficult for us as officials to express an opinion.

1701. *Chairman*: Can you say, in defence of monetary policy against these criticisms, that those concerns which in the past have been chary of distributing their dividends and have kept their profits in realisable form will be in a stronger position when you implement this weapon than those who have not?——That is, if I may say so, the same as the tax question. Anything in the monetary field must fall with a different degree of weight on people according to their liquidity and wealth.

1702. *Mr. Woodcock*: And their expectations?——Yes, but the expectations would affect more what they were in a position to offer, whereas the other things affect more whether they have to borrow or not.

1703. But does not what they are able to offer affect what they can get?——Yes.

1704. *Sir Reginald Verdon Smith*: Paragraph 43 is all written in terms of the difference between the situation today and in earlier periods. You say: "The greater part of profits is now retained by the businesses which make them". I should have thought that one of the things which had been evident in a great deal of the discussion earlier today is that this is a very rapidly changing situation generally, that the degree of liquidity of businesses is markedly different today from what it was two years ago, let alone over the whole period, and that we are in fact seeing an increasing bite from monetary policy upon businesses particularly industrial, which this paragraph does nothing to reflect, except to say that there is some evidence to suggest that "this liquidity may have been declining". Is it not increasingly evident that this is the case from the position of company indebtedness to banks, and in a number of other respects?——I agree that there is evidence that this position is changing, both from the profit figures and from the dividend distribution figures, though I am subject to correction when we see the final figures. I still think that the company sector is more self-financing than it was in the pre-war period.

1705. *Chairman*: Would you say that several times since the war the liquidity of companies has markedly varied as between one year and another?——I think that they were a bit squeezed on liquidity between 1951 and 1952, because of the combined effect of rapidly rising prices of materials and increases in stocks. That was the most marked year, but my impression is rather the

same as Sir Reginald's, that in the last couple of years that there has been a significant change in the position.

1706. *Professor Cairncross*: You are, of course, excluding in paragraph 43 nationalised undertakings completely?——Yes. They do not retain anything like the same amount of their profits.

1707. But they represent a substantial part of the total national investment?——Yes, but we have argued earlier in the paper that their investment is much more determined by direct decisions than by the price they have to pay for their capital.

1708. And all comparisons between the immediate post-war period and now are affected by the exclusion or inclusion of this group of industries?——Yes. I think our view is made clear in the paper. The combined effect of the nationalised sector being a much larger proportion of total investment than before and of the self-finance element has been that the first bite, at any rate, of monetary policy has been more restricted than it used to be.

1709. *Mr. Woodcock*: You have just undertaken to give us some figures on this question. The Royal Commission on Taxation had certain statistical statements bearing on the extent to which industry was capable of financing itself. Perhaps you would look at these when you are doing yours, because they did not exclude nationalised industries, nor did they refer to a particular year; indeed, the comparisons in the T.U.C.'s statement were with pre-war?——Yes.

1710. *Professor Sayers*: Are paragraphs 44 and 45 intended to suggest that the interest rate as a weapon influencing the external capital position is of little effect now?——I do not think that follows. We are saying two things: first, that the ratio of reserves to short liabilities is less favourable than it was, and therefore the work that the interest rate (if you are thinking of that as a weapon) might have to do is potentially larger; secondly, that, as has been mentioned in 46 (*h*) confidence factors are an important element which have to be taken into account. It would be "of less effect" rather than "of little effect".

1711. *Lord Harcourt*: Given that these two paragraphs explain that the technical effect of the change in interest rates is less than it used to be, is the psychological effect still an important one in the confidence factor? Does confidence in sterling tend to increase if one takes action on the Bank Rate? Is a change in the Bank Rate important for the earnest of intention that it appears to give?——During speculative periods that is the dominant factor; the differences that would follow from variations in interest rates would be small compared to the possibilities of exchange rate change from a speculative point of view. If it is thought that action on the Bank Rate is going to lead to other kinds of action it would be important, but not if it is not so thought. The foreigner naturally looks at the total policy, of which changes in Bank Rate may be one part.

1712. *Sir John Woods*: Would you say that what the foreign holder of large balances in London is concerned about is very largely the continuous and large rise in costs and prices?——That is certainly a factor.

1713. *Professor Sayers*: Is his judgment affected by the inclusion of the Bank Rate? If the Bank Rate were not changed, and the picture were in other respects identical, would his confidence be increased to the same extent as it would when the Bank Rate also increased?——*Sir Roger Makins*: If we only knew what the elements in the foreigner's judgment were with any certainty, I think we might do a little better than we have done.

1714. *Chairman*: So far as the movement of short-term foreign balances goes, the foreigner can surely only be concerned with two things: the rate of return that he gets on the balance, and the possibility of an exchange alteration by which be will lose, if he leaves it here. Is not the rest of our economy a matter of indifference to him, unless it is reflected in one or other of those changes?——My own feeling is that the change in the rate of interest probably has some effect on the foreigner, but less effect than it used to have; that he regards the rate of interest as part of the economic policy which the Government is pursuing, and that so far as one can tell he judges that in relation to its likely effectiveness, and to how the British economy as a whole is going to develop.

1715. Is he not indifferent to all the elements of our economy, except those which give him a comparatively favourable return upon his money, and the possibility of exchange loss?——*Sir Robert Hall*: Strictly speaking yes, but I think that is an over-simplification, because he has to guess whether there will be a change in the exchange rate or not, and he has got to look at the internal facts to make an informed guess.

1716. I was allowing for that, but I think those are the only two things that matter, are they not?——*Sir Roger Makins*: They are the only things that should matter.

1717. *Mr. Woodcock*: Before the war, with the gold standard, a man was not concerned about the value of his money; therefore the interest rate was the thing that he would look at exclusively. Now he looks not only at the interest rate but at the possibility of a change in the exchange value. I understood Lord Harcourt's point to be this: when you put up the Bank Rate, does it impress such a man as evidence that the kind of conditions which you get under the gold standard are likely to exist, and is that as much or more of a factor in encouraging money to stay here or flow here than the actual rate of interest earned?——It is almost impossible to say. There is nothing to go on.

1718. Whatever the implication from the foreigner's point of view, it could not do anything but strengthen his belief that money was likely to remain stable?——*Sir Robert Hall*: I think it is clear that, if you are absolutely certain you are going to stay on the gold standard, the second factor goes out of the picture.

1719. *Chairman*: Is there not a third factor? The foreigner may fear not necessarily that the exchange rate will be altered but that some form of exchange control will be imposed on the money he has got here?——*Sir Roger Makins*: Yes.—*Professor Cairncross*: He is also interested in knowing what is going to happen to alternative currencies. Every normal trade transaction has to be financed somewhere, and he may regard it as a matter of indifference which currency he is left with, because all of them may be pretty shaky. In that case he will go to the centre where the transaction can be financed most cheaply.

1720. *Sir Oliver Franks*: This question of the sense in which the movement of interest rates psychologically promotes confidence could not arise under the gold standard conditions; it could only arise under present conditions. What is looked at is not a movement in interest rates by themselves; it is a general judgment on the way of the economy and the effectiveness of Government. This is rather a reflection abroad of something which seems to be also true at home, which is that nowadays people do not go by the movement of the Bank Rate or interest rates one way or the other; they look at a much wider context in which this is simply one ingredient. In that sense must not the element which moving interest rates plays in promoting or undermining confidence be, though real, relatively minor in comparison to the general state of the economy or the whole of Government policy?——I think that your general point is a good one, though one might debate the degree to which the movement of the interest rates enters in. You said that it was relatively minor; I would not necessarily accept that, but I agree it is only one element. I think the actual part that it plays is a matter for debate.

1721. On that you are agnostic?——Yes.

1722. *Professor Sayers*: The burden of the papers we have had from the Treasury has been again and again to indicate a disbelief that any useful consequence of any degree of weight would emerge from moving interest rates. If that view were also taken by overseas people interested in the position of sterling, those people would not look at what was happening to the Bank Rate at all, because they would consider that the other points in the picture of the Government policy were the important ones, and that the Bank Rate was purely of some domestic interest in influencing the distribution of income between stockholders, taxpayers, and so on. Is that not so?——If they thought that, obviously your conclusion is right; but I doubt whether they do think like that.

1723. *Professor Cairncross*: Do you adhere to the word "strict" in paragraph 47?——Since we say "strict exchange control" we mean strict exchange control, but if

you want to examine the degree of strictness or otherwise which the present arrangements have, it would be better to examine the experts.

1724. *Sir John Woods*: There is also exchange control between other parts of the sterling area and the outside world. I take it you would agree in general that the control there is liable to be less strict than in the case of the United Kingdom?——There are variations.

1725. *Mr. Woodcock*: Has there been any attempt to make a quantitative assessment of the effect of the policy of dividend and wage restraint referred to in paragraph 49? It relates to this question of the cash reserves or the liquidity of companies. If they practise dividend restraint, then in the subsequent period they are obviously much more liquid than they otherwise would have been. I think when you come to wages, it is going to be impossible to get any quantitative assessment; but has any attempt been made to see what were the effects of this policy? Can we see, for example, how the reserves of companies moved in this period?——*Sir Robert Hall*: The general assessment of the Government on the wage restraint aspect, to some extent, and on the dividend restraint aspect is covered in some little detail in the White Paper on the Economic Implications of Full Employment. I hope that there will be some indications on the cash position of companies as a result of the work that you have asked for this morning. It did have an incidental effect in that it led to the takeover bids, which have attracted a good deal of attention in recent years, because companies shares tended to be valued in the market, to some extent, by their dividends, although their assets were growing.

1726. *Chairman*: Were not takeovers often the result of an arrangement under which fixed assets were sold and made available by being leased back? Were they primarily related to over-retention of distributable profits?——*Sir Robert Hall*: To the extent that the quotations on the market were based rather more on the dividends that were available than on the capital value, the point of the take-over bids was to realise some of the difference between the market valuation and the real valuation by treating the assets in the way that you mentioned. One of the difficulties about dividend restraint was that it led to this situation.—*Sir Edmund Compton*: The victims certainly complained that they were the victims of dividend limitation, that that had rendered them vulnerable.

1727. *Professor Cairncross*: Did this apply particularly to private companies?——*Sir Robert Hall*: Yes.

1728. *Mr. Woodcock*: Could I make a general point here? Time and time again in this paper we come across the difficulty of forming a reasonable judgment, in the absence of any quantitative assessment. We came across it on this point that Lord Harcourt raised this morning about the effect of an increase in the Bank Rate on short-term funds. Paragraph 50 has another example; we come across this statement: "The change in monetary policy was one of a number of factors which contributed to this result, but it is difficult to evaluate the exact contribution of each of these". There are many occasions when you do say that. If we could get some illustrative figures on these points it would certainly help me?——*Sir Edmund Compton*: I am afraid that difficulty will be with us all the time. We always do our best; as regards the Exchequer, we have been able to give you figures showing what the results have been. But what seems impossible to us is to assess now various influences that have been exercised have contributed to that result, and how much you attribute to each.

1729. It is not too happy a position, when we are appointed to consider the working of the monetary system and the working of monetary instruments. Are statistics as a whole deficient?——*Sir Robert Hall*: No, though we certainly would not claim that we have got the best statistics possible, and we have been trying to improve them. There is a fundamental difficulty in this: if you want for experimental purposes to isolate the effects of a particular measure, you have to get a situation in which the only thing that has changed is that particular measure. The conduct of economic policy is so complicated that in practice it is difficult to find a period in which you did only one thing. Even if you did, you could still argue for a long time as to whether the other factors were similar. We are very conscious of the fact that in a number of places we are forced to say that we cannot say exactly how much was to be attributed to one and how much to another, but I think that the difficulty could not really be overcome by statistics alone; you would have to have an economy to experiment with.

1730. *Professor Cairncross*: Would you lay a great deal of stress on monetary policy as one of the factors that contributed to the change in 1952? In most of the period since 1951 there was an alteration in the balance of payments, accompanied by an off-setting alteration in stocks. What was taking place was clearly, to some extent, a process of investment and disinvestment in imported goods, which showed itself on the one hand in movements in stocks and on the other in changes in the balance of payments. This may have been affected by a variation in interest rates, but I do not see any attempt to demonstrate the precise relationship between monetary policy and investment in stocks.—*Sir Oliver Franks*: If one compares paragraph 50 with the final sentence in paragraph 60, it seems to me still more difficult to infer that the part played by monetary policy was of real importance. It says at the end of paragraph 60 that "some recession would have taken place even if monetary policy had not been changed at the end of 1951"; and then goes cheerfully on and says that "monetary factors had combined with the other forces at work on consumption, investment and imports." I appreciate why it is impossible to isolate one factor and say exactly what it did or did not do. But if we are necessarily in the realm of opinion and judgment, there seems to be an opinion and judgment expressed here; and that judgment seems to be that, while monetary policy was one of the factors, there does not seem to be any very great reason to suppose that it had a major influence, because the whole situation was going to be of the sort that it was, quite apart from the application of these policies at all. Was not that the judgment of that time in reference to this particular period?——*Sir Edmund Compton*: The Bank Rate is spoken of as a "reinforcement", both at the time and in retrospect. The paper quotes from the Budget speech of 1952 to that effect.

1731. *Chairman*: We have a variation of sources; we have statements in the Economic Surveys and other documents which throw in monetary measures as one of the causes of certain things which happened, and we have speeches which also, to a greater or lesser degree, do the same thing. Now that we have you here, do you think it possible for any process of demonstration to isolate the causative element of monetary policy from the other caustive elements, and say postively that it had this or that effect?——*Sir Robert Hall*: I do not think we can. It is extremely difficult in looking at the period under consideration to arrive at any quantitative assessment. The most that you can do is to get pointers. For instance, the question of stocks, which Professor Cairncross mentioned, comes up again in the 1955 period; there we began with some predisposition to think that monetary policy would be an important factor in stocks, and ended with a good deal of uncertainty as to whether it was.

1732. In 1952 quite apart from monetary measures were there not several independent good reasons why the balance of payments should have improved and why stock-holdings and work in progress in this country should have gone down?——Yes.

1733. *Mr. Woodcock*: The ultimate decision in any case is bound to be complex; but when we are considering the working of the monetary system we have to consider whether a decision to move Bank Rate to, say, 7 per cent., is just, if I may put it crudely "think of a number"; it must be more than that?——The question facing the Chancellor when he considers monetary policy in this particular context is: "Do I want to move in a deflationary or in an inflationary direction, or do I want to keep things more or less as they are?" We make the best assessments that we can to help him to answer that question, and the question as to how much action he has to take. He has to decide, with the best advice that he can get, what his own judgment is on the things that are placed before him, because he is finally responsible for the decisions. It is not a mechanical process at all, and I think it would be wrong to make it so, because the assessment itself contains both statistical

uncertainties and uncertainties about behaviour. Then he has to select among the various means at his disposal. It does become, I think, extremely difficult at that point. We might have a shot in advance at saying what effects we think particular measures will have, but the way that we tend to proceed is to see whether it works. We cannot say: "It would be very useful to find out whether moving the Bank Rate up from one place to another will get the situation under control, so let us do that and nothing else"; that is not the way that decisions are taken. If you take a number of measures, you are still left at the end trying to judge, firstly, whether they were enough as a whole or whether you ought not to tighten them up or not, and, secondly, which ones will have the effect you want. There is, at least at present, a good deal of argument about whether the thing will be effective or not, besides the other policy aspects of the decisions. You might, in choosing between various measures, have some which you thought would have a precise effect and others which would have a more general effect, and yet there might be perfectly good reasons for which you would select the less precise one. The decisions are so complex and the facts that have to be weighed by the person taking them are so complex.

1734. *Sir Oliver Franks*: But, in all the decisions that have been taken in the five years we are more particularly looking at, it has never been the case, judging by what has actually been decided, that people thought that the movement of interest rates by themselves would be adequate to accomplish any desired effect. Whatever in any given year was the objective that people were trying to obtain, there has always been a package of monetary measures?——Yes, there has always been a package of measures. What was regarded as the field of choice in the movement of interest rates was of a narrower range, perhaps, than you may feel we ought to have considered. I do not think that we would have asked ourselves whether a 10 per cent. or a 20 per cent. interest rate would not have done the trick, because we were thinking in terms of the complex questions that we have already discussed. From the point of view of experiment it would be nice to make a big change to see what happened, because then you would know better next time whether it really worked or not. But we cannot think of it in that way; we have to think that everything that is done will cause criticism. There is an inherent difficulty here, and I can see that from your point of view it must be extremely frustrating.

1735. *Professor Sayers*: To take an actual incident: in March, 1952, the Chancellor announced in his Budget speech that the Bank Rate was going from 2½ per cent. to 4 per cent, and he said: "The Bank rate will reinforce the other factors already operating to restrict investment at home." He did not say "may"; he said "will." What reason was there for supposing that the Bank Rate would reinforce the other factors operating to restrict investment at home?——I do not know what reason was in the Chancellor's mind, but the official attitude could be put something like this: "We have had a period during which the Bank Rate has been kept absolutely constant, and the economy has been run largely by physical controls. We are going to reactivate monetary policy to some extent. We are entering on an experimental period. In the past the view has been widely held, and supported by a good deal of evidence, that an increase in the Bank Rate is a restrictive rather than an expansionist factor." (As I was saying, the test of the means is which direction it pulls in. I do not think anybody would have claimed in 1952 that to put the Bank Rate up from 2½ per cent. to 4 per cent. was an expansionist factor.) "We want to tighten up a bit. What can we do? One of the ways to tighten up is to raise the Bank Rate."

1736. But that raised the cost to the Exchequer of servicing the floating debt; and it raised the cost of servicing the overseas debt, and therefore imposed some immediate burden, comparatively small, on the balance of payments. It had therefore distinct disadvantages of two kinds. The Chancellor must have been very sure of his statement that "the Bank Rate will reinforce" to incur those disadvantages, which must be very obvious to a Chancellor of the Exchequer. What reason was there for supposing that the balance of advantage was in favour of taking this step?——*Sir Edmund Compton*: The effect on the Budget, of course, is one that has got to be taken account of. It has an immediate effect every time the rate is shifted one way or the other. That was certainly in his mind at the time.

1737. *Sir John Woods*: In paragraph 58 you quote from the Economic Survey for 1953: "Monetary policy undoubtedly played its part in checking the rise in stocks and work in progress." It may be unfair to question the particular drafting of particular words of particular people, but there it is. Why had the writers of the Economic Survey of 1953 apparently no doubt? Looking at it in retrospect does the Treasury have any doubt now?——*Sir Robert Hall*: I think we held then and we hold now that the movements of monetary policy in one direction or another do have some effect in the desired direction.

1738. *Mr. Woodcock*: You raised the Bank Rate for the purpose of achieving some objective. You say that it was on a balance of considerations, and that it was broadly a move in one direction which was reinforced by other measures and trends. When you are doing the Budget you do estimate, at any rate, what will be the yield, say, of an increase of 1s. in the income tax. You may be out, but you nevertheless make an estimate, and one assumes the Chancellor makes up his mind in the light of that estimate. If you were deciding upon a reduction in total consumption by a system of licensing on, say, buildings, you would decide the amount you were going to allow, though your estimates might be exceeded. When you are dealing with the Bank Rate, are you on much less sure ground? You are only considering trends; you are only using it to get things moving in a certain desired direction. Is it fair to say that?——*Sir Robert Hall*: Yes. This has been an experimental period, where we moved back, after a lapse of 13 or 14 years, to the active use of the Bank Rate. Not only had a transformation taken place in the economy in the intervening period, but also there were the major differences in the conduct of economic policy which follow from the Government accepting the responsibility for the level of employment. I think it must follow that the instruments that we had recently been using and had considerable experience of were more familiar to us than the ones which we were now using. When you get on to the later period you see again the same problems; the use of monetary policy to achieve certain things, and the gradual realisation, on the part of the people concerned, that there were additional factors.——*Sir Edmund Compton*: You asked what we did to estimate the effect of a proposed change in the Bank Rate. There are some calculations that can be and are made, of what you might call the immediate effect upon the monetary system. We can and do assess the cost to the Exchequer, and can make some forecast of what the immediate effect upon the monetary system will be. Then we can make our estimate of what market prices will be. But the area in which we can only say that we hope there will be a trend, where we cannot put a figure on it, is, I suggest, not unlike the effect on the economy of, say, a rise in income tax. We cannot put a figure on what the response of individuals will be, either by way of saving or not borrowing, to an increase in interest rates. In that area we are dealing with not the effect upon the monetary system but the effect on the economy, and we have to rely on the direction in which we think a change of that kind will take us, and not put a figure on it.——*Sir Roger Makins*: Some of the factors which enter into the judgment are capable of quantitative assessment, and those quantitative assessments are, of course, made. The other elements that go to make a judgment are not capable of such an assessment, and therefore the total judgment is not capable of a quantitative assessment. Insofar as a quantitative assessment can be made, of course it is made in every case.

1739. *Professor Cairncross*: Wherever you are trying to use a general weapon to limit the degree of inflation, or offset deflation, you are very much in the dark about what effects you are trying to create. In formulating the Budget you dress up your decisions or recommendations in quantitative form, but that does not really mean that you know to any great extent what will be the effect of the various measures that lie behind these quantitative calculations.

If you put down some figures for cutting down Government expenditure, and some figures for changing taxation, and try to add them up, are you not almost as much in the dark?——*Sir Robert Hall*: We are always in the dark, of course, about the validity of our assumptions about how the non-controllable elements in the domestic economy are going to operate, and about the climate of world opinion, so that the assessment is admittedly uncertain to that extent. We are also uncertain to a different degree according to both the instrument employed and the measure of our past experience about the effects of particular masures.

1740. If I understand you aright, you have much more confidence that there will be a positive outcome to action on Government expenditure or taxation, than you have in relation to movements of interest rates. You believe for one reason or another that a rise in interest rates is bound to exercise a restrictive influence on the economy, but it is much more difficult, I take it, to indicate specific examples of the way in which interest rates work than it is where you are, say, cutting Government expenditure by £50 millions?——I am not sure that that is necessarily inherent in the situation, or whether it is a reflection of the short period, from the point of view of experiment, which has elapsed. I would like to repeat again that there was, inevitably, an element of moving into the unknown during this period. Professor Sayers said earlier that the Chancellor must have taken into account the cost to the Budget and to the balance of payments of a change in interest rates. He would not only have had to weigh that against the things that he would have had to do if he had not moved interest rates, but had relied on the kind of measures which have been used before; there would also have been a political element in the judgment. The temper of the Government was to put rather more weight on the monetary factor and rather less either on the direct controls or the fiscal factor. It would seem to me to be perfectly possible and natural that, having made the best quantitative assessment that he could, his decision might well come down on one side rather than another because of something which was completely unquantifiable in the complex of things that he has to think about.

1741. *Mr. Woodcock*: I suppose it would follow from what you and Sir Edmund said that, if you are dealing with, say, licensing, the Government may decide that they will only licence X amount but they still will not know whether that is the right amount, any more than in fixing the Bank Rate.——*Sir Roger Makins*: No, but there is a difference here. You can get more certainty in some judgments because you can quantify more of the problem, quite apart from whatever political considerations may ultimately enter into the judgment of the Government of the day. In some cases the non-quantifiable element may not be a very great one, but there will always be such an element.

1742. *Professor Cairncross*: In the case of specific action you can usually quantify that; but where you are relying on the size of the Budget surplus, or something general like that, it is much more difficult?——*Sir Robert Hall*: If I could give an example, in the days when we had a complete control over building, we could decide at the beginning of the year how many houses were to be built in the year, and the outcome would really be a measure of the administrative detail which you chose to give to it. If the Government attached sufficient importance to it, and said "300,000 houses will be built this year" it had the means at its disposal to ensure that no more would be built. In that sense a direct control, with the administrative means behind it, will give more direct results.

1743. *Chairman*: How much importance are we to give in this connection to the sentence in paragraph 49: "These programmes were consistently exceeded"? Was the excess small, or did it really show that, however much attention you were giving, you could not get the figure right?——It was significant in the sense that we would have felt more comfortable if it had been nearer to the figure, both in the public and in the private sector.

1744. *Professor Cairncross*: I confess to some astonishment at this sentence. My recollection is that programmes were consistently fallen short of. Certainly if you take the programme for electric power, more was sanctioned than was ever achieved, and I thought that that had been true in other directions. Many of the large investors particularly at that time had more confidence in their power to achieve a result than a detached observer would have shared. I think that far more was usually put in hand than could be completed; and there is a very big difference between talking of investment plans and talking of investment completed. Is it not quite easy to embark on a cut in investment, which has the effect of increasing the total investment accomplished, because less is in hand at one time, and more gets done?——Yes, that is possible, but I do not think we meant that.

1745. *Mr. Woodcock*: Are you speaking of a physical excess here or an excess in the amount?—*Professor Sayers*: Or an excess in manpower?—*Sir John Woods*: Does it mean that, if you add the programmes up, the total of the programmes was consistently exceeded, even though individual ones were consistently not reached; or does it mean that we consistently did more than we could afford to do?——I had better check it, but my recollection of the period was that more resources were utilised than was expected, I believe that that is what is meant here.

1746. *Sir Oliver Franks*: Is this a fair way of putting your opinion: if one takes into account the political and social presuppositions of paragraphs 5 and 9 of this paper, and then looks at the experiment of reviving monetary policy in these last five years, by and large, you do not doubt that the measures of monetary policy had some effect at any given period when they were employed, given the limits, at least in the earlier years of the period, within which it was thought possible to move interest rates; but it was discovered that, in the changed conditions of the economy, the effects of monetary weapons were both slower and less decisive than had been thought. I do not see how you can make sense of the various quotations which are given in different parts of the paper without some such reflection?——We were very uncertain indeed about the probable effects in the period 1951-52. There was a tendency for people to say: "The Government has used monetary policy and the situation is being transformed; therefore monetary policy has done the whole trick". The quotations from the Survey and from Chancellors' speeches are meant to indicate that we were conscious that other things were present. As for the period 1955-56 the whole tenor of the paper is that not as much was realised as had been expected. Mr. Butler said explicitly in the two speeches which are quoted that he had expected more from monetary policy than had in the period been secured.

1747. *Chairman*: In 1951-52 were you not much supported in your expectations by outside opinion? Was it not generally thought at that time that monetary policy was making an effective contribution to improving the balance of payments and adjusting supply to demand?——Yes, it was making a contribution, but there was a good deal of controversy as to exactly how much. As it was impossible to extract from the situation a precise answer, inherently you would expect different schools of thought to claim different degrees of importance.

1748. *Professor Cairncross*: It can be argued that when the Bank Rate goes up its principal impact is through its effect on the whole structure of interest rates; or it can be argued that its effect is on the availability of finance, almost independently of interest rates. Would it be fair to say that there was over this period some shift of emphasis away from the first set of considerations towards the second?——Yes, I think that is fair.

1749. *Professor Sayers*: When it was decided that interest rates should be used again, was the intention mainly to affect the level of long-term investment, or to operate on the holding of stocks? What was in the Treasury mind on this point at the time, and what do you feel that experience has taught on that point?——At the time I think it was rather more a feeling that things were pretty difficult and we wanted to get out of it, which would imply that we hoped for some change on the stock side, and perhaps for some marginal contribution on the fixed investment side. Subsequently I think

25 October 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B. [Continued

that we have felt rather puzzled about the behaviour of stocks in relation to the changes in interest rates, and we have felt that monetary policy has some effect on fixed investment.

1750. *Chairman*: I think perhaps we ought to enlarge on that when next we meet you, by which time I hope we shall have had time to read and take side by side your debt management paper.——*Sir Roger Makins*: Yes; and I hope that the papers on the external side will be ready by then.

(*The witnesses withdrew.*)

(*Adjourned until* 2.30 *p.m.*)

C. F. COBBOLD, ESQ., Governor, H. C. B. MYNORS, ESQ., Deputy Governor, L. K. O'BRIEN, ESQ., Chief Cashier, and W. M. ALLEN, ESQ., an Adviser to the Governors, of the Bank of England, called and examined.

1751. *Chairman*: We have two papers still to come from you; Principal Changes in the British Monetary System since 1931 and Some Possible Modifications in Technique. Can you tell us how they stand?——*Mr. Cobbold*: I am sorry we have been rather long about this. I would hope that they might be ready within two weeks.

1752. Thank you very much. Then there were a number of points on which answers were going to be looked for, arising out of the earlier evidence we had from you. I am grateful for the written statements which have been circulated, which cover some of the points. There were some others not so susceptible of being dealt with in writing, I believe?——I would like, if it is convenient to you, to deal with those today. I sent you copies of speeches which I recently made at the Mansion House and at Ipswich. May I take it that those are on the record as a supplement to Appendix 1?

1753. Yes. Would it be convenient for you to deal with your points now?——Thank you. The first point relates to Question 312, when we were talking of hire purchase companies and the possibility of covering them by the Bank of England Act. I then indicated, subject to confirmation or modification, that I thought it might be practical to cover other financial institutions (we were speaking mainly of hire purchase companies) under section 4 (3) of the Bank of England Act, 1946. This gives the Bank powers to give directions in certain circumstances. Our conversations with the Treasury and other Government departments have since proceeded, and we have been advised that there are some legal doubts. At the moment alternative methods are being considered by the Treasury. I thought that I had left you perhaps with a slightly wrong impression there which, in the light of subsequent discussions, I ought to correct.

1754. Thank you. Is there a point on Question 547?——The Chief Cashier gave an account of the method of establishing banking convention on the liquidity ratio point, and went on to state that that was a matter which I might wish to confirm. The account which the Chief Cashier gave of the origin of the 30 per cent. minimum liquidity ratio is in accordance with my understanding of the matter. It is, however, a point which the Committee may also wish to discuss with the banks themselves. I have left the banks in no doubt, during the recent phase of credit restriction, of my view that they should not allow their liquidity ratios to fall significantly below 30 per cent.; and I have made it clear that I reserved the right to make observations if there were any considerable divergence.

1755. Then there are questions 132, 136 and 137, relating to influences brought to bear on the discount market?——The Chief Cashier has already emphasised the particularly close nature of the contact which exists between the Bank and the discount market. This covers the point that they can come round at any time and talk. The purpose of the weekly meeting between myself, or the Deputy Governor, and the Chairman and Deputy Chairman of the Discount Market Association is that we should personally keep in touch with the representatives of the Market, so that we may know what is in their minds; and that they should have the opportunity of discussing the general situation with us. I often give them confidentially my views on the position and outlook both on the domestic and foreign scene: and they are naturally free to take these views into account in choosing the rate at which they tender. Beyond such expression of views and opinions I do not seek to influence their judgment. The market's independent assessment of the rate at which they should tender, made in the light of all the circumstances (including our own operations and such general views as we may have expressed) and as they see them, is of value to us.

1756. *Professor Sayers*: Would you care to illustrate what you have just said by reference to the events of the last four or five weeks, when the tender rate of the discount houses has been consistently the same although conditions, on the face of it, have varied from week to week? Are we to infer that stability of the rate at which the discount market has tendered has been entirely a matter of decision by the discount houses themselves?——It has been entirely the market's independent assessment of the rate at which they should tender, made in the light of all the circumstances, including our own operations and such general views as we may have expressed, as they see them. I would have said this sort of thing to them: "This is early days. It is going to take time to work all this through. Don't let us think we are all out of the wood because the exchange is better in three or four days".

1757. Would you agree that this period was unlike other periods that have followed a change of Bank Rate in that on other occasions the discount market has been rather quick to vary its rate in the first few weeks?——I should have to look that up. I would rather like to stand on the question you asked me about this time.*

1758. *Chairman*: Then we have Questions 147 and 442, which refer to the holdings of Treasury Bills by the clearing banks, the discount market and the Banking Department?——You already have some figures, and we are in the process of getting the agreement of our overseas central bank customers to supply certain other figures.†

1759. *Chairman*: The next point is on Question 596, about the passivity of the Issue Department in issuing notes?——I think that the size of the note circulation is very important. It is a figure which we watch continuously as a significant component of the total money supply: and I think it is one of the figures which should continually be before the public. But this does not alter the fact that the present role of the Issue Department in the supply of currency is passive. I have seen it suggested that limitation of the fiduciary issue would by itself help to control the money supply and reduce inflation. The position of the note issue in the monetary system, as I see it, is as follows. The public keep deposits with the clearing banks on the assumption that they can get notes when they want them. The clearing banks keep deposits with the Bank of England on the same assumption. No useful purpose would be served if the Bank of England refused to supply the clearing banks with the notes required by their customers. It would either lead to increased use of cheques, bankers' drafts, postal orders, or other means of payment, or else to a run on the banks and complete confusion—probably to a bit of both.

In fact the Bank stand ready, as they always have done, to supply the demands of their customers (in particular the big commercial banks) who want notes against the balances on their accounts. To fail to do so would be, in effect, an act of insolvency: and in the last century, when a rigid statutory limit on the fiduciary issue was in force, it became necessary on occasion to suspend the operation of the statute precisely in order to avoid such an act of insolvency.

I should add that the division of the total money supply between deposits and notes seems to me difficult to control: and only important as indicating some shift of purchasing power between different sections of the community and some change in the degree of activity of the money supply. It follows that the demand for notes is a resultant of general monetary conditions, modified to some extent by

* See Appendix to Minutes of Evidence.

† See Appendix to Minutes of Evidence, note to Qn. 2248, and Memoranda of Evidence Part I Appendix 2.

changes in public habits. I do not think that a formal limitation on the size of the fiduciary issue would be effective unless, at the same time, the underlying reasons for growth of the money supply were being effectively tackled. If they were not, we should in fact have to suspend this limitation when we ran into the inevitable difficulties.

Thus I regard the size of the note issue as a barometer of the success or failure of the authorities, and a very important barometer, but not as a weapon in their hands. We recognise that in any revision of the monetary system it would be most important to consider the various possibilities of controlling the money supply, including the note circulation. We feel that the future of the fiduciary issue should be considered in this general context. We hope to have an opportunity of discussing this with the Committee when we come to consider the various possible methods of credit control.

1760. *Professor Sayers*: In the light of this statement would you care to comment on the fact that in 1954 an Act was put on the statute book regulating the fiduciary issue, while no action was taken to do anything about statutory regulation of any other element in the money supply?——I think that is a Treasury question.

1761. *Chairman*: But the general question, if I understand you, will be dealt with in your forthcoming paper on possible alternative methods of control?——It will be indicated, certainly; and I thought to deal with any discussion under that paper.

1762. *Chairman*: Then there were two Questions, 646 and 679, about the independence of the Issue Department? We were asking about the distinction between the departments who had an independent investment policy and those who were, in one form or another, in control?——The Bank are responsible for the Issue Department, and consequently for the securities held by that Department. We inform and consult the Treasury who, in this as in other matters, have over-riding powers to ensure conformity of the Bank's policy with general Government policy. I shall be speaking in more detail about Issue Department operations when we come to Paper No. 9, to which I hope to be allowed to make some introductory remarks, covering some of the major issues that go through it all the time. One of those is about the Issue Department, which it might be convenient to take now.

When we speak of departmental transactions with the public, we mean for all practical purposes Issue Department transactions. They are sometimes assisted by transfers between Issue and other Departments or in other ways; but I will, if you wish, go into that aspect later on.

The general objective of the Issue Department is to maintain an orderly market in gilt-edged securities, sometimes by providing a market or meeting a demand for a particular stock, and sometimes by ironing out what seems an unreasonable fluctuation. Occasionally, when some new development takes place which might cause uncertainty or fluctuation, the Issue Department intervenes temporarily in the market to give a lead or to steady the market, but it is no part of general Issue Department policy to resist a definite trend of markets in one direction or the other.

Superimposed on this general function has been the part which Issue Department has played for many years, and especially since the war, in the Government's borrowing and refinancing operations. The needs of Government (including, of course, those of the nationalised industries which have to be met in one way or another on Government credit) are nowadays very large, and even in so broad a market as London, and in favourable conditions, a new issue of some hundreds of millions of pounds cannot be absorbed in a day. At the same time it is undesirable, in normal circumstances, to keep subscription lists open for more than a day at the most. For if the market tendency is downward, the stock will not be subscribed; while if it is upward the availability of the stock at a fixed price will act as a brake on prices generally, and H.M. Government will be borrowing on less favourable terms than the conditions ruling would have justified. These difficulties are overcome by the technique of using the Issue Department as underwriters of Government issues. Applications from the public are supplemented by applications from the Issue Department sufficient to ensure that the whole amount of stock on offer is taken up; and the Issue Department thus usually secure a substantial holding of any new stock. This they stand ready to sell as demand develops at the price ruling, much as would the underwriters of an ordinary issue. Similarly, the Issue Department usually acquires substantial holdings of any stock approaching maturity, and so in effect enables H.M. Government to assure in advance the conversion of a considerable part of any stock for which a conversion offer is made.

This underwriting function of the Issue Department is well-known and understood by the market. I believe it is generally regarded as an advantageous system, by which the impact of large Government debt operations can be smoothed out and funding can be made an almost continuous process.

The Issue Department is therefore, and is known to be, normally a seller of stock of various dates when the market is receptive but a buyer of the next maturities when they are on offer. This is obviously likely to have the effect of retarding a general rise in market prices but of supporting the price of the shortest maturities. But it has always been Issue Department policy, whilst taking full opportunity of a strong market to carry out these funding operations and intervening very occasionally to give a lead or to steady markets, not to resist a definite gradual rise in market prices. Nor has it ever been Issue Department policy to force sales on a weak or falling market.

I think it well to state this positively, and to give the Committee some of the reasons, as I am aware that it is a point on which there are many (and very understandable) divergences of opinion. Our attitude is based on two main grounds, one of short-term expediency and the other of long-term considerations, combining both expediency and the repute of H.M. Government as a borrower. As I have said, when the market is strong, we take full advantage of demand by selling at firm or at gradually rising prices. This is the normal procedure of any underwriter, it is well understood by the market and in no way reflects on the status of Government loans; in fact it quite frequently adds to the demand. If, however, Issue Department were to attempt to force sales on a weak or falling market, the consequences would be very different. On the short view we should not in fact make the sales easily, because in such conditions there are scarcely any buyers and it takes two to make a deal. It can be argued that there is always a price at which buyers will appear. That is doubtless true, but the price might be a long way down, much damage might be done on the way to markets and to confidence at home and abroad (I need not remind you how closely the exchange markets and the gilt-edged market watch each other) and in the end buyers might be few and shy if they felt that a repetition of this process was likely. What influences demand in this, as in other markets, is not so much the price of the day as the public's view of the likely movement in following weeks, months and years. Long-term rates are influenced by demand and supply of capital, and by the general outlook: they can also be influenced through the short-term rate structure. It would, of course, be possible to force down the price of gilt-edged securities by direct sales on the market. But we take the view that if the Government, or the Bank, as the Government's issuing bankers, were deliberately to sell the Government's own securities in order to drive down the market price, it would greatly damage the Government's credit. This would in my view be true even at times when the Government did not have to make frequent new issues and conversions. At times like the present, when the Government are often in the market for new money and for conversions, it would be indefensible either in equity or in practice.

I should like the Issue Department's policy in this respect to be clearly on the record. I should like it also to be clearly on the record that the Issue Department do not indulge in what is popularly called "rigging the market" before a new Government issue. The Issue Department make a point of limiting their activities shortly before or shortly after a new issue to the normal operations which I have described above. And in their general monetary operations the Bank are always concerned so far as is possible to avoid action which might affect market prices one way or the other in close conjunction with a new Government issue.

The degree of funding which has proved possible has varied very much from time to time, as the Committee

25 October, 1957] MR. C. F. COBBOLD, MR. H. C. B. MYNORS, MR. L. K. O'BRIEN and MR. W. M. ALLEN. [Continued

will see from Paper 9. The degree of importance attached to funding has also varied to some extent with the size of the floating debt and the level of the bank liquidity, but the general objective has been constant throughout. Although the cost to the Government of funding at expensive rates has naturally always been a factor to be considered, it has never in these years been held to outweigh the need for a continuous funding policy on the lines which I have described.

I would also ask the Committee to remember, when going through Paper 9, that the net figures of Departmental sales to the public always understate the degree of real funding achieved. This is because, as I have said, the Issue Department tends to be buying maturities to help conversion. The net sales of medium and long stocks are therefore much bigger than the total net sales. We are thus all the time pushing the debt further ahead. This is what really matters, for I should not attach much importance from a funding point of view to an operation which merely exchanged Treasury Bills into a very short stock. We have sometimes done this to reduce immediate bank liquidity (at the cost of adding to the problems of the next few years), and we have sometimes done it as a first step towards a more real funding, as in the big operation in 1951, when we made the first real attack on excessive post-war liquidity. But these short, semi-technical operations are never the final objective, which is to spread and lengthen the maturity of public debt as a whole.

In this connection it might be of interest to the Committee to have the figures of total net transactions of the Issue Department with the market over the last ten calendar years in various categories. Total net sales amounted to around £600 millions. But whilst the Department made net purchases of about £1,500 millions of stocks maturing within five years (that is mainly to assist conversions) net sales of stocks maturing between five and ten years amounted to some £600 millions, and net sales of stocks maturing later than ten years to nearly £1,500 millions. These figures, I think, give some idea of the part played by Issue Department in the process of real funding.

1763. There are one or two questions I would like to raise before we go on. I appreciate fully the almost ethical difficulty of the Government "selling down its own stock". You say that it must damage Government credit and that you must always remember that: but is not the same think done if you raise the Bank Rate?——*Mr. Cobbold*: You do affect the market through the short-term rate structure; indeed, every act of Government policy may affect it in one way or other. We should rightly or wrongly take the view that that is a very different thing from actually selling your own securities and depressing them on the market.—*Mr. O'Brien*: In any case a rise in Bank Rate probably does not affect all the yields on Government securities through the list; in fact on the longer securities the effect is often transitory and, as on the last occasion, the rate is very quickly brought back.—*Mr. Cobbold*: In some cases a rise in Bank Rate has given the impression that the whole range of Government measures is going to do good, and has brought the market up a bit.

1764. I have one or two of these occasions in mind; but over a longer term that has not proved to be the case, has it?——Our view is that, generally speaking, a rise in the level of short-term rates tends to work through, and to cause some rise in the level of long-term rates but that this is by no means a regular rule and there is no time factor that you could ascribe to it.

1765. *Professor Sayers*: Surely one of the factors would be the degree to which the market had already anticipated the movement of the Bank Rate? If the market had been anticipating a reduction of Bank Rate then the prices of medium and long-term securities would already have moved up a little, and the reduction of Bank Rate accordingly would do no more than steady the market: it would not cause a further rise. And correspondingly, a rise in Bank Rate, if it had been anticipated by the market, would already have caused a depression of gilt-edged securities, and the effect of the rise in Bank Rate would naturally be associated with a steadying of the market and not with a further depression. But surely that does not invalidate the conclusion that a rise in Bank Rate tends to depress the long-term prices and *vice versa*?——It tends to work through the system.

1766. And does not the extent to which it works through the system depend partly upon the instructions given to the Government Broker as to how to act in the day or two following the change?——I think I have dealt with that point in the statement I have just made.

1767. Then were not the instructions that were given in February of this year, when the Bank Rate was reduced, different from corresponding instructions given on other occasions? There have been three occasions in the last five years of a reduction in Bank Rate. On those three occasions were the instructions given to the Government Broker precisely parallel?——*Mr. Mynors*: Not precisely parallel, no.—*Mr. O'Brien*: But broadly speaking, yes.—*Mr. Cobbold*: I think that on previous occasions we were less concerned about the danger of giving a "green light". The instructions were then to the Government Broker to keep the market generally steady. On this last occasion we went to great pains, in a speech which the Deputy Governor made for me, to stress that this was not a "green light". We were somewhat concerned that it should not be mis-read; and so the first day or two after that alteration of Bank Rate we gave rather more specific instructions to the Government Broker to hold the market steady and to give a lead to the market. We were concerned to give the market time to make up its mind after having digested the statement we put out, in case their first impression might have been a wrong impression. We did not try, and would not have been able to, carry through any intervention over a long period. We were merely concerned about any fluctuation based on what we should have judged to be a misleading impression of the situation.

1768. The unusual element in your action on that occasion was not taken on the ground that the change might have had an undesirable reaction on long-term rates?——I think you are taking me a little further than I said there. We thought that, if the market reacted immediately to that change without thinking it over, one thing might have happened; and we would have preferred them to have time to digest the situation and take the sort of decision which we should have expected them to take when they had had time to digest it.

1769. But surely the market always has time to digest it, in the sense that, if it puts the price at one level today and tomorrow thinks that it has interpreted the situation wrongly, it can, and does, move prices back again?——It can; but all the practical experience tends to suggest that the initial move is a very important one.

1770. *Chairman*: But, if I understand your view, in February 1957 you hoped that the long-term rate would not fall, although you were making a small reduction in the short-term rate?——Certainly; but I would not say we continually operated to bring about that result. We made the intervention in order to give the market time to reach a conclusion which I was very pleased that they did reach, after they had had time to appreciate the situation.

1771. *Professor Sayers*: You did not take such action in 1953 or 1954?——We were not so worried about the "green light" aspect then.

1772. *Sir John Woods*: And if they had taken the other view after reflection?——We should not have resisted a gradual definite trend.

1773. *Lord Harcourt*: You said that in the course of its underwriting activities the Issue Department is at various times left with substantial holdings of a given stock. Have there been, or are there frequently, times when the Department is left with such a large quantity of stock that it has proved to be virtually unsaleable?——By and large, no. In my experience the Issue Department has never been gummed up, if I may use the phrase, with a particular stock. We normally hold quite a fair quantity of most of the range of Government stocks over various maturities in order to enable us to carry out the functions which I have already described in the market, supplying a particular need or keeping a particular stock level, so that we can intervene whenever necessary. When we have taken up a large holding through the underwriting arrangement I have described, it normally takes between three months and eighteen months to bring the holding of that stock down

to the level which we should normally expect to hold as part of our general requirements of stock. I do not remember a case where it has taken us more than two years from the moment of issue to get down to what we would call a normal requirement. So there has been a pretty constant turnover in the Department, and we have never become overloaded with unsaleable stock.

The only occasion on which we have felt anxiety on this point was in 1955 and 1956, when we had to take up a succession of nationalised industry Government guaranteed issues. We were very much concerned at that time that, if the process went on, we might find ourselves with Issue Department funds increasingly tied up in nationalised industry Government guaranteed stocks, and so becoming involved in long-term financing rather than in pure underwriting arrangements. And we have definitely taken the view that the long-term financing of nationalised industry or indeed the long-term financing of the Government (which is really only a slightly modified method of short-term borrowing, because the Department has to sell Treasury Bills in order to put itself in funds to take up those stocks) is not a proper subject for Issue Department financing. The Committee will remember that that particular trouble was removed in the 1956 Budget, when nationalised industry financing was taken under the direct wing of the Exchequer; we have not been concerned about that aspect since then. That was the only time, and even then I would not say that we had got to the stage of being cluttered up with a lot of unsaleable stock. We were just frightened that it might work out like that if those arrangements continued indefinitely.

1774. *Chairman*: Did you make known to the authorities your unwillingness, which I quite understand, to take on these long-term obligations which you could only finance by selling Treasury Bills?——Yes.

1775. *Professor Sayers*: The fact of your holding all these nationalised industries stocks in large amounts had the effect of preventing the prices of long-term Government securities from falling as much as they would otherwise have fallen. Were you not, in effect, supporting the market by holding those securities? Were you not taking a view on the desirable level of long term rates?——I should regard that as being entirely covered by the statement I made.

1776. *Professor Cairncross*: Would it be normal for an underwriter to hold on to stock for a period of eighteen months to two years?——I hesitate to answer that question in the presence of Lord Harcourt; but I think they would normally be glad to get rid of it within two years unless it was a very particular operation.

1777. Am I right in thinking that you have put out no information about the portfolio of the Issue Department?——That is so. We have been thinking of putting something in the Annual Report on the lines of Paper No. 9 which, though not giving details of actual holdings, would give a good deal of information about movements over a period some way back. We should be very reluctant to issue a list of actual securities held, on operational grounds; but I should be very ready to consider giving some sort of spread between maturities, on the lines which I have just given to the Committee (under-five, between five and ten, and over ten years), so long as the figures could, on operational grounds, relate to periods some way back.

1778. We had some discussion on this with the Treasury. Would you verify that Treasury Bills are a material element? They must fluctuate a good deal; were they extremely low in 1955-56?——They fluctuate, but they are never extremely low. The Issue Department's holdings of Treasury Bills and Ways and Means Advances nowadays represent rarely less than 50 per cent. and not infrequently more than two-thirds of their total holdings; that is the liquid portion of the holding.

1779. *Lord Harcourt*: You said in your statement on the workings of the Issue Department that this was a system which was well known and understood by the market. On that I want to ask a question about the activities of the Government Broker. When the Government Broker is selling securities on behalf of the Issue Department, does he invariably go through the gilt-edged jobbers, or does he deal directly with other clients?——*Mr. O'Brien*: Almost invariably through the gilt-edged jobbers

1780. It should be his duty, if the market is there, so that the market would know at all relevant times at what price he was willing to buy or sell?——Certainly. As a matter of principle he would deal with the market and not outside the market.

1781. There would be no suspicion whether at times he might not be placing large lines of stock with big institutional investors, so that the market would be ignorant at what price he was dealing?——No, not for a moment.

1782. *Chairman*: You spoke of the policy of buying in stocks that were mature for redemption. Would that policy be pursued whether or not there was a conversion offer in the wind?——*Mr. Cobbold*: Yes, so as to avoid having to pay out too much. If there is not a conversion offer the real effect of those operations is that you gradually make the redemption over a number of months rather than on one day.—*Mr. O'Brien*: We should not normally in any case know whether or not there would be a conversion offer until very late in the day, so we have to be prepared for either eventuality.

1783. When a conversion offer does come along, should we take it that the amount of maturing stock in the Issue Department is automatically converted?——Not completely automatic, no. We merely have room to do what we like.

1784. It would be exceptional not to convert it?——Yes. —*Mr. Cobbold*: We might keep a bit to keep a level book of a great number of maturities. We keep assented and non-assented stock from time to time.

1785. *Mr. Jones*: If you do not know till late in the day, does that mean you are not consulted as to whether there should be conversion?——Certainly we are consulted; indeed, the initiative would come from us, as the Treasury's issuing banker.

1786. Then you would not know about it "too late in the day", would you?——It would be too late in the day for what the Chairman was asking about; we should be operating in the market about a year ahead buying up the next maturity, but we should not normally know whether or not we were going to convert until two or three weeks before, or reach a definite decision until actually the day before. The Treasury would reach a decision, after consultation with us and on our advice, about two or three weeks before a maturity as to how to deal with that maturity. The final arrangements would be agreed between the Chancellor of the Exchequer and myself, or our representatives, twenty-four hours before the operation, in the light of the market as it then stood.

1787. Conversion need not wait until the actual date of the maturity?——*Mr. Cobbold*: Not necessarily.—*Mr. O'Brien*: Zero day, the last date on which a conversion offer could be made, is as a matter of practice a month or six weeks before the maturity.—*Mr. Cobbold*: If we make a conversion offer at that or an earlier stage, the decision would be taken two or three weeks before the actual operation.

1788. You have told us that the Issue Department is the underwriter of all Government issues. Having regard to the trend of the increase in Bank Rate within the last four or five years, has that underwriting resulted in material losses to the Issue Department? Have you been selling Government stocks at substantially less than the price at which they were issued?——On recent dates, certainly. But this is a "swings and roundabouts" arrangement. Sometimes we make considerable profits and sometimes considerable losses. It depends not only on which way the Bank Rate is moving but on all the other considerations which, as I have said before, affect Government securities. If Government securities are trending downwards and we are funding all the time, we are making a loss because we are selling at a lower price than that at which we took them on our book. If Government securities are on the upward movement we are making a profit.

1789. The present trend is therefore a loss; it is a falling market?——Yes, recently.

1790. *Professor Cairncross*: Apart from your underwriting operations are you in a position of independence from the Treasury? Does the ultimate decision rest with

you, or would the Treasury on occasion bring pressure on you to change the distribution of the portfolio?——The Bank are responsible for the Issue Department's operations in securities and for the composition of its portfolio. The Bank regularly inform and consult the Treasury who have overriding powers to ensure that Bank policy does not conflict with the policy of the Government.

1791. As a matter of practice, would you say whether you have found that easy?——As a matter of practice we keep the Treasury closely and regularly informed and we very frequently discuss with them general Issue Department policy. I would not say we discuss with them exactly what quantities of each particular stock we hold. That is obviously of no interest to them; it is purely a market operation. So far as policy is concerned, I do not recollect any instance since I became Deputy Governor of any conflict on this point between ourselves and the Treasury. If we had a disagreement we should seek to resolve it as we do normally in all our business, and come to an agreement. In the last resort the Government have the final word, because they have powers to direct; but I think I could say without impropriety that if the Treasury were to attempt to force the Issue Department to hold securities which the Court of Directors of the Bank of England did not think it was appropriate to hold, the Court would be very reluctant to be pressed to do so, either by directions or otherwise.

1792. *Sir Oliver Franks*: From the discussion we have just had I suppose one major issue of policy has emerged; that is that open market operations in the long term bond market on a regular and large scale are thought unethical; or at least a policy which you would not wish to embark on?——You are generalising a little from what I said, which was that we would think it not only unethical but extremely impractical to try to force down the price of Government bonds on a weak or falling market. I think you said open market operations on a large scale would be unethical. We carry on open market operations of a very large character.

1793. I meant if they were designed to affect the prices of securities?——On that I must rely on the text of what I said: "It has always been Issue Department policy, whilst taking full opportunity of a strong market to carry out these funding operations and to give a lead or to steady markets, not to resist a definite gradual rise in market prices. Nor has it ever been Issue Department policy to force sales on a weak or falling market."

1794. *Professor Sayers*: If the Treasury desired as part of general economic policy to see long term rates fall, would the Bank he prepared to use the resources of its Issue Department to hasten or to create such a fall?——I think the reply I have given covers your point.

1795. *Chairman*: There is the possibility of running against the wind, where security prices are rising and you think they should not?——Only as a very temporary measure for a day or two to steady the market in particular circumstances.

1796. *Sir Oliver Franks*: That would be neither regular nor, in the sense I have used it, large scale. *Chairman*: In the reverse position, where the prices were falling and rate of interest lengthening, would you as a matter of policy move into the market on any protracted scale to try to correct that?——I think that it follows from what I have said that we do not intervene on any long term or large scale in order to shift prices one way or another. But (I do not know whether Professor Sayers would regard this as a reservation) we have the superimposed requirement of funding all the time, which inevitably tends to retard a rise in market prices to some extent.

1797. On that I gather that your policy has been that, although you wish to fund, you are not prepared to fund if the cost of doing so is to knock prices down?——I would not quite put it like that. The cost to the Government of funding has always been a factor which has never been held to outweigh the need for continuous funding policy.

1798. That is not quite what I had in mind, but the answer lies in that. There has been a desire to carry out a continuous funding policy, and you have recognised the possibility there always may be a price at any one time at which you could continue funding; but I gather you thought it a wrong policy to try at all costs to find that price?——*Mr. Cobbold*: Wrong and ineffective.—*Mr. O'Brien*: Ineffective is the operative word.—*Mr. Cobbold*: In effect it cannot be done. I am naturally very much interested in the long term standing of Her Majesty's Government's credit, which I think any operations of that nature would affect very much; but I am also interested in getting on with the day to day business of funding, and we should not be able to carry on with that.

1799. *Mr. Woodcock*: But the result is that you keep on selling in small quantities?——Yes, when the market is firm and when there is an appetite.

1800. *Sir Oliver Franks*: Given that there are not large scale regular open market operations in the long term bond market designed to manipulate price, and allowing for intermittent and particular interventions that may take place as described, does it follow that the only means by which the Bank can really affect the rate for long term bonds is by operating on the short term money rates and letting them work through?——Yes; that operates both directly and by the influence that it may have on general expectations of economic outlook as a part of general policy.

1801. That is the other side of the penny to not intervening regularly and on a large scale with deliberate intent to move prices?——I accept that.

1802. *Professor Sayers*: Does it not mean that you can only influence the long term rate by moving the Bank Rate?——No. Bank Rate is a very important point, both directly through its impact on the short term rates and through its general impact as a part of more general measures to correct the economic outlook or make people feel control of inflation is in hand, and other influences which may affect the long term market.

1803. One of the objections commonly advanced to the use of the rate of interest for restraining inflation is that once you get the long rate of interest up it is very hard to bring it down. If the Bank only seek to influence long rates in the ways we have just been told, does that mean that, should the Treasury want, in order to stimulate trade, to bring long rates down, the operations of the Bank would still be confined practically to the short term rates?——Policy hitherto has been as I have described it: I do not think I can project myself into policy a long time ahead.

1804. It is not a long time ahead; this is relevant to the present question whether or not high interest rates should be used to restrain inflation, which depends partly upon whether engines can be reversed quickly and effectively, should the economic climate change too much?——If you are asking me whether, on the present basis of Issue Department policy, we should support the gilt edged market heavily in certain circumstances with the object of shifting prices, the answer is no.—*Mr. O'Brien*: The possibility of buying securities in order to improve prices in the gilt edged market is really the converse to selling securities on an unwilling market. We say that to attempt to sell securities in large quantities on an unwilling market is by experience bound to be unsuccessful. Conversely, if we were to buy securities in order to support prices, we should have everything in the shop window thrown at us; it would be an impossible task to take on.

1805. In 1932 did not the Bank in fact help the depression of the long rate of interest by its operations in the security market?——*Mr. Mynors*: I think you are referring to the holding of securities not in the Issue Department but in the Banking Department. There was an increase in securities in the Banking Department, with a corresponding change in the level of bankers' balances, which tended to affect the credit base. That was the significant feature, if there was one, in 1932; not the operations of the Issue Department in altering its portfolio.

1806. Do you mean that the Bank was aiming simply at the widening of the credit base and not at any effect on security markets?——I do not know how far we can fairly answer for the people in charge in those days, obviously without attempting to deny any responsibility that the Bank as Bank may have had. But I think it

is difficult to distinguish 25 years later, how far it was any specific rate of interest in the long term market which they may have had in mind, and how far easing of credit conditions, which might have led to encouraging, let us say, the clearing banks to make more advances. Easier money might have presented itself to them in different kinds of emphasis from what we have just been considering.

1807. *Chairman*: What is the economic difference between the buying proceeding from the Banking Department and from the Issue Department?——In the early months of 1932 there was an absolute increase in the amount of Government securities held in the Banking Department, with a roughly corresponding increase in the Bank's liabilities to its customers; whereas in the Issue Department we are only talking of a change in the make-up of a portfolio.

1808. *Sir Oliver Franks*: It seems to me that there will generally be some sympathetic movement between a change initiated in the short term money market and changes in rates on longer term bonds. If, simply as a hypothesis, it was desirable that the cost of long term money should stay pretty high, but that the cost of short term money should not be high, and if the Bank's operations, as you have described them, naturally begin at the short term end, is it practicable to secure that sort of difference between shorter and long-term rates? Could the existing machinery cope with that sort of situation? Would it be a difficult situation to achieve?——*Mr. Cobbold*: I would rather, if I may, consider that when we take Paper 12, which has a long section about interest rates, and deals very much with the broad point you are just raising.

1809. Am I right in thinking that there is a difference in practice here between the views you have given about what the Bank of England does and what the United States Federal Reserve system does?——It is not exactly similar. There has been over recent years a good deal of controversy within the Federal Reserve System on a related point. The set up is so different that it is very difficult to compare the two, but we shall in course of time be letting you have some descriptions of the American system as well.

1810. *Chairman*: Then have you anything on Questions 681 and 682, about the Bank of England's power to refuse Ways and Means Advances to the Exchequer?——Yes, Sir. The legal position is as follows. The Bank of England Act, 1819, lays down that—

(1) the Bank may not lend to H.M. Government without the express authority of Parliament:

(2) when it is deemed necessary for the public service to make application to the Bank for an advance, such application shall be made in writing by the Chancellor of the Exchequer to the Governor and Deputy Governor of the Bank, to be laid by them before the Court. A copy of all such applications made, and the answers, is to be laid before both Houses of Parliament once a year.

For many years now the requirement of written application has been satisfied by a regular quarterly letter requesting the advance of such sums as may be required in the coming quarter. Parliamentary authority for borrowing is regularly given in the Appropriation and Consolidated Fund Acts, which authorise borrowing on Treasury Bills or otherwise up to the total amount of supply expenditure voted, and specifically mention that the Bank may advance to the Treasury any sum or sums not exceeding the total of such expenditure covered by the Act in question. Thus the intention of the 1819 Act clearly was that the Bank should be under no compulsion to lend.

I imagine that it would legally be open to the Treasury, if the Bank were unwilling to make an advance, to direct them to do so under the powers conferred by Section 4 of the Bank of England Act, 1946. I feel some doubt myself whether this was the kind of subject for direction intended by this Act, and whether the Treasury would readily conclude (as they must do before issuing directions) that it was necessary in the public interest to force their bankers to lend to themselves. We certainly treat this matter in practice, and should continue so to treat it unless and until directions were issued, as one to be freely negotiated, both as to amounts and as to rates of interest, in the normal way as between banker and customer. This is how it has always happened and the question is therefore hypothetical. But I would judge that, in a matter which primarily concerns the Bank as a bank rather than as a monetary authority, the Court of Directors would be very reluctant indeed to be pressed against their judgment, either by direction or otherwise.

This question of Ways and Means Advances raises a wider issue, on which I would like to touch at this stage in a preliminary way. As has already been stated the banking system is very heavily loaned, in various forms, to the Government and the present arrangements enable the Government to borrow from the banking system at short-term such money as they require, on a virtually automatic basis. It is true that, even under the present system, the Bank of England could, unless directed to the contrary, impede this automatic arrangement by not making sufficient cash available to ensure that Government requirements could be met through Treasury Bills. Such action would force the Government to look to the Bank for Ways and Means advances, and the question with which I have just dealt would arise. But such action would also at once change the whole character of the existing money market arrangements, which rely on the immediate and unlimited liquidity of Treasury Bills and call money. It is therefore action which neither the Bank, nor I expect the Treasury, would wish to contemplate without very full consideration of all the consequences.

The question in the forefront of my mind is this. Is it in the public interest that Government borrowing from the banking system should be made easier, left as it is, or made more difficult?

As things are at present the only checks on Government borrowing from the banking system are—

(*a*) the possibility to which I have just referred, but which I do not regard as very practicable at the moment, of the Bank of England taking action to interfere with the automatic availability of cash,

(*b*) the traditional desire of the Treasury to maintain a sound financial position (to which I hope that the support of the Bank has made and does make some contribution),

(*c*) the public concern which would be caused by a big increase in the money supply or the floating debt,

(*d*) the warning which is provided by the bank liquidity convention (to which in this context I attach great importance) whenever the floating debt is growing too fast and bank liquidity rises significantly above the 30 per cent. level.

My own view is that it would be a mistake to make Government borrowing from the banks easier than it now is. I am therefore opposed in principle to variable liquidity ratios, Treasury Deposit Receipts, or similar devices which, though they might be intended to set a maximum to lending to the private sector, would have the effect of forcing the banking system to lend a minimum to the Government. This effect would be obvious: and the variable nature of the device would enable Government to extend the floating debt, and borrowing from the banking system, to an unlimited extent with even less checks than at present.

Whether it would be in the public interest to tamper with the present highly efficient money market arrangements in order to impose more checks on Government borrowing and on the creation of money from Government sources, seems to me a much more debatable question. It could, of course, be done by a variety of methods, either by legislation or by changes of practice or by a combination of both. But whether we should have gained in the end by substituting for our present methods (which admittedly have their risks) a system which prevails in some countries, by which the Exchequer lives from hand to mouth and has at intervals to argue with the Central Bank about advance limits, I am not sure.

I do not suggest going into this question in detail at this stage. It will come up when you come to consider the paper on alternative possibilities, and we hope that you will then give us an opportunity of discussing it. But I thought it might be useful to the Committee if I indicated at this stage our view that this is one of the central problems, perhaps the most important of all.

1811. *Chairman*: Thank you. May we take that when we have your paper on alternative possibilities?——I

thought it would be convenient to let you know now that it is a question to which we attach very great importance.

On Question 773, I was asked a question about publicity in relation to the Exchange Equalisation Account. This is a question of personal judgment. As in all these matters one has to choose a path between the operational inconvenience of frequent publication and the importance of keeping the public fully informed. When we are in trouble, the monthly publication of gold and dollar figures is apt to hang over the foreign exchange and gilt-edged markets as a cloud for a week or two before publication. My own view is that it would have been wiser in the event to adopt a more comprehensive and less frequent statement giving figures a little in arrear. But it can be dangerous to discontinue a regular statement once it is there.

1812. *Professor Sayers*: In other words, your experience in this particular matter tends to confirm your suspicion that operating efficiency can be seriously damaged by frequent publication?——By too frequent and up to date publication.

1813. *Sir John Woods*: You ended by saying it might be dangerous, once having established a regular statement, to discontinue it. Would you think it might be possible to consider changing that sort of arrangement when you are in rather calmer waters?——Certainly. We have discussed that matter with the Treasury at various times when the water was a little calmer. I am afraid it has normally turned less calm before we reached a decision.

1814. *Professor Sayers*: Looking at these three possible steps, you would prefer the second to the first or third; that is to say publication some time after the event, and relatively infrequent figures?——Yes, I should prefer the second.

1815. Would you say the same in relation to Issue Department figures, for instance?——I am talking about the Exchange Equalisation Account; I would prefer to leave it at that.

1816. *Chairman*: I think that disposes of the outstanding questions. May we move to the Bank of England's Paper 9?* I know that this has involved a great deal of work and research, for which we are most grateful.——*Mr. Cobbold*: Mainly on the part of Mr. Maurice Allen. —*Chairman*: It gives us a lot of basic material, but what matter ultimately are the points of principle which we can extract from it. So may we go straight through it and see where the questions arise?——I hope that you will not cross-examine us too closely on the exact operations over four or five years ago, because it is very difficult. We will do what we can.

1817. We shall put the questions in order to elucidate the points of principle; it is not just a question of past history. But I believe you wish to say something before we start going through?——This paper, to which appendix 2 is in some sense the statistical appendix, being as it were a blow-by-blow account of the main problems and decisions of the period, inevitably comes back again and again to the same facts and the same problems. I thought it might be helpful to the Committee, in discussing this paper, if I were to make some opening remarks, putting the paper in some perspective, at least in the perspective as I see it. I propose to mention one or two of the outstanding facts and figures, and also one or two of the policy questions, which run through this paper. I have in fact already mentioned the Issue Department operations, which are some of the most important.

To take first one or two questions of fact. By far the most difficult and intractable domestic problem with which we have had to contend over this period has been the financing of Government and other public requirements coupled with the refinancing of maturing public debt—both as an actual financial operation and in its effects on the money supply.

The actual financial problem over the five-year period from the beginning of the year 1952-53 has been as follows. Here are some figures: †

Net requirements for Budget and nationalised industries (Items 1, 2 & 3 of Appendix 2)	£1,722 million
Net sterling requirements for external operations (Items 4 and 5)	£332 million
Net repayment of small savings and T.R.C.'s (Items 8 (*a*) (i) and (ii)) ...	£106 million

The total amount of new money to be found for the Exchequer and nationalised industries over the five-year period has thus been £2,160 million. On top of this Government and Government guaranteed stock amounting to more than £5,000 million has matured and had to be refinanced during the period. In the result, after refinancing the maturing debt, the new money of £2,160 millions has been found by

Sales of quoted stocks to the market (Item 8 (*b*) (i))	£1,325 million
Increase of fiduciary issue (Item 7) ...	£525 million
Increase of floating debt with market (Item 8 (*b*) (ii))	£310 million

So much for the actual financial problem.

I turn to the effect of these operations on the money supply. Ignoring switches of debt from non-banking to banking holders, additions to the money supply can come broadly from two sources, bank credit to the private sector and net overall Government outpayments. Over the period we have been continually concerned to restrain bank credit to the private sector. Sometimes with the help of technical pressures, but mainly owing to the co-operation of the banks in following indications of official policy, this has not proved too difficult, though the methods used have unsatisfactory features, and would not be suitable indefinitely. It is true that at times bank advances have increased, but the movement has always been controlled and usually reversed. The period under review actually shows an addition of less than £100 millions in bank credit to the private sector.

Over this five-year period the net addition to the money supply has virtually all come from net Government outpayments of one sort and another. As I said before, total net overall Government outpayments amounted to £2,160 millions. After net sales of public debt (short and long) to the public outside the banking system and other changes in the holdings of the public debt, there was a net addition to the money supply of £736 millions of which £525 millions was in the form of increase in the note issue and £211 millions in the form of increased bank deposits.

These figures indicate the size of the problem which has confronted us, and explain why the paper shows continual preoccupation with the refinancing of maturing debt and meeting the new requirements of the Exchequer and the nationalised industries. This position has recently improved and there has lately been little, if any, addition to the money supply from these sources. I repeat, however, that, in my view, this has been by far the most difficult and intractable of our domestic monetary problems, and, in spite of the recent improvement, it might well become so again.

I turn to another question of policy which recurs throughout this paper, the determining factors in deciding on bank rate movements. Some more general considerations about interest rates are dealt with in Paper 12, but I should like to stress two or three points at this stage. They are mainly points which I have brought out at one time or another in speeches of which the Committee have copies.

This has been an experimental phase—I am always referring to the five year period—and we have had to feel our way in new circumstances. Our general view has been (and on the whole I think it has been supported by the outcome) that Bank Rate and allied measures in the field of credit control could have useful effects if operated in line with other financial policy, but that, particularly with high taxation and the predominance of Government activity in the whole economic field, they could not be effective by themselves or if they ran counter to policy elsewhere. As will appear throughout this paper, we have always been concerned to limit rises in Bank Rate, both as to timing and as to amount, to occasions when we foresaw some possibilities of achieving results, and more particularly when they fitted in with change in emphasis of Government policy or of action in other fields.

* Memoranda of Evidence Part I No. 9.

† The figures in this statement have been revised so as to be consistent with the revised versions of Memoranda of Evidence Part I No. 9 and Appendix 2.

We have sought not to overstrain the monetary mechanism by pushing these measures too far when other conditions were not aligned. We have sought to avoid a position where extreme use of Bank Rate and allied measures would have been operating too much in isolation and would therefore have invited failure, with prejudice to their future utility. We have at all times been impressed by the importance of keeping Bank Rate real and in touch with market rates, and by the consequent need of flexibility up and down. We have, too, been very conscious of the cost of high short term interest rates to the budget and to the balance of payments, and of the consequent need to be satisfied the whole time that increasing or maintaining this cost could always be justified on wider grounds.

These are the main points which I wanted to emphasise in introducing this paper.

1818. *Chairman*: You drew attention to the fact that over the period bank advances had only made a comparatively small increase, something of the order of £100 million; but you said that the banks had been restrained by various measures, including direct appeals, and that you did not regard those as altogether satisfactory features. Could you enlarge on that?——I said that they have some unsatisfactory features. I think the most unsatisfactory single feature is that they include an agreement among the clearing banks not to compete with each other. I hesitate to speak on this subject with Sir Oliver Franks present, but my own view is that, if that arrangement were maintained a very long time, it would be very damaging indeed to the British banking system, and probably to the British economy. What is happening at the moment is that over the country a new generation of bank managers, who in the end have to operate this, is being brought up not to do business instead of to do business. That seems to me, although it is tolerable for a few years, to be highly damaging if maintained for a long period.

1819. What is actually meant by "not competing with each other"?——The Committee of London Clearing Bankers will tell you better than I can; but generally speaking it means that, if you have been refused an advance by Barclays Bank, and you go round to the Midland and say you would like an advance, and you will be prepared to transfer your account if they care to oblige you, the Midland are expected to ring up Barclays and say: "Is it true that you have refused?". If it is true, they are expected to refuse too, and not take the encouragement of the transfer of the account. Is that the position broadly, Sir Oliver?

1820. *Sir Oliver Franks*: Certainly. I think that we should all agree that it is a most unsatisfactory feature necessarily built into this existing arrangement.——I think it has been necessary. That is a particularly unsatisfactory feature. There are several other unsatisfactory features, but the other main one to my mind is that there is a gradual and increasing tendency for financial arrangements to be pushed in other directions. If over a longish period selected institutions or groups of institutions, such as the British Banking Association, the Scottish Banks, the American Banks and others, refuse financial accommodation, people are always looking for ways of raising elsewhere money which they would normally raise from the banking system, ways which are probably less desirable and less amenable to any control.

1821. *Sir John Woods*: I was a little surprised to hear you say you moved the Bank Rate in this last period where you saw possibilities of achieving some good result by so doing, because I got the impression that when you moved the Bank Rate, upwards anyway, it was not so much that you saw the possibility of achieving a result but that you positively needed to get some result, because of difficulties arising with the balance of payments or with losses to the reserves. Am I wrong in that?——I would not say that that would have been more than one of the factors.

1822. Do not the upward movements of the Bank Rate, in fact coincide with the balance of payments troubles?——I should have to check to be sure it was true every time; it has certainly been true several times. I meant to cover that when I said: "We have always been concerned to limit rises in Bank Rate, both as to timing and as to amount, to occasions when we foresaw some possibilities of achieving results, and more particularly when they fitted in with change in emphasis of Government policy or of action in other fields"; I had in mind action in other fields which affected things on the exchange front. The external position is always, or very often, a factor, but by no means the only factor; on each occasion of Bank Rate move we have had an eye very firmly on the internal economic position as well as on the external.*

1823. *Chairman*: May we now take the paper. Are there any questions on paragraphs 1 and 2? Paragraph 3? Paragraph 4?—*Professor Cairncross*: Have you any view as to the relationship that normally obtains between currency and deposits and the national income?——*Mr. Allen*: One has to go back a very considerable time in order to get any period to which one could look for a normal relationship. The war years and post war years have clearly produced a largish rise in both currency and deposits relative to the national product. I do not suggest that there is any normal relationship one could establish as a fixed ratio.

1824. Has not the ratio dropped since before the war? But perhaps you would agree that it is not proper here to discuss currency and deposits alone; you have to include the whole of the floating debt for this purpose. Would that be the normal approach you would make to the matter?——One would need to look at substitutes for money on that definition, as well as money alone.

1825. From that point of view the total relationship between money and near money to the national product may be rather higher?——I am afraid I should need to consult statistics.

1826. Let me ask the question in a different way. Have you any idea as to where the price level would settle if the banking system were left free to sweat out the excess liquidity in the usual way?——*Mr. Mynors*: I have really no idea.

1827. Would you think that the degree of liquidity required in the kind of conditions we are living in today is highly compressible or elastic, or fairly fixed? We have seen in the last few years how the country has gone along with a good deal less money relative to income than it used to have. Do you think this is a process which could go on almost indefinitely?——Could we think about that, Mr. Chairman? That is not a question that we should like to tackle offhand.

1828. *Chairman*: We should be grateful if you would. I think the question is: assuming that an important element in this situation has been the increased velocity in the use of money, is there a point at which you can foresee that expansion of velocity being exhausted?——*Sir John Woods*: Could we also have an explanation of what is meant by near money, and how it works?——*Professor Cairncross*: Perhaps I might put an additional point on this: has the Bank determined the degree of funding that it wants in order to be able to get a grip on the money supply? We keep being told that there is excessive liquidity, which means in practice a high floating debt. Is it clear what degree of transfer from floating debt into longer dated bonds will be necessary in order to reduce the liquidity of the banking system to the 30 per cent. that you want?——*Mr. Cobbold*: I could not say honestly that I have addressed my mind to that, because I am confident that it will take all the funding I can do for some time ahead—*Mr. O'Brien*: It is not sufficient to get yourself into a position where you can squeeze the bank's liquidity. You have to remain there; that is the difficult job.—*Mr. Cobbold*: We have all these maturing short loans.

1829. *Sir Oliver Franks*: We were talking to the Treasury this morning about the unwieldy size of the existing floating debt and the maturities coming in in each of the next two or three years; they felt themselves unable to express more than hopes that the next few years would be less difficult to deal with on that score than the past five had been. I think that in putting these questions to you we are asking you whether you, from your angle, could find in the experience of the last five years any solid ground for doing more than just hope, or whether we are going to live with this concomitant product of over liquidity as far as you can see ahead?——The creation of money from Government sources has got a good deal better over the last year or so, as I have said,

* See Appendix to Minutes of Evidence.

and if that is maintained and improved then there is considerable hope. That appears to me to be the fundamental point, to stop more money coming in. We have made considerable progress, as I have said, in the funding process; so long as the additions to the money supply generated from various sources (and I have given my view which is the most important source) can be kept in hand, then the prospects should be better than the experience has been over the past years.

1830. *Chairman*: Several factors might very easily unseat that progress: a big addition to the reserves, or an added reluctance from the public to fund under existing circumstances?——Certainly, and also the overseas sterling balances problem.

1831. *Mr. Woodcock*: Some of my colleagues this morning had some difficulty in understanding why it was so difficult to fund bonds when there is apparently so much more saving through insurance companies and pensions funds. Have you any views on that?——Over the past few years the tendency of pension funds and trust and semi-trust funds has been very much to consider shifting from gilt-edged to equities, for reasons that I think are familiar to all of us; in one word, inflation. Equities were regarded as a "hedge against inflation."

1832. Would you agree with the point put this morning that in some cases they have been trying to keep a better balance after having acquired a good deal of Government stock during and just after the war?——Traditionally a lot of the sort of trustee and semi-trustee funds I was referring to hold a very high percentage of gilt-edged securities, and, in fact, there were legal provisions that they should. In quite a number of cases permission has been sought to alter those legal limits to enable these sort of funds to move from gilt-edged securities into equities. There certainly has at times been some public doubt about the future of Government securities. Where people think that costs are going up and prices are going up, which is likely to mean that the value of equities will go up and the value of gilt-eded and fixed interest securities will go down, they will tend to switch from gilt-edged to equity shares.

1833. But apart from that surely a factor in pre-war days was the fear of losing money in equities?——Yes, and vice-versa.

1834. So stability in full employment and continuing demand is a general factor in activity?——One would hope that the balance was kept more or less in line, that there would be no tendency to switch from one category to the other.

1835. *Mr. Jones*: Has not there been more investment by insurance companies and trustees of pension schemes not only in equities but in real property as against gilt-edged?——I should not like to be too definite about that; I will look into the figures. My impression is that it is particularly towards equities that the money is shifting from gilt-edged. I would have expected the property investment to be a little more constant and the equity percentage to have gone up rather considerably.

1836. *Lord Harcourt*: When we were discussing this this morning with the Treasury I suggested difficulties had perhaps arisen from two facts: first, that during the war the insurance companies, I think by agreement with the Government, devoted the whole of their net increase of funds to the purchase of long dated Government securities, which meant that in 1946 their portfolio was seriously out of balance as compared with the traditional portfolio; and secondly, that with the nationalisation of the basic industries they were faced with a transfer of ordinary shares, preference shares and industrial debentures into Government guaranteed stock, which again expanded their gilt-edged portfolio. Would you agree that that was probably a much more potent factor in their hesitating to buy gilt-edged than the inclination to switch into equities, because, although people talk very glibly about switching into equities, it is not easy for a large pension fund to acquire equities at anything like the speed it would want? Does not this have great relevance to the funding of Government debt?——Absolutely major relevance. I would fully accept your two points. The first point relates to the insurance industry; the second is a more general point, which I think we mentioned earlier in evidence. It is certainly mentioned in our paper as being one of the major factors.

1837. *Mr. Woodcock*: If we had had during this period a tax on capital gains, would there have been in your view the same move towards equities?——I do not think I could answer that one offhand.

1838. *Chairman*: Is there any means of knowing whether the force of Lord Harcourt's two points is likely to be spent by now?——The first will be largely spent by now; but the second point certainly not. We have stressed in Paper 10 that in the old days a normal portfolio would have had, say, 40 per cent. in Government securities, 10 per cent. electricity, 5 per cent. gas, 5 per cent. railway stocks, which are now all under one hat. The manager would say that all those ought to be considered in the 40 per cent., even if he did not wish to reduce the 40 per cent., because they are all Government or Government guaranteed stocks.

1839. Then he would set about adjusting his portfolio over the years. Is there any means of knowing whether the adjustments have by now become effective?——It depends to some extent on the overall balance of the Budget, including the finance of nationalised industries. If there is not an enormous amount of new borrowing required for the capital programmes of Government and nationalised industry, you have only to consider the stocks on the books, and the effect of them wears off. The existing nationalised industries' stocks tend to get absorbed, and indeed to become a part of a recognised percentage of a portfolio; and perhaps are less likely to be disturbed over the next period than they were over the last period.

1840. *Lord Harcourt*: Have you any indication in the Bank of England as to whether this readjustment of portfolios does appear to have taken place? Have you any statistics showing whether the life insurance companies are beginning now to move into the gilt-edged market in a bigger way than they have been?——Some signs, but no statistical record at the moment. It is too early, I would say.

Chairman: I think perhaps we might close at that point, and take paragraph 6 next time.

(*Adjourned until Tuesday, 5th November, at 10.30 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

NINTH DAY

Tuesday, 5th November, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	SIR REGINALD VERDON SMITH
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	GEORGE WOODCOCK, ESQ., C.B.E.
	SIR JOHN WOODS, G.C.B., M.V.O.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	MR. R. T. ARMSTRONG, *Secretary*
PROFESSOR R. S. SAYERS, F.B.A.	MR. G. PENRICE, *Statistical Adviser*

C. F. COBBOLD, ESQ., Governor, H. C. B. MYNORS, ESQ., Deputy Governor, L. K. O'BRIEN, ESQ., Chief Cashier, and W. M. ALLEN, ESQ., an Adviser to the Governors, of the Bank of England, called and examined.

1841. *Chairman*: We should like to follow up with you the statement you made last time about Issue Department policy [Q. 1762], before we continue to go through Paper 9 in detail. There are one or two questions that arise when you are stating the policy with regard to funding and the impossibility of funding on a falling market. You say:—

> "It would, of course, be possible to force down the price of gilt-edged securities by direct sales on the market. But we take the view that if the Government, or the Bank as the Government's issuing bankers, were deliberately to sell the Government's own securities in order to drive down the market price, it would greatly damage the Government's credit."

I do not follow your thought completely; surely the suggested purpose of the selling is in order to achieve as much funding as you can, even at the cost of the price of gilt-edged falling, not "to drive down the market price"; that is an unfortunate consequence but not the purpose?——*Mr. Cobbold*: That is certainly the ultimate purpose; but I think we should be driving down the market price in order to get down to a level where we might hope, on that thesis, that buyers would come in.

1842. The consequence might well be that you would find the price falling?——I would put it the other way: we should he trying as a matter of policy to drive the price down, with, I agree, the objective of attracting huyers; hut I am very uncertain, as I say, ahout that thesis.

1843. The less the price fell the more satisfactory your operation would be?——If you were successfully to get in a lot of buyers only by driving the price down a small amount these disadvantages would arise to a lesser degree. I was not trying to suggest that when we were selling Government securities in order to drive down the market price we should be doing it for fun. There would he the objective of attracting buyers; but I still think that if you were adopting that policy you would be trying to drive the market price down.

1844. You might want to drive it down not in any sense for fun but for a separate reason, hecause you desired to establish as a matter of policy a higher yield on gilt-edged and, therefore, a lower price?——Yes, but it would still be deliberately selling Government securities in order to drive down the market price.

1845. Yes, hut I did not think that was the situation you were trying to achieve?——I said that we had not heen concerned to resist a definite trend in the movement of market prices; I think that would cover hoth those aspects.

1846. Does that mean that, as a matter of policy, you would not use the operations of the Issue Department deliberately to establish any long-term rate that you thought appropriate?——I said last time that we would "occasionally give a lead and steady the market when it needed time to consider new circumstances", or something like that.

1847. But that is a temporary thing?——Yes; though, as I tried to explain, the temporary action might have some rather longer than purely temporary effect. We have always found in these market things that it is important where the market settles after the first reaction to some change in the circumstances; a lead does create some suggestion where the thing might settle, or in which direction it might go. It is not permanent, obviously, but it is not only concerned with what happens today; it does affect what happens tomorrow and next week perhaps.

1848. *Professor Sayers*: What are the reasons the Bank has against this deliberate driving down of the price, whether it is desirable from the point of view of funding or for wider purposes? When you say that "it would greatly damage the Government's credit", what effect have you in mind there?——Put briefly, that if we have just issued a new stock at, let us say, 100, and we then proceed actively to sell it down ourselves to 95, we bave largely by our own direct actions on that security forced a book loss of five points on the people who took the security at 100.

1849. But suppose that your operator sells a short bond or a long bond, even a Treasury Bill, at today's prices, and then on Thursday you put the Bank Rate up, say, from 7 to 9 per cent., you impose by that action a book loss on that person to whom you sold today, do you not?——It probably is that way, on the very shorts. notably; but not always on the longer bonds, for reasons which I have given already.

1850. But it is going to influence the holders of the bonds?——It is going to influence them, hut that is only one part of the story; as we bave tried to illustrate, the market depends more on the general view of the success of anti-inflationary measures. There have been times when the rise in the Bank Rate has actually steadied the long bond market.

1851. That is from day to day; would you not agree that the yield of long term bonds now is appreciably higher than it was three years ago, largely because the Bank Rate has gone up by a very considerable margin?——I would not put that as the first reason myself. I would put as the first reason that the public bas formed the opinion over these years that inflation was gaining ground.

1852. Suppose that instead of putting the Bank Rate up over the last years from $3\frac{1}{2}$ to 7 per cent. you had held it at $3\frac{1}{2}$ per cent., would not the yield on long term bonds be appreciahly lower today?——I would not at all guarantee that. It depends on so many other factors. My own judgment would be that, if we had held the Bank Rate at $3\frac{1}{2}$ per cent. and had not put it up to 7 per cent., inflation would have gathered momentum much more than it has done, and the general view about gilt-edged securities would be a good deal worse than it is.

1853. That is supposing that you would not have been able to moderate the inflation, to the extent it has been moderated, by other measures?——Exactly.

1854. Is not that a large assumption?——I make the assumption that the higher Bank Rate has contributed very considerably to the effective anti-inflationary measures. I am not trying to dispute the argument that on the whole a rise in Bank Rate, and the consequent rise in short term rates, tends to work through to the long term rate.

1855. For some holders of Government securities the impact of loss when the Bank Rate goes up is very serious; a discount house, to take an obvious case. Does that damage Government credit in this sense?——No, it does not. It is perhaps a little difficult to say why. I see a definite difference between taking measures in other fields, including the Bank Rate and general Government fiscal policy and all sorts of economic policy, and actually selling Government long term securities, where we are definitely operating immediately on a particular sort of asset which we have recently sold to the public, and which we are hoping shortly again to sell to the public.

1856. It operates in a similar way in your sales of Treasury Bills from day to day; the Bank Rate will very definitely affect the Treasury Bill rate. You impose a loss on all holders of Treasury Bills?——I accept that, but that is the recognised play of the money market. There is never any criticism, from the point of view that I am talking about, of affecting prices in the short term market through the play of the Bank Rate, any more than of affecting them through the play of fiscal measures, or any other measures the Government might take.

1857. If people recognised that a movement of long term rates was desirable from the point of view of economic policy, would you equally have an objection to operating directly in the long term market for the purpose of moving these rates?——I should still object, because I think that, if you sell down a long term security, you are directly depriving the holder of value; and you are threatening to do it in the future, which is even more disturbing to me.

1858. Is there not an argument the other way: if you are imposing a loss of this kind on the holder of a Treasury Bill, that is a loss that may come home to roost very quickly because he may have bought it with a view to the possibility of having to unload it before its maturity; but if a person buys long term securities he buys them, presumably, as a long term investment: what happens to the price tomorrow does not matter nearly as much to him as a change of price matters to a financial institution that is dealing only with short term?——The holder of Treasury Bills will, of course, get repaid the full value on maturity very shortly afterwards, whatever happens.

1859. Why is the one transaction objectionable and the other not?——The Treasury Bill and short bond market is a technical market, where these things are clearly understood. There is a tremendous lot in all that of swings and roundabouts; people think that if it goes against them one day it will come back another day, and that is all part of a recognised procedure. I have never heard it alleged by, for example, the discount market, that there was any impropriety, in the sense in which I have been using the idea, in taking action which had a depressing effect on short term bonds. They regard that as a perfectly proper operation; they are in fact all the time bearing that in mind in their tender prices. It is one of the things they are thinking about. It is certainly not one of the things the institutional or public investor is thinking about, in the sense in which the short term market are reckoning with these possibilities.

1860. He is reckoning on payment in full at maturity, and that is not affected by this procedure?——*Mr. Cobbold*: But in the case of the longer stocks it is a long time away; payment at maturity is extremely important but people are apt to look at the values in between.—*Mr. O'Brien*: That is not the only point. You buy a security at 100 when it is offered by the Government and, as you say, if you intend to hold that security until maturity you do not suffer any loss from any intervening reduction in market price. But if, shortly after you bought it at 100, you found someone else buying it at 92 or 93 your confidence would be very seriously reduced. We cannot afford to impair people's confidence.

1861. *Chairman*: But the Issue Department is in fact selling at the current market price, not at 100. If the market is falling, and the Issue Department has taken up whatever the appropriate proportion is, you would find the Issue Department in the course of the next few months selling below the issue price?——*Mr. Cobbold*: But at market prices; that loss has been established by other reasons and not in any way by the Issue Department's activity.—*Mr. O'Brien*: There is a clear distinction between on the one hand selling existing stocks at whatever the market price may be and on the other hand offering new stock at par and then shortly afterwards selling it much cheaper.

1862. *Professor Sayers*: I am thinking about the possibility of varying sale prices of existing stocks, not about the issue of new stock. I did not think this passage referred to the issue of new stock. I can see the force of the argument the Governor has put, as an argument for a general policy of maintaining a considerable degree of stability in the gilt-edged market; but is not that a policy that would abjure all but very limited uses of interest rate policy, including Bank Rate policy, for the purpose of economic control?——*Mr. Cobbold*: It might in certain circumstances involve the exact contrary. It might involve the Government in using public funds to hold the price and supporting the price on a very large scale.

1863. It might. There are arguments, which you have been putting, for maintaining a quite considerable stability in the market. But the market does fluctuate; in my lifetime I have seen Consols at 91 and at 44, with very considerable variations in between. Given that, and given that those variations are brought about partly by the use of other weapons by the central bank, is there really any objection to this procedure, if it were once recognised as proper procedure for a central bank?——I think that if that was once recognised the general view towards Government securities would become very much more discouraged than it already is. It is not always recognised what a delicate plant the long-term Government security market has been at times over recent years. I do not think I should be overstating my own view, which may be right or wrong, in saying that if we had done this heavily we might have really made the situation very difficult indeed.

1864. I can see that. But does it follow that in moving the Bank Rate you should be very careful not to move it so far as to disturb appreciably the level of the long-term market?——I have to go back to the fact that I regard Bank Rate movements as part of the general financial and economic influence on the public view of long-term Government securities.

1865. You think people should swallow the Bank Rate?——I think people should, and do, swallow the Bank Rate.

1866. *Chairman*: Your view is that they would generally accept without resentment the fall in the value of medium and long term bonds brought about by a change in the Bank Rate?——Yes. I think the resentment is more apparent when they feel that nothing is being done about inflation, that Government securities are being allowed to drift, and that all the talk about equities and the general bias against fixed interest stock is being allowed to go on unchecked. In some senses I think there is more resentment about not doing something than about doing something about the Bank Rate. I have generally found that among the principal sort of people who would hold long term securities; for example on the last instance of the 7 per cent. rise in the Bank Rate and the parallel measures taken in other fields, to which, as you know, I attach immense importance, I think that the majority of holders of long term gilt-edged greeted it with a sigh of relief rather than a sigh of despair.

1867. They accept a loss of realisable value, because they accept that the action taken is calculated to help the value of their long term and medium term bonds in the more distant future?——I think that is fair.

1868. *Professor Sayers*: It is going to help preserve the purchasing power of the dividends they are going to get and the ultimate redemption value?——Yes.

1869. *Sir Oliver Franks*: In a way, our difficulty is that these arguments which have just been used could, up to a point, be used equally well about Government intervention in the long term market for the same purpose, the long term objective. I wonder whether the point of view which the Bank of England is expressing could be put like this. When the word "impropriety" or any similar word is used, some degree of moral disfavour is imported. Whether you look to direct intervention to lower the level of long term stocks, or at a series of lively operations by means of the Bank Rate, you have the opportunity of producing much the same effects on the general volume of long term stocks over a period, and it is difficult to speak, in terms of moral flavour, of a difference in the attitude. But if you come away from this rather abstract position to things as they occur and the state of people's minds, then it seems to me that what you are saying is this: "The movements of the Bank Rate, with very quick effects on short term money and longer effects on long term money, are matters of tradition and well understood. Therefore when they occur people do not kick against them; they may be sorry it has happened, but they are not aggrieved. On the other hand direct intervention to depress long term bond prices is something which is not well understood in this country and is not, therefore, a part of the tradition. So it would tend to produce a different feeling in people's minds, the feeling, say, of being aggrieved." In one case tradition and the understanding of what is being done contribute to make it acceptable, and in the other they do not; so that the impropriety really hinges on tradition and the state of people's minds rather than on the nature of the action. Is that fair?——I would accept quite a bit of that, but not by any means the whole. I do not wish to put too much weight on the abstract morality of this. What you say about the difference between the traditional reactions to the one type of operation and those to the other is true, and I accept that as part of the argument. But I do not accept that they have the same effects, or are likely to have the same effects, because I think the degree of difference is likely to be very much greater if you are selling heavily. Perhaps I may put it another way. It seems to me an extremely difficult conception that it could be easily accepted by the public, including the institutional holders of long term securities, that the authorities should operate directly to depress the market price when they thought it right in the short term interest to do so. I am perhaps even more concerned about the effect for the future. If we once did this in a big way, for example, if we sold Consols down to 40, as they came back to 60 nobody would have any guarantee that we were not going to do precisely the same thing to force them down a long way again. I believe that in the course of time that would react very definitely indeed on the market view of long term securities. There are not nearly the same swings and roundabouts as in the short term market, where the whole thing is really quite different from that point of view. But I accept a good deal of what you said.

1870. The question that arises out of this is what powers the authorities have over the long-term rate. For the sake of argument let us assume that there may be a period of capital famine in the world; then possibly the ability to deal with the price of long-term money as well as its quantity might be very important. How is it done?——We take the view that the supply and demand has a pretty big influence on the price. I accept the view, as I have already accepted from Professor Sayers, that the Bank Rate tends to work through to the longer term.

1871. *Mr. Woodcock*: Are you saying in effect that in this respect the Bank Rate is more an effect than a cause?——I do not think so, no. I think it works through; but supposing you raise the Bank Rate from 5 per cent. to 6 per cent. you can forecast almost exactly what effect that is going to have on a bond maturing within six months or one year, or up to four years probably, because it is going to have a pure money market effect on those bonds. You could not forecast exactly what effect it would have on a bond maturing in, say, thirty years. We use the Bank Rate in order to produce different climates and changes directly in short-term rates; and our experience is that they tend over a period to work through into the long-term structure as well.

1872. *Professor Sayers*: Supposing there is a state of capital famine which is becoming more acute, the effect of that, I would say, would be to make the world more inflationary. I should expect that, without anybody doing anything particular about it, to drag up the level of interest rates, as an effect of the "supply and demand situation". What are the monetary authorities to do in such a state? Are they just to stand by and raise the Bank Rate when they cannot help themselves and the drag of the market has become too much for them? Or are they to try to moderate the inflation by hastening the rise in interest rates? And if the interest rates that are the most relevant for the purpose of checking the inflationary process are the long-term rates, why not get people used to your operating on the long-term rates just as they are used to your operating on the short-term rates?——*Mr. Mynors*: Your suggestion, if I understand it, is that you get your capital shortage reflected in the price of gilt-edged securities sooner or later so why not hasten it if you can, and you assume that, if you artificially depress the price of gilt-edged and so increase the yield of gilt-edged, you will have a correspondence between that and the movement of the price at which you can raise equity capital? In other words, you are assuming a fairly close interlocking of the different parts of the capital market.—*Professor Sayers*: Some, but not necessarily a very close one.—*Mr. Mynors*: I should have thought that the objections to crying "stinking fish" in terms of Government securities, which the Governor has outlined, would still apply. There is a difference between exercising a general influence on the market situation and leaving people who are in business to sort it out for themselves as far as possible, and operating on a specific range of securities held by a definable list of people, as it were. When market forces are operating prices will certainly fluctuate considerably, but the man who is in the market is constantly making a judgment of what he and his colleagues are going to do, and people have the power to protect themselves by taking such action as is open to them. If we were artificially to attack the price of a particular range of securities that is not a thing that the man who is expert in market behaviour and the likely trend of events could forecast unless he had inside knowledge of the way the minds of the authorities were working.

1873. *Professor Cairncross*: I am perplexed by what you mean by monetary policy. I have always assumed it to mean operations to control interest rates, either short term or long term. Now the more you attempt to stabilise the long-term rates the more you take the sting out of the short-term rates. It is obviously highly desirable to stabilise long-term rates if you can, but if you want them to have an effect you have to let them move. What you are saying now, as I understand it, is that you believe in operating at the short end of the market, you think that is an inevitable part of legitimate monetary policy, but that you do not believe in intervention directly on long-term rates and transactions in bonds other than to keep long-term rates from changing about too abruptly. Surely, you are anyhow deliberately influencing the judgment of the people who deal in the market in order to alter long-term rates. Or is the view now put to us that monetary policy should be restricted to the movement of the short-term rate without regard to consequences at the other end of the market?——*Mr. Cobbold*: No, that is not the view.

1874. Immediately you seek to influence long-term rates then you are making that a part of your policy, and the public must take account of it?——Certainly; and we work through general measures, including Bank Rate measures, fiscal measures and every other measure of Government policy.

1875. Is this not part of monetary policy?——Bank Rate and its influence on the short-term rate is certainly part of monetary policy.

1876. The more you seek to influence long-term rates to a degree which you have clearly in your minds, the more you set people in the market speculating on the precise degree of change you are trying to effect in the long-term market. This does not seem very materially different from operating on the price of bonds directly. Take the

opposite case; in 1932 there was a conversion operation which altered the price of bonds very substantially in an upward direction. Was that an artificial movement?——I do not know whether you would call it artificial or not. It was absolutely different in kind and character from what we have been discussing about deliberate sales of government securities to bring the price down.

1877. Let me ask the question which seems to me to go to the root of this: do you at any time have in your minds a long-term rate of interest that you think is appropriate as part of the monetary policy being pursued?——We are perhaps a little more interested in the trend than in the absolute level; but we are certainly very much interested in the level as well as in the trend of the long-term rate.

1878. You do not regard the long-term rate in itself as of any importance, except in relation to the burden on the Treasury?——I certainly regard it as extremely important.

1879. If it is a regulator of activity, is it not the height of the rate of interest and not its trend that matters?——I would not have thought so.

1880. In what way does the trend in the long-term rate influence the market?——People are interested, in making plans ahead, as to the likely rates they are going to borrow at later on, as well as the rates they are going to borrow at here and now.

1881. Is there not in your mind a rate at any point of time which you would like to see established in the market?——I repeat that I am a little more interested in the trend than in the exact level of the rate, but I am certainly interested in the level of the rate at any time.

1882. *Sir Oliver Franks*: But there is, for example, a long-term rate at which the building of private houses probably becomes difficult if not impossible; is that not a function of the rate rather than the trend?——I would say, of the rate and the trend. If there was a general expectation that it was coming down fairly shortly it would have much less discouragement than if there was a general feeling it was likely to stay where it was.

1883. *Professor Cairncross*: If you are trying to influence long-term rates by movements in Bank Rate, you run the risk of having to put Bank Rate up and keep it up to such a point that long-term rates are below short-term rates. This is an artificial structure of interest rates, but it might persist for some time. It is also a rather costly structure of interest rates, from the point of view of debt charges and of influence on the economic system. If you are not going to operate in the bond market so as to push long-term rates above short-term rates, how do you expect to see the long-term rate move to what would eventually be established?——*Mr. Mynors*: We should not seek to stabilise the long-term rate below the level at which the market would tend to let it settle.

1884. *Professor Sayers*: How can you tell? During the last few years there has been throughout the world a persistent scarcity of capital. That has been dragging interest rates up in this country and elsewhere, and it has been forcing prices up. Put it round the other way, if you like: there has been persistent capital shortage, which has led to a continual rise of prices, and that has dragged up rates of interest. The authorities have wanted to pursue an anti-inflationary policy; that has led to the pushing up of interest rates. They have done this by pushing the short rate up. But the effect of pushing the short rate up is much weakened when we look at the structure of long-term rates; it has therefore been necessary to push the short rate up appreciably beyond the level of long rates, in order to get the level of long rates to a point at which they were beginning to bite on the inflationary situation. That has been, on the face of it, the most costly possible policy for Government debt operations. Would not an alternative seem to be (though it is one which is precluded by the considerations you are putting forward) to put the long rates up more directly, more quickly and with more bite on the inflationary situation and not at so great a cost to Government debt operations? Could not the structure of rates as between short and long have continued to be more normal?——*Mr. Cobbold*: I thought I heard you earlier to say that it could be argued that monetary operations had been so conducted as to keep the long-term rate down, but I do not think that was the point you were developing in your subsequent words. I want it to be quite clear that we do not set out to intervene in a trend. We definitely did not set out with any idea of stabilising rates in a sense of holding them level.—*Mr. Mynors*: As I understand it, Professor Sayers is not now saying that the authorities are seeking to stabilise rates, but only that they were not pushing them up as much as the inflationary situation would have suggested. Does not this raise the question whether action on long-term interest rates taken by itself in the conditions of the last few years would have satisfied people that the shortage of capital was going to be dealt with and that the inflationary situation, which has given rise to it and which it in turn has encouraged, was being brought under control? I think there is an assumption that by sufficiently drastic action on interest rates you could have done the thing by monetary means alone; we should regard interest rate policy as having a part to play alongside other engines of general economic policy.

1885. *Chairman*: Mr. Governor, I think the essence of what we are saying to you is this, and I would like you to treat it in your answer as widely as you like. Did you not have potentially at your hand in recent years an instrument for establishing a long-term rate other than the ones which you have used? If you agree that there was such an instrument, that is operations in the long-term market, would it not have been wise to use it in order to achieve what I think is the accepted purpose, to establish such a rate in the long-term market as would be appropriate to deal with the inflationary situation brought about by the shortage of capital?——*Mr. Cobbold*: I can answer that quite briefly, Mr. Chairman: we did have such an instrument in our hands, because we could have flogged Government securities very hard indeed; we did not think it wise to use it in that manner.

1886. If I understand your view as to why it was not wise, it was that you thought that the resentment of those persons who were holders of long-term bonds would be of such an order that it would do vital harm to the possibility of raising large sums for the Government on long-term issues in the future?——I am here giving a personal opinion on an important matter, which I might wish to check with some of my colleagues. My personal view is that, if we had pursued the policy suggested of selling Government securities down hard—and I must come back to the words "in order to drive down the market price", because I think that is what we are talking about now—, I think I would go so far as to say that, if we had done that on more than two or three occasions, I should have reckoned to have made it practically impossible for succeeding Chancellors of the Exchequer and my successors to run the public finances of this country properly.

1887. Even though it was reasonably plain that the reason for the action was to establish a long-term rate of interest that was needed for the general economic health of the country?——Yes, even doing one's best to make it plain that "it hurts me more than it hurts you."

1888. *Sir John Woods*: Are you in effect saying that the effect of using this instrument of direct operation on the long-term rate, if pursued a number of times and vigorously, would lead not only, as Sir Oliver said, to people being aggrieved but really to a great loss of confidence in gilt-edged as a desirable investment?——Certainly.

1889. The reason for your saying that, if I understood your earlier answer, was that operating on the short rate is an understood thing and a tradition among people working short-term money. It is still difficult to see why over a period of time people should not get accustomed to the idea of operating direct on the long-term rate if it is made quite clear that the purpose of so doing is the same purpose, namely, in the present context, to fight inflation?——I would come back there to the very great distinction between the professional and technical monetary operations of the extreme short-term end, where Bank Rate is immediately and directly effective, and the quite different investment end of the long-term securities. At the very short-term end there is, as I said before, a great deal of swings and roundabouts in all

this. With one movement of Bank Rate the technical monetary operators, although they have had this in mind and will probably have done their best to cover themselves, know that there will be a certain loss; they know over long experience that when it moves the other way (this is all short-term operations of course) they will probably recoup that loss. They are thinking all the time about Bank Rate, and about the influences on monetary policy of the authorities, in making their calculations. I think I can say categorically that the movement of Bank Rate and its repercussions in the short-term market do not affect the general credit of Her Majesty's Government or their possibilities of borrowing. It would never occur to my mind, if I may put it in a slightly different way, that because one involved the discount market in a loss one week it would make it more difficult over the next two or three weeks to get them to cover the tender for Treasury Bills or carry on their investment policy generally. When you get to long-term securities you are in an entirely different field of people who are investing their money with belief in the good faith of the borrower, who is the Government. Obviously I am not going to try and make a case that, if we were to depress long-term securities by ½ per cent. or 1 per cent. once in three years, that is going to make any significant difference; I am talking about doing this vigorously as a matter of policy and repeating it two or three times. Here again perhaps I may give a personal view, to make what I have in my mind a little clearer. I am a trustee of a great number of large funds of one sort and another. If this had been done two or three times by myself and my colleagues in another capacity, I would feel myself required in my capacity as a trustee to review my whole attitude towards gilt-edged securities, and probably to get out when I saw the next chance to get out; and I believe a great number of other people would feel in the same position.

1890. I see your point of view very clearly on the question of swings and roundabouts; but, if you operated on the long-term rate for a specific purpose, the same purpose for which you operate on the present short-term rate, would not there be swings and roundabouts?——A thirty year swings and roundabouts is very different from a three year or six months swings and roundabouts.

1891. You would hope to deal with the inflationary position in a year or two, and thereafter the prices of long-term securities would come back again?——I have the graph in front of me covering the movements of long-term prices from 1945 to the end of 1957; and there have been a lot of swings and not much roundabouts. In the short-term market there has been quite a bit one way or the other.

1892. *Professor Sayers*: This is a period in which you have abjured this weapon. Are we not faced with this attitude of the trustee as you have just described it, as a result of the gilt-edged market having been encouraged to fall in this particular way? If five years ago there had been one steep step and perhaps one or two years ago another step, is it not possible that trustees would have liked the ensuing state of the gilt-edged market better than they like it today? I am putting this in rather an extreme way, I am afraid, but I should welcome your comment on that?——I can only say that it is a matter of judgment, and my own falls the other way.

1893. *Mr. Woodcock*: I understood you to say that when the money market is affected by operations on the short end, including Bank Rate, any loss on the part of an owner of bonds is compensated for by the confidence he has that inflation is being tackled. It still seems to me that there is a puzzling question as to why he should not be equally reconciled to operations at the long term end by the knowledge that they were directed towards the same ends?——I think that, if we had to take, say, 10 points off his 100 points by selling securities down, he would feel that he was paying a very direct and immediate price; and as this would only be a very small part of the general climate and body of other measures, I think he would feel that he was being singled out very much, and perhaps not getting the full 10 per cent. benefit, which would be very widely spread over the whole area.

1894. *Mr. Woodcock*: Yes, but I gathered that Professor Sayers was arguing not that this should be an isolated operation, but that it would be part of a whole series of operations.—*Professor Sayers*: Yes; I do not believe that one can move the long-term rate about frequently by many steps, and I am afraid I have been arguing all the time on that assumption. As it is, the long-term rate has been moved by many steps and the holder has seen not 10 points but 20 or 30 points off his price. I find it very difficult to believe that pension funds, insurance companies and so on would really be more upset by a very occasional definite step rather than a continual sagging in the market during the years, which has not yet produced the desired effect.——I think we come back to the Deputy Governor's point, that we regard the interest rates as one of a number of things.

1895. *Sir Oliver Franks*: May there not be a causal link between this view that you must regard the interest rate, and indeed monetary policy, as one of a number of things, and your unwillingness to operate directly on the long-term rate? If, for example, there is strong inflation and if that manifests itself essentially in an investment boom, and if one is not willing to operate on the long-term interest rate directly but only indirectly and by diminished effect through the short-term interest rates, then it seems to me that it must follow that, if adequate restraints are to be put upon the investment boom, other means than monetary policy must be called in, whether fiscal policy or direct controls. I am speaking purely hypothetically; but may it be that these consequences would not follow with the same necessity but for the inability, for reasons shown, to operate directly and substantially on the long-term interest rate?——My view is that they would follow very largely even then, though possibly to a lesser extent. Might I just come back to one other point, because in this discussion we seem to have lost track of it a little bit: funding is always one important side of this. We have set out our view, which I know is arguable, that this would make funding more difficult rather than less difficult. That has always been one of the factors in our minds.

1896. *Chairman*: Would it not be equally possible in the case of funding to make it plain that any policy pursued was done in order to reduce an unhealthy amount of floating debt, which would be the purpose of your operation in that case?——Our view is that generally speaking the possibilities of funding on a falling or depressed market are very much less than they are on a steady or gently rising market.

1897. *Professor Sayers*: You can force the interest rate up but you cannot force people to buy?——No.

1898. *Professor Cairncross*: The distinction between the short market and the long market is of course affected by the capital loss involved in two cases. In one case you were referring to a possible loss of 10 per cent. in bonds; nothing like a 10 per cent. loss could possibly occur on Treasury Bills?——No.

1899. *Chairman*: Then there is the introduction to Paper 9* which the Governor gave us last time too; are there any questions on that?——*Sir Oliver Franks*: Would it be fair to say on the introduction to Paper 9 that there is a causal relationship between the inability to resist some net addition to the money supply and the necessity of direct controls, for example, on the banks? If you assume that monetary policy will normally in any strong situation require supplementation, must not the need to come to direct controls arise, if liquidity remains impregnable? Is not the effect of this paper to say that over the five year period it was not really possible to do anything about the essential liquidity of the situation?——Once or twice we have got near it, I should say; and there have been several occasions over periods of months when I would say that the banking system had some, although not violent, liquidity preoccupations.

1900. They got to the stage of selling short bonds?——*Mr. Cobbold*: And taking losses.—*Sir Oliver Franks*: A little.—*Mr. Cobbold*: I would have said that part of the banking system got to the stage of selling some longer bonds, which they did not welcome.

1901. *Chairman*: They were equipped with the means of restoring their liquidity even at some loss?——Yes, certainly. I would entirely accept Sir Oliver's point, if

* See Questions 1817 to 1822.

opposite case; in 1932 there was a conversion operation which altered the price of bonds very substantially in an upward direction. Was that an artificial movement?——I do not know whether you would call it artificial or not. It was absolutely different in kind and character from what we have been discussing about deliberate sales of government securities to bring the price down.

1877. Let me ask the question which seems to me to go to the root of this: do you at any time have in your minds a long-term rate of interest that you think is appropriate as part of the monetary policy being pursued?——We are perhaps a little more interested in the trend than in the absolute level; but we are certainly very much interested in the level as well as in the trend of the long-term rate.

1878. You do not regard the long-term rate in itself as of any importance, except in relation to the burden on the Treasury?——I certainly regard it as extremely important.

1879. If it is a regulator of activity, is it not the height of the rate of interest and not its trend that matters?——I would not have thought so.

1880. In what way does the trend in the long-term rate influence the market?——People are interested, in making plans ahead, as to the likely rates they are going to borrow at later on, as well as the rates they are going to borrow at here and now.

1881. Is there not in your mind a rate at any point of time which you would like to see established in the market?——I repeat that I am a little more interested in the trend than in the exact level of the rate, but I am certainly interested in the level of the rate at any time.

1882. *Sir Oliver Franks*: But there is, for example, a long-term rate at which the building of private houses probably becomes difficult if not impossible; is that not a function of the rate rather than the trend?——I would say, of the rate and the trend. If there was a general expectation that it was coming down fairly shortly it would have much less discouragement than if there was a general feeling it was likely to stay where it was.

1883. *Professor Cairncross*: If you are trying to influence long-term rates by movements in Bank Rate, you run the risk of having to put Bank Rate up and keep it up to such a point that long-term rates are below short-term rates. This is an artificial structure of interest rates, but it might persist for some time. It is also a rather costly structure of interest rates, from the point of view of debt charges and of influence on the economic system. If you are not going to operate in the bond market so as to push long-term rates above short-term rates, how do you expect to see the long-term rate move to what would eventually be established?——*Mr. Mynors*: We should not seek to stabilise the long-term rate below the level at which the market would tend to let it settle.

1884. *Professor Sayers*: How can you tell? During the last few years there has been throughout the world a persistent scarcity of capital. That has been dragging interest rates up in this country and elsewhere, and it has been forcing prices up. Put it round the other way, if you like: there has been persistent capital shortage, which has led to a continual rise of prices, and that has dragged up rates of interest. The authorities have wanted to pursue an anti-inflationary policy; that has led to the pushing up of interest rates. They have done this by pushing the short rate up. But the effect of pushing the short rate up is much weakened when we look at the structure of long-term rates; it has therefore been necessary to push the short rate up appreciably beyond the level of long rates, in order to get the level of long rates to a point at which they were beginning to bite on the inflationary situation. That has been, on the face of it, the most costly possible policy for Government debt operations. Would not an alternative seem to be (though it is one which is precluded by the considerations you are putting forward) to put the long rates up more directly, more quickly and with more bite on the inflationary situation and not at so great a cost to Government debt operations? Could not the structure of rates as between short and long have continued to be more normal?——*Mr. Cobbold*: I thought I heard you earlier to say that it could be argued that monetary operations had been so conducted as to keep the long-term rate down, but I do not think that was the point you were developing in your subsequent words. I want it to be quite clear that we do not set out to intervene in a trend. We definitely did not set out with any idea of stabilising rates in a sense of holding them level.—*Mr. Mynors*: As I understand it, Professor Sayers is not now saying that the authorities are seeking to stabilise rates, but only that they were not pushing them up as much as the inflationary situation would have suggested. Does not this raise the question whether action on long-term interest rates taken by itself in the conditions of the last few years would have satisfied people that the shortage of capital was going to be dealt with and that the inflationary situation, which has given rise to it and which it in turn has encouraged, was being brought under control? I think there is an assumption that by sufficiently drastic action on interest rates you could have done the thing by monetary means alone; we should regard interest rate policy as having a part to play alongside other engines of general economic policy.

1885. *Chairman*: Mr. Governor, I think the essence of what we are saying to you is this, and I would like you to treat it in your answer as widely as you like. Did you not have potentially at your hand in recent years an instrument for establishing a long-term rate other than the ones which you have used? If you agree that there was such an instrument, that is operations in the long-term market, would it not have been wise to use it in order to achieve what I think is the accepted purpose, to establish such a rate in the long-term market as would be appropriate to deal with the inflationary situation brought about by the shortage of capital?——*Mr. Cobbold*: I can answer that quite briefly, Mr. Chairman: we did have such an instrument in our hands, because we could have flogged Government securities very hard indeed; we did not think it wise to use it in that manner.

1886. If I understand your view as to why it was not wise, it was that you thought that the resentment of those persons who were holders of long-term bonds would be of such an order that it would do vital harm to the possibility of raising large sums for the Government on long-term issues in the future?——I am here giving a personal opinion on an important matter, which I might wish to check with some of my colleagues. My personal view is that, if we had pursued the policy suggested of selling Government securities down hard—and I must come back to the words "in order to drive down the market price", because I think that is what we are talking about now—, I think I would go so far as to say that, if we had done that on more than two or three occasions, I should have reckoned to have made it practically impossible for succeeding Chancellors of the Exchequer and my successors to run the public finances of this country properly.

1887. Even though it was reasonably plain that the reason for the action was to establish a long-term rate of interest that was needed for the general economic health of the country?——Yes, even doing one's best to make it plain that "it hurts me more than it hurts you."

1888. *Sir John Woods*: Are you in effect saying that the effect of using this instrument of direct operation on the long-term rate, if pursued a number of times and vigorously, would lead not only, as Sir Oliver said, to people being aggrieved but really to a great loss of confidence in gilt-edged as a desirable investment?——Certainly.

1889. The reason for your saying that, if I understood your earlier answer, was that operating on the short rate is an understood thing and a tradition among people working short-term money. It is still difficult to see why over a period of time people should not get accustomed to the idea of operating direct on the long-term rate if it is made quite clear that the purpose of so doing is the same purpose, namely, in the present context, to fight inflation?——I would come back there to the very great distinction between the professional and technical monetary operations of the extreme short-term end, where Bank Rate is immediately and directly effective, and the quite different investment end of the long-term securities. At the very short-term end there is, as I said before, a great deal of swings and roundabouts in all

this. With one movement of Bank Rate the technical monetary operators, although they have had this in mind and will probably have done their best to cover themselves, know that there will be a certain loss; they know over long experience that when it moves the other way (this is all short-term operations of course) they will probably recoup that loss. They are thinking all the time about Bank Rate, and about the influences on monetary policy of the authorities, in making their calculations. I think I can say categorically that the movement of Bank Rate and its repercussions in the short-term market do not affect the general credit of Her Majesty's Government or their possibilities of borrowing. It would never occur to my mind, if I may put it in a slightly different way, that because one involved the discount market in a loss one week it would make it more difficult over the next two or three weeks to get them to cover the tender for Treasury Bills or carry on their investment policy generally. When you get to long-term securities you are in an entirely different field of people who are investing their money with belief in the good faith of the borrower, who is the Government. Obviously I am not going to try and make a case that, if we were to depress long-term securities by ½ per cent. or 1 per cent. once in three years, that is going to make any significant difference; I am talking about doing this vigorously as a matter of policy and repeating it two or three times. Here again perhaps I may give a personal view, to make what I have in my mind a little clearer. I am a trustee of a great number of large funds of one sort and another. If this had been done two or three times by myself and my colleagues in another capacity, I would feel myself required in my capacity as a trustee to review my whole attitude towards gilt-edged securities, and probably to get out when I saw the next chance to get out; and I believe a great number of other people would feel in the same position.

1890. I see your point of view very clearly on the question of swings and roundabouts; but, if you operated on the long-term rate for a specific purpose, the same purpose for which you operate on the present short-term rate, would not there be swings and roundabouts?——A thirty year swings and roundabouts is very different from a three year or six months swings and roundabouts.

1891. You would hope to deal with the inflationary position in a year or two, and thereafter the prices of long-term securities would come back again?——I have the graph in front of me covering the movements of long-term prices from 1945 to the end of 1957; and there have been a lot of swings and not much roundabouts. In the short-term market there has been quite a bit one way or the other.

1892. *Professor Sayers*: This is a period in which you have abjured this weapon. Are we not faced with this attitude of the trustee as you have just described it, as a result of the gilt-edged market having been encouraged to fall in this particular way? If five years ago there had been one steep step and perhaps one or two years ago another step, is it not possible that trustees would have liked the ensuing state of the gilt-edged market better than they like it today? I am putting this in rather an extreme way, I am afraid, but I should welcome your comment on that?——I can only say that it is a matter of judgment, and my own falls the other way.

1893. *Mr. Woodcock*: I understood you to say that when the money market is affected by operations on the short end, including Bank Rate, any loss on the part of an owner of bonds is compensated for by the confidence he has that inflation is being tackled. It still seems to me that there is a puzzling question as to why he should not be equally reconciled to operations at the long term end by the knowledge that they were directed towards the same ends?——I think that, if we had to take, say, 10 points off his 100 points by selling securities down, he would feel that he was paying a very direct and immediate price; and as this would only be a very small part of the general climate and body of other measures, I think he would feel that he was being singled out very much, and perhaps not getting the full 10 per cent. benefit, which would be very widely spread over the whole area.

1894. *Mr. Woodcock*: Yes, but I gathered that Professor Sayers was arguing not that this should be an isolated operation, but that it would be part of a whole series of operations.—*Professor Sayers*: Yes; I do not believe that one can move the long-term rate about frequently by many steps, and I am afraid I have been arguing all the time on that assumption. As it is, the long-term rate has been moved by many steps and the holder has seen not 10 points but 20 or 30 points off his price. I find it very difficult to believe that pension funds, insurance companies and so on would really be more upset by a very occasional definite step rather than a continual sagging in the market during the years, which has not yet produced the desired effect.——I think we come back to the Deputy Governor's point, that we regard the interest rates as one of a number of things.

1895. *Sir Oliver Franks*: May there not be a causal link between this view that you must regard the interest rate, and indeed monetary policy, as one of a number of things, and your unwillingness to operate directly on the long-term rate? If, for example, there is strong inflation and if that manifests itself essentially in an investment boom, and if one is not willing to operate on the long-term interest rate directly but only indirectly and by diminished effect through the short-term interest rates, then it seems to me that it must follow that, if adequate restraints are to be put upon the investment boom, other means than monetary policy must be called in, whether fiscal policy or direct controls. I am speaking purely hypothetically; but may it be that these consequences would not follow with the same necessity but for the inability, for reasons shown, to operate directly and substantially on the long-term interest rate?——My view is that they would follow very largely even then, though possibly to a lesser extent. Might I just come back to one other point, because in this discussion we seem to have lost track of it a little bit: funding is always one important side of this. We have set out our view, which I know is arguable, that this would make funding more difficult rather than less difficult. That has always been one of the factors in our minds.

1896. *Chairman*: Would it not be equally possible in the case of funding to make it plain that any policy pursued was done in order to reduce an unhealthy amount of floating debt, which would be the purpose of your operation in that case?——Our view is that generally speaking the possibilities of funding on a falling or depressed market are very much less than they are on a steady or gently rising market.

1897. *Professor Sayers*: You can force the interest rate up but you cannot force people to buy?——No.

1898. *Professor Cairncross*: The distinction between the short market and the long market is of course affected by the capital loss involved in two cases. In one case you were referring to a possible loss of 10 per cent. in bonds; nothing like a 10 per cent. loss could possibly occur on Treasury Bills?——No.

1899. *Chairman*: Then there is the introduction to Paper 9* which the Governor gave us last time too; are there any questions on that?——*Sir Oliver Franks*: It would be fair to say on the introduction to Paper 9 that there is a causal relationship between the inability to resist some net addition to the money supply and the necessity of direct controls, for example, on the banks? If you assume that monetary policy will normally in any strong situation require supplementation, must not the need to come to direct controls arise, if liquidity remains impregnable? Is not the effect of this paper to say that over the five year period it was not really possible to do anything about the essential liquidity of the situation?——Once or twice we have got near it, I should say; and there have been several occasions over periods of months when I would say that the banking system had some, although not violent, liquidity preoccupations.

1900. They got to the stage of selling short bonds?——*Mr. Cobbold*: And taking losses.—*Sir Oliver Franks*: A little.—*Mr. Cobbold*: I would have said that part of the banking system got to the stage of selling some longer bonds, which they did not welcome.

1901. *Chairman*: They were equipped with the means of restoring their liquidity even at some loss?——Yes, certainly. I would entirely accept Sir Oliver's point, if

* See Questions 1817 to 1822.

this very big change in policy was purely the influence of a new Chancellor or that there arose a change in Bank Rate as a result of a long continued view of the Bank that a move in this direction should be made, and then certain technical changes just happened to coincide?——You get me on to rather difficult ground there. I do not think you would wish me to go too closely into relations and discussions with Ministers of the Crown. On the other hand I think it would be proper to say, on this general matter of policy about the rigidity of short term rates, that the Bank's view had been consistent for some time past, and there had been a divergence of opinion between Her Majesty's Government and the Bank of England for some years preceding the changes made in November 1951.

1937. *Sir John Woods*: In relation to paragraph 11, would you explain to us why Treasury Deposit Receipts were embarrassing for day to day adjustment?——*Mr. Cobbold*: That is one of the things we shall cover in more detail when we come to Paper 13, so perhaps a detailed essay might be reserved till then; but we could certainly give you some of the main objections without going into a lot of technical detail. My great objection to Treasury Deposit Receipts in peace time is that they are the easiest method of resiphoning from the banking system into Government the money which is intended to go back into expenditure as quickly as it can get there. That was the whole purpose of Treasury Deposit Receipts in war time. From the point of view of general policy today it does not seem to me to be a good idea to make that process easier than it is at present. That is my main objection, but there are a great number of others from the point of view of relations with the banks and technical arrangements. It was a voluntary arrangement in time of war which everyone subscribed to willingly; I think it would be very different now.—*Mr. O'Brien*: It was a device created during the war to simplify, at a time when the Government was the chief spender, the borrowing back from the banking system of the money which the Government had spent. Treasury Deposit Receipts were created of five, six and seven months' duration, and the amount required from the banks was decided upon each week (a very large sum, of course, much larger than would normally have been obtained through the ordinary tender Treasury Bill mechanism) and the banks were told the amount they would be required to provide. Not all the banks were included in this arrangement, only the banks principally concerned, because of the great technical difficulties of including everybody. There is no virtue in including the small people in connection with so large a total anyway.—*Sir Oliver Franks*: No administrative virtue?—*Mr. O'Brien*: No administrative virtue. They agreed among themselves how they should divide up the amount each week. They took that amount and held the Treasury Deposit Receipts. The certificates could also be used to finance subscriptions, by the banks themselves or their customers, to the national loans issued by the Government during the war.

Treasury Deposit Receipts were supposed to be outside the banks' normal liquid assets. In fact, as the years went by, the normal liquid assets of the banks went down far below the traditional 30 per cent.; it was clear that Treasury Deposit Receipts were being regarded as part of the banks' liquid assets. That is an important point in connection with any suggestion that they might be revived. After the war, as Government assumed a more normal position in the money market, as its requirements were gradually reduced, less and less of these Treasury Deposit Receipts were required. Eventually it was decided, as part and parcel of returning to the more freely operating monetary system, that this artificial mechanism was no longer needed.

1938. *Chairman*: They were interest bearing?—*Professor Cairncross*: But non negotiable?——Yes.

1939. *Professor Sayers*: What about the "embarrassment to adjustment"?——It is more embarrassing to have a system under which you ask certain people voluntarily to partake in a special financing arrangement for Government as against a mechanism where you merely invite the market to subscribe to what the Government offers.

1940. *Sir John Woods*: I am still not quite clear why it is embarrassing to day to day adjustment?—*Sir Oliver Franks*: I should have thought the embarrassment simply related to the distinction between voluntarily imposed and accepted control and market dealing?——Mainly; I think also that there is a rigidity in such a system in that you have to decide each week what you want, and you have to take that. Calculations may be wrong. Things are much easier under our present system.

1941. *Chairman*: Is the embarrassment this: that on the one hand you have to take the monies put in and on the other you cannot be sure you will get the monies you need, because there is a voluntary system?——*Mr. Cobbold*: I think "embarrassment" is related to the fact that we fixed this on a particular day and that embarrassed our subsequent operations during the week. I do not think it meant anything more than that.

1942. *Professor Sayers*: Do you not fix the Treasury Bill issue in the same way?——*Mr. O'Brien*: Yes, but we can cut that down.

1943. You can adjust your Treasury Bill issue just as you like, and you operate in Treasury Bills all the time. This is, therefore, a point that would be relevant if one were suggesting replacement of the entire Treasury Bill issue by Treasury Deposit Receipts, but it is surely not an argument against the use of Treasury Deposit Receipts alongside Treasury Bills?——*Mr. Cobbold*: My memory is that Treasury Deposit Receipts bulked so large during the war that the daily operations handled by the Chief Cashier took a subsidiary place. As a result of the 1951-52 measures, we were bringing normal market dealings back. In my recollection it is pretty clear it would have been more difficult to reinstitute the normal less rigid arrangements in the short term market if we had looked to the Treasury Deposit Receipts as we did during the war.

1944. *Chairman*: We will come back to that on your Paper 13. Paragraphs 12? 13? 14?——*Sir Oliver Franks*: Will you consider it at any stage relevant, when, for example, dealing with alternative policies and so on, to discuss the importance of hire purchase regulations and whether or not they are superior as a weapon for example to a generalised purchase tax? Is that one of the things you had in mind or not?——No, we had not. I think I have observed earlier that the specific question of hire purchase was and is under discussion by Her Majesty's Government in consultation with ourselves. As I have said, this is one of the subjects on which we are not at all happy that present policies are as they should be.

1945. *Professor Cairncross*: Does this mean you will not submit anything on hire purchase finance?——We have already made a number of references to hire purchase finance. If the Committee would like them further developed we should be ready to give them anything we can.

1946. I should have thought that hire purchase was likely to be an expanding feature of finance to industry. I was not thinking exclusively of restrictions on hire purchase, but more on the role of the commercial banks in hire purchase. There is at least one bank in the country which has a hire purchase subsidiary; there may be others?——I think that question is more for the commercial banks.

1947. *Professor Sayers*: Have you ever expressed to any of the commercial banks your views on whether the commercial banks should enter this field?——The commercial banks both collectively and separately have frequently asked my views on that subject. I think that is really between me and them.

1948. *Lord Harcourt*: I do not think we have covered the question of hire purchase finance companies in the last three or four years really breaking into the banking field by acceptance of short term deposits. Is that important?——We do not feel entirely happy about the existing control or supervision over deposit-taking by finance companies doing hire purchase business. As I have said the Treasury, in consultation with us, are looking into that actively. That is a Governmental matter.

1949. *Chairman*: We may get more on the hire purchase question from the Board of Trade; but perhaps you could give us more on the point that this may be a new and secondary market for finance. Is it true that these finance organisations are not solely concerned with financing hire purchase but are a supplementary source of finance generally?——*Mr. Mynors*: Our information is

extremely short on that subject. I should say that that kind of thing is going on to an increasing extent, but it is very difficult to tell how much the scale of it is.—*Mr. Cobbold*: My impression is that the scale is not enormous at the moment but might increase considerably, particularly if other arrangements with the clearing banks were maintained in their present form.

1950. *Sir Oliver Franks*: One of the things which I do not understand at all well, and which I suspect ought to be understood, is the extent to which, when restrictions are placed on credit, more particularly bank credit, unexpected effects follow. It usually happens, when you dam a flow of water, that as the water piles up it begins to seep through in other directions. Similarly, there are a great many other ways of extending credit than bank credit. For example, credit is, I suppose, extended by most of the departmental stores in this country; that is one-way traffic between the store and the particular individual. The hire purchase companies stand as it were in an intermediate position between the banks and the department stores. There are a great many other relationships in which credit may be either contracted or expanded; for example, between commercial and manufacturing concerns, where a firm's amount of credit may be greatly expanded or considerably reduced. In the general problems of quantity and velocity of money the amount of credit of these sorts, which move by declination from ordinary bank credit, may be of growing importance. It is not simply a question of what happens with the finance houses. It is also a question of how far the other forms of credit are playing an important part in hindering or promoting whatever the policies of the Government may be from time to time. Has the Bank a broad view on that?——I agree entirely. This is an extremely important field. I would regard the chain of commercial credit as far more important in volume than hire purchase finance companies. I think it is impossible to have reliable figures about that.

1951. *Professor Sayers*: Is it impossible to have useful figures?——*Mr. Mynors*: We certainly have not got them at the moment. I think they would be very difficult to get.—*Mr. Cobbold*: We hear and think a great deal about it. It is much in our minds when we are talking to people and collecting general impressions about the credit squeeze and its working, because we have found that the credit squeeze is passed on from manufacturer through wholesaler to retailer right down the line. This is probably where the credit squeeze is being most effective.

1952. Is it not ironed out to some extent as it is passed on?——Yes, there must be erosion all the time as it passes through. I think that question whether the credit squeeze is being felt right through the chain is very relevant.

1953. *Professor Cairncross*: Do you get any indication of the extent to which funds normally applied to long term purposes are being used for short term credit?——We should have a definite view from time to time at what sort of bracket of maturities insurance companies and investors generally are seeking to lend. We should know, for instance, if there were an easy supply of capital, say, up to five years, but a more difficult supply from five to fifteen.

1954. Would you agree that substantial sums appear to have been switched into short term markets?——Yes; as interest rates move a lot of people take views as to how long they want to be involved at particular rates and when they would like to have their loans repaid.

1955. *Lord Harcourt*: By and large, as regards life insurance companies, the higher the interest rates are the more tendency there will be for them to insist on lending longer with no repayment clause at an early date?——That is certainly the very strong tendency.

1956. Am I right in thinking that whereas the other great acceptors of deposits for relending, that is the building societies, are regulated to some considerable extent by the Registrar of Friendly Societies, the hire purchase finance companies are not regulated in any way?——You are correct.

1957. *Chairman*: In paragraph 18 you tell us that in the first part of 1952 the banks began to sell investments. Do you know on what scale, because this was a falling market?——*Mr. Mynors*: Investments in the quarter January to March, 1952, fell by £31 millions, and in the quarter April to June by £18 millions.

1958. *Professor Sayers*: Was there any maturity during that period that would account for any part of those figures?——I am afraid I cannot answer that without looking it up.*

1959. *Chairman*: Paragraph 20 gives the analysis of the reasons which governed the rise to 4 per cent. in March, 1952. This was an occasion when, by choosing the figure of 4 per cent., if I understand it, you expected to have a direct effect upon the gilt edged market?——*Mr. Cobbold*: It was expected "to help to promote more settled conditions".

1960. That is quite different from an attempt to push prices down; if I follow your treatment of this, you wished the market to think that, in arriving at 4 per cent., they had arrived at something like a plateau, and that now was the time to buy because they would not get better in the foreseeable time ahead.—*Professor Cairncross*: In point of fact there was a rise of yields throughout the whole of the second part of that year?——Yields were down a touch in the second quarter, from February to April; then they started to go up towards June. You will see from paragraph 29 that the price of gilt edged stock fell immediately after the increase in Bank Rate was announced on 11th March; thereafter they rose slowly until mid-April; then from mid-April prices again fell.

1961. *Professor Cairncross*: Do you regard that as a more settled condition?——Temporarily, but not for long.

(Adjourned until 2.15 p.m.)

C. F. Cobbold, Esq., H. C. B. Mynors, Esq., L. K. O'Brien, Esq., and W. M. Allen, Esq., further examined.

1962. *Professor Sayers*: In the middle of paragraph 22 you speak of the alignment of commercial bill rates with those current in financial centres abroad. That made me wonder which rates the Bank considers are the most directly relevant to the movement of short funds in and out of London? Is it the rate of discount on commercial bills or is it the Treasury Bill rate?——*Mr. Cobbold*: Broadly speaking the total cost, including commission and so on, of borrowing on commercial bills in one market or another, which takes different forms, of course.

1963. *Professor Cairncross*: What is meant by "Other Accounts" in paragraph 26?——*Mr. Mynors*: It includes things like items in transit and, I think, various internal balances. The detail of that would be a matter clearly for the clearing banks.—*Mr. Cobbold*: But the vast preponderance of "Advances and Other Accounts" is advances.

1964. *Chairman*: On paragraph 27 and the following paragraphs would it not be true that although credit extended by the banking system to private borrowers fell by over £300 million in the nine months following March, 1952, and in fact over the year 1952-53, there was a very large increase on the other hand in the money lent by the banks to Government on Treasury Bills, and a considerable increase in the fiduciary issue too?——*Mr. Allen*: That is true on that period. In the financial year 1952-53 the net deposits of the clearing banks were raised by some £150 million.—*Mr. Cobbold*: That is one of the periods when one of the points I made in my opening statement to this paper is very clearly demonstrated.

1965. What happens is a shift of the credit given to the private sector to the public sector?——I would have put it more generally: that over the period the credit given to the private sector has been held approximately level within

* See Appendix to Minutes of Evidence.

comparatively small limits, but the credit given to the public sector has gone up very considerably.

1966. *Professor Sayers*: In paragraph 29 there is a reference to the issues of guaranteed stock for the nationalised industries. That operation was in effect an attempt at a funding of bank advances; but in so far as it meant a substitution of Treasury Bills for bank advances, there was no reduction in the total short term borrowing of the Government?——There was no long term funding, to the extent that those Government guaranteed issues were not taken up by the public.

1967. *Chairman*: The advance is taken off the banks by the issue of the stock; in so far as the stock is not taken up by the public it goes into the possession of the Issue Department but as the money has to be found somehow it is raised for the time being again from the public or the banks by Treasury Bills?——Much more from the banking system than the public.

1968. For the future it depends on the progress you make in turning out the stock into the hands of holders and reducing the Treasury bills?——Yes.

1969. *Sir Oliver Franks*: Would it be improper or absurd to consider a system whereby the money required for the long term capital expenditure of nationalised industries would have to be raised long term at whatever might be the right rate, and it would be impossible to float it for the time being on Treasury Bills?——The ideal arrangement in all our minds would be that the corporations should borrow on their own credit, for the periods for which they would borrow in the ordinary course of events if they were private companies.

1970. *Lord Harcourt*: In advance of their expenditure?——In advance of their capital expenditure or concurrently, as any business would do.

1971. *Professor Sayers*: How would that differ from Government credit?——It would differ in the sense that it would relieve the Government of having to borrow for them. Government guaranteed borrowing and direct Government borrowing are so nearly alike as to be indistinguishable. If the nationalised industries were borrowing on their own credit their issues would not be a direct competitor with Government loans to meet its own expenditure or to fund Treasury Bills.

1972. Why would it not be a direct competitor? Surely these issues would be as secure from default as British Government issues?——Without a Government guarantee? I do not think they would be judged so, without a guarantee in the contractual terms. What would they depend on? They would surely depend on the revenues of the individual corporation.

1973. But are not these concerns under certain statutory obligations, which in effect rule out the possibility of default?——*Mr. Mynors*: The statutory water undertakings' issues are on a much smaller scale, but they are not quite on a parallel with Government credit.

1974. Is that not because they are small?——Marketability certainly is a factor.

1975. *Chairman*: Would it be a factor with issues of the size that we are assuming?——*Mr. Cobbold*: If they were not Government or Government guaranteed, they would have to be underwritten, and I think you would find it extremely difficult to get loans of that size underwritten. That is the first problem. Then I do not think the public view about a nationalised industry stock without Government guarantee would be the same as towards nationalised industry stock with guarantee.

1976. *Professor Sayers*: Do you mean that it is conceivable that any British Government would allow one of its nationalised corporations to default on a bond issue?——I am not suggesting that at all. But what the investor looks at is the terms of the prospectus and exactly what the strength of the guarantee is.

1977. *Sir John Woods*: Would not the practical effect be to increase the rate at which they borrowed, as compared with the Exchequer?——It would certainly increase the rate of interest on the sort of scale that they have been borrowing over the last few years. My own judgment would be that it would not have been a possible proposition except at quite outside rates; as a practical proposition one would have to write off the idea that they could have borrowed on their own credit over this period.

1978. *Chairman*: The original question was not so much, I think, on the possibility of separate issues as to whether monies required for long term capital expenditure should not be raised by some security that was equivalent in period before the expenditure was incurred?——That puts us back into the general question of funding and of long term borrowing. Their loans are Government guaranteed and are therefore an addition to the whole bulk of Government borrowing. We have only been able to sell, either by direct issue or by the funding process through the Issue Department, a certain amount at the longer dates. If we had tried specifically on each occasion to match a nationalised industry requirement by a long loan at that moment, we should have run up against precisely the difficulties that I have described; we should not have succeeded in selling that except by forcing the issue on the market very hard indeed.

1979. *Sir Oliver Franks*: You would regard it as not possible to consider the view that a nationalised industry should not be able to get on with its capital development unless it can raise its own long term money?——I should come to the regrettable conclusion that over the period we are now talking about it would have been quite impracticable to raise the money on that basis.

1980. But this is a period in which the volume of expenditure on Government capital projects was steadily going up, whereas bank advances to the private sector were more or less running along level. Does this not mean that, in so far as the boom which developed was very largely an investment boom, what we are talking about now had quite a lot to do with it?——A very great deal to do with it.

1981. Therefore this impracticability of matching long term expenditure with long term money is a very serious thing, because so far it has produced the imbalance which is so difficult to right?——The financing of the nationalised industries, coupled with direct Government borrowing to meet their own overall deficit where it existed, plus the funding of the maturing obligations each year, has certainly, as I said in my opening remarks, been far the most difficult, indeed the fundamental, technical monetary problem over the period.

1982. That I am sure is so. I appreciate that, if one were looking at it from your side of the table, it must be the way in which all these things have come together that makes the total problem so difficult to handle. But I am not sure that it is not worth pursuing this separate problem of the capital expenditure which Governments undertake. If one simply rolls that problem up with all the others of Government expenditure in general and Government borrowing, one tends to lose sight of the fact that this particular kind of expenditure is of a different kind. It is capital expenditure for long term, and therefore ought to be matched by long term provision of money. Can we hope to avoid the sort of difficulties of the last five years unless in some way this matching of money and commitment can be achieved?——The Government have overcome that to a considerable extent in the last two years by getting much nearer to an overall surplus in their Budget accounts, including the needs of the nationalised industries, and therefore dealing with much more of the long term capital needs out of revenue. That leaves a smaller amount to be raised by borrowing of one sort or another. I agree that it is extremely desirable that at least that element in the public borrowing programme should be met by long term borrowing of some form or another. I should be very much concerned, and have been very much concerned, when the global borrowing in one way or the other of Government at long term does not equivalate the nationalised industries' long term requirements. If we fall short of that on our global borrowing programme either through direct issues or through the Issue Department machinery, then we are getting into dangerous waters, and to some extent increasing the short term debt for this long term purpose, which I dislike very much indeed.

1983. It must be about as wrong in principle as anything can be?——I absolutely agree with you. That was one of the factors conducing to the change which was made nearly two years ago in the Budget of 1956. The Issue Department had taken up a number of these Government guaranteed nationalised industry stocks, and

we were beginning to find in practice we could not turn them over very easily. These corporations were thus becoming financed on short term debt, which seemed to us to be a most inappropriate process. That has been changed since their requirements were taken into the Budget. In the last two years a great deal more of that has been financed out of revenue, so that the position is a great deal more healthy.

1984. *Professor Cairncross*: Are not the obligations of the nationalised industries in practice part of the National Debt now?——Yes, when they are Government guaranteed.

1985. So the issues made by the nationalised industries must tie up with the Government's own funding operations?——Certainly; and as I was saying, during this period, until the new system was working, they were definitely competitive, and in fact embarrassing. They were, in a slightly different sense, embarrassing to the general Government borrowing programme, not only because of their frequent incidence but because of the fact that the market know perfectly well that we should have to come, say, in May or June for £X million for one of the nationalised industries, and, say, in July, August or September for £Y million for another one. That was continually overhanging the market and had a bad effect on our more general Government and funding operations.

1986. The general purport of Sir Oliver Franks's question is surely that the capital expenditure of the Government must be related to its ability to borrow on long term. It would be impossible to separate the needs of the nationalised industries from the other capital needs of the Government.—*Professor Sayers*: How can you say that it is the capital needs of the nationalised industries that have been met by your funding and not some other part of the Government's needs?——You can only take it overall now, but one has at the back of one's mind the very relevant point that Sir Oliver made, that the nationalised industries are the first thing to look at, because that is definitely long-term capital expenditure, and that ought to be matched by long-term borrowing.

1987. In the middle of paragraph 31 there is a reference to the minor funding operation of the autumn of 1952. It is stated that:—

"The response to these offers was considerable; it was not prompted by requests from the authorities to financial institutions to subscribe specified amounts."

Would that statement be equally true if one left off the last four words? Were there requests otherwise than "to subscribe specified amounts"?——On that occasion equally true.

1988. Were there statements by the authorities that the authorities would be pleased if the financial institutions took a certain course?——As far as I can remember there was no indication of any kind. I will check on that and if I should have to qualify that statement in any way later, I will do so; but my present reaction is none.*

1989. *Professor Cairncross*: Your refer in paragraph 32 to "home holdings outside the banking system" increasing. Was this the first occasion in the period from 1951 in which you observed a substantial increase in these holdings?——*Mr. Mynors*: It was the first occasion since 1951 but not the first occasion until then; they would have been larger in earlier years.

1990. Is it the experience of the Bank that the demand for Treasury Bills outside the banking system has been increasing? Is there a secular element in this?——I should doubt whether you could say there was anything sufficiently regular to look like a secular change. It depends on the relative attraction of short bonds contrasted with Treasury Bills, which depends on how people think rates are going to run in the future, and a little, though perhaps not very much, on the change in the margin between interest earned on Treasury Bills and the interest earned on bank deposits.

1991. Were holdings of Treasury Bills outside the banking system comparable before the war?——*Mr. Mynors*: It is a post-war development. The total figure is very much larger now, of course, because everything is absolutely so much larger. We have made some fairly detailed calculations for the early thirties; the proportion one to another then was not far different from what it has been now, and then it fell away very much in between. —*Mr. Cobbold*: I might add a general rather than a statistical observation on that. We hear of more large industrial companies taking an interest in and talking about Treasury Bills. The interest in Treasury Bills is a little wider spread than it was pre-war. Would you agree, Mr. Deputy?—*Mr. Mynors*: I would. You come across it in the balance sheets of large industrial companies who expressly say they have never held them before. They have now become Treasury Bill conscious. To that extent I think there is a change which might become permanent.

1992. But would not the change be from the holding of short bonds rather than from holding cash? If they were holding Treasury Bills in preference to cash it would make very little impact on the general state of liquidity. If they were moving over from bonds to Bills it would be an unfortunate change?——*Mr. Cobbold*: The trend I was talking about was more from cash to Treasury Bills. They are becoming more Treasury Bill conscious than they were before the war; at least in my experience, which is only people I happen to hear of but that covers a fairly wide area, that has been increasing quite considerably.

1993. *Chairman*: I am not clear whether you have any policy that favours or disfavours this kind of movement. As I understand the position holders of Treasury Bills outside the banking system may be foreign holders of money brought in for the time being, overseas holders of sterling, or they may be internal holders such as the companies with spare money you are speaking of. To the extent they come in they take the liquidity represented by Treasury Bills off the banking system. Do you have any policy to promote that, or is it something which responds to current conditions and is beyond your control?——*Mr. Mynors*: It is mainly a response to current conditions, and we cannot tailor our moves specifically to encourage that.

1994. Could you not make the Treasury Bill return from time to time comperatively attractive as opposed, let us say, to bank deposit money or short bonds? You have in that field pretty good control?——*Mr. Mynors*: The margin between bank deposit rates and the Treasury Bill rate can and has varied a bit, but they are both more or less tied, each with its own string, to Bank Rate. The banks' deposit rate will vary explicitly with the Bank Rate; the Treasury Bill rate will be a varying amount below. So we have not a very wide margin of play there. One of the things that I think is relevant (this is only a personal judgment) is the stability of the Treasury Bill rate. I am not sure that you would get a development of an outside demand for Treasury Bills if the rate were very widely fluctuating.—*Mr. Cobbold*: It certainly has proved on some occasions convenient to us from the point of view of bank liquidity to see a movement of this sort, and the fact that some such movement might be probable, though it has not been anything like a major factor, has certainly been present in our minds in taking certain decisions.

1995. At all periods when you are troubled for policy purposes by the liquidity of the banking system, you would wish to expand this outside holding?——Outside holdings of Government paper in general, of which this is a component.

1996. And possibly rather an important one?——But much less likely to stick. This is much more volatile.

1997. But if it was your policy to expand it you would need additional powers beyond what you possess today to achieve it, because, as you say, the comparative rates would govern it, and they are governed by their own strings and centre round the one thing, Bank Rate?——Yes.

1998. *Professor Sayers*: Are not the strings rather more elastic than the Deputy Governor suggested? The gap between the Bank Rate and the bankers' deposit rate is almost completely static, but the gap between the Bank Rate and the Treasury Bill rate, which is virtually under the control of the authorities, has varied very much? It is at the moment about 9s. per cent., I suppose; three months ago it was one and a half per cent.?——*Mr. Mynors*: I am sorry. I thought I had indicated that it was to some extent elastic.—*Mr. O'Brien*: Although, as Profes-

* The witness later confirmed that no indication of any kind was given.

sor Sayers says, the bankers' deposit rate is geared closely to Bank Rate, the difference per cent. between the bankers' deposit rate and the Bank Rate is not constant. For instance, now we have a 7 per cent. Bank Rate and a bankers' deposit rate of 5 per cent. Those rates tend to come closer together when Bank Rate is lower. The Treasury Bill rate is almost always, particularly when we are having tight conditions, substantially above the the bankers' deposit rate, so you may say that, generally speaking, the Treasury Bill, leaving aside considerations of liquidity and so forth, is more attractive purely from the rate of interest point of view than a bankers' deposit. I think firms have been attracted into Treasury Bills because the degree of that attraction has been greater in recent years and has been apparent to all. Firms have also been attracted not only into Treasury Bills but further on into short bonds for the same sort of reason; they have gone into short bonds, I think, where they have dared to put their money that far forward, having in their minds the liquidity of the short bonds, their marketability and so forth.

1999. *Sir Oliver Franks*: And I suppose you have to add that the movement has been what it was because the commercial banks did not try to stop it? There are various things which they could have done, but there has been too little for them to do with their deposits for it to be worth while?——Yes.

2000. *Professor Sayers*: There is one general question on paragraphs 44-to 48, about the reduction in Bank Rate in 1953. On balance the authorities decided that it would be right to reduce rates, to confirm the tendency of short rates to fall. The reasons for that are set out here. Retail prices were still rising at this time, and went on rising. Was that considered as a reason against the easing of interest rates?——*Mr. Cobbold*: The situation of prices would certainly have been a relevant factor at that time.

2001. The notes and coin in circulation with the public were rising very steeply at this time, and yet the Bank Rate was reduced?——*Mr. Mynors*: We say in paragraph 47 that "technical considerations clearly favoured a reduction, general considerations were divided"; that might cover these things which would be in one's mind.—*Mr. Cobbold*: In general terms I would say this: we can all take for granted that a higher Bank Rate and high interest rates have unattractive features, in the added charge to the Budget and to the balance of payments. We have always been concerned to be sure in our own minds that the factors on the other side outweighed those obvious disadvantages, and that the general advantages of, say, remaining at 4 per cent. as opposed to going to 3½ per cent. at a certain moment would be sufficient to outweigh the advantages of going down half a point to meet those other objections. The other factor very much in our minds has been a great desire to keep flexibility and future freedom of manoeuvre. From the beginning of the more flexible policy in 1951 we have always been anxious lest we should find ourselves stuck on a high rate because of the dangers, both psychological and to some extent factual, of coming down a little when we thought that the general considerations warranted coming down a little. We have always been keeping a tight hand on money, but we have wanted to keep a little flexibility, to be able to follow market trends to some extent at certain periods where we thought that the balance of advantage lay that way rather than in keeping absolute rigidity, partly with a view to keeping freedom of manoeuvre for going upwards again when we might feel that some slightly more shock treatment and a definite hardening was necessary.

2002. There is one difficulty about that line of reasoning that seems to me to be well illustrated in this episode. The Bank Rate had been up at 4 per cent., and the effect of that Bank Rate on the long term market depended in part upon expectations that it would before very long come down again. The inflation was continuing all the time. If the level of long term rates was to be hardened, Bank Rate had got to be kept up, and possibly pushed up further. On the other hand, if Bank Rate were brought down, that would just confirm people in their expectations that the 4 per cent. episode was a mere flash in the pan, and that we were going on in the days of 3½ or 4 per cent. long term rate. To put the Bank Rate down at this stage instead of just sitting on it at 4 per cent. was bound to have the effect of keeping down long term rates. In fact long term rates fell, and that at a time when the inflation was proceeding. Does this mean that the Bank was prepared to acquiesce in a fall in long term rates and did not mind the continuance of inflation being encouraged by that fall in long term rates?——I can only say on this particular change that there were considerations both ways. In a sense we compromised by unification of Bank Rate with the special discount rate for Treasury Bills, which brought Bank Rate down but did not bring the whole level of rates down. But that did have an effect on the long term rate.

2003. *Professor Cairncross*: You refer in this paragraph to the rather uncertain international outlook in September, 1953. Did that play no part in the reduction of Bank Rate?——My recollection is that rates were falling round the world at that time.

2004. I was not thinking just of the movement of rates but of the doubts that were then being expressed, in some quarters at least, about the prospect of a slight recession in the United States?——That was certainly one of the general considerations which were present.

2005. On the other hand I notice that the liquidity ratio in this period was as high as 37·4 per cent. Was not that a very high ratio from which to begin a relaxation?——We were not talking in terms of easing money there.

2006. *Professor Sayers*: Was it not easy enough already?——It was easy in some ways and not in others. We were keeping a pretty tight hold on bank advances and credit to the private sector.

2007. *Chairman*: You say in paragraph 46:—

"It is a cardinal principle of policy that Bank Rate should not be used to influence security prices in close connection with a stock operation."

If stock operations consisted of issues in the private sense, which took place on a certain day on certain terms and then were over, that would hear upon it; but under the system which you have explained to us, under which there is a continuous stock operation all through the year in course of which Government securities are sold and other securities bought, for reasons which I quite appreciate, how can Bank Rate help influencing the Government's dealings in stock which are going on all the time? ——This phrase here is meant to refer to a specific new stock operation.

2008. *Professor Sayers*: You mean the issue of a prospectus?——*Mr. Mynors*: Yes, or a conversion offer.—*Mr. Cobbold*: We would seek to avoid changing Bank Rate a week or a fortnight before a major Government stock issue, which would clearly be read, even if it were not the major reason for the operation, as designed almost entirely to help that issue. We should do our best to avoid either using or appearing to use Bank Rate, or other monetary techniques, for the purpose of rigging the market to prepare the way for a specific issue.

2009. *Chairman*: I am not thinking of rigging the market; but, as the issues do not get issued at the time the prospectus is put up, I am puzzled as to what this can mean in practice. Your Bank Rate changes are bound to affect the way the stock gets out of the Issue Department's hands on to the market?——*Mr. Cobbold*: We are bound to affect the current gradual operations through the Issue Department, but we seek to keep well wide of a prospectus or a public issue where we are inviting the public to subscribe on a certain date.—*Mr. O'Brien*: It must not be assumed that we always get nothing on the date of issue.—*Mr. Cobbold*: I think that "with a stock operation" might have been more happily worded in a different way; "with a new issue".

2010. *Sir Oliver Franks*: That alteration would weaken the sentence. It is an important doctrine that Bank Rate is not used to influence security prices when the Bank is selling stock, but if it is simply that it is not used when the Bank is advertising the sale of stock or making a conversion, then it begins to get much nearer a technical point that it does not use Bank Rate to press sales on the day of issue, though of course the work of selling will be going on through following months. That would be a very different phrase?——Yes. The more general influence takes us back to what we were talking about this morning.

2011. *Chairman*: I agree. You may get caught with an issue like the Eternity Stock in February, 1957, which, I believe, came out a few days after a Bank Rate change?——It did; but the Bank Rate change had been discounted beforehand, and we took the view, which was supported by our advisers, that the market had not in fact been changed by that Rate; so we regarded it as perfectly proper and normal to go ahead with it.

2012. I did not mean it was not proper?——No. All I was saying was that the point was considered, and if we had thought that it would have the effect of shifting market rates we probably should not have done it.

2013. *Professor Sayers*: Would it be fair to say that the issue of the prospectus for the issue of Eternity Stock in February, 1957, was part of the general attempt of the authorities to hold the market at the existing level?——*Mr. Mynors*: Not quite. We had said aloud that we did not want that reduction of a half per cent. interpreted as meaning that everything was now perfectly all right. The market took that and was extraordinarily uninfluenced by the actual change in Bank Rate, so that the close period for a change of Bank Rate was shorter both before and afterwards than usual. In a very few days one could see that the way was free to go ahead, and we went ahead exactly on the market level, on the price which had been ruling both before and after the Bank Rate changed, if I remember rightly.—*Mr. Cobbold*: What Professor Sayers says is correct in one sense, that this was to give the Issue Department more ammunition at that sort of date so that we could carry on our normal operations. If we had not had that stock available for sale then the price would have tended to go up more quickly.

2014. I interpreted it at the time as something of a warning flag: whereas you usually deliberately avoid issuing a prospectus close to a Bank Rate change, on this occasion you deliberately made it close. Was that fair?——No, I would not have said that. We should have avoided doing it if the market had changed. Long term prices in fact declined just before. They did not change immediately after the Bank Rate, so that we felt free to go ahead and issue this. It was not a flag in that sense; it was to provide the Issue Department with stock of that date so that we could continue our ordinary funding operations.

2015. When you say the market did not change, you are not forgetting that the Government broker said that he was dealing in gilt edged at unchanged prices after the Bank Rate change?——I covered that point in answer to a question the other day; we certainly did give a lead in order to allow the general idea, that we hoped would get around, to get around.

2016. *Sir John Woods*: In paragraph 47 the view of the Bank is given, that technical considerations were in favour of lowering the Bank Rate, and general considerations were divided, and you end up by indicating that you wished to resist an interpretation that this was "a return towards easy money". In commenting on the same move in Bank Rate the Treasury said that it was "in accordance with the general strategy of expansion and stimulus to private investment". Does it not look as though the intentions of the Bank and the intentions of the Treasury at that time were not wholly in line?——The motives moving the Bank and the motives moving the Treasury may easily have been different. We deliberately form our own views on these matters to some extent apart, so that we can consider them and then have two views to set together. I could not at all say whether the motives working the minds of the Treasury were the same as the motives working the minds of the Bank. All I could say was that the decision was taken by agreement, as in all the other cases since 1951. It was recommended to the Government as being the proposal of the Bank to take this action, and was accepted by them. There was no difference about the decision. Exactly what was in their minds I could not say.

2017. *Sir Oliver Franks*: The point has to be taken one stage further: it is not simply a matter of exploring motives which were essentially private; it is a matter of contrasting statements which do not say quite the same thing?——I can only answer for the Bank's decisions and the reasons for which the Bank formed those views.

2018. *Chairman*: In paragraphs 48 and 49 you tell us that the effect of the reduction of half per cent. in the Bank Rate was that there were consequences all round; deposit rates fell, advances rates fell, gilt edged moved up and there was a considerable increase in advances by the banks. Did you expect that there would be this all round adjustment in response to the half per cent. reduction, or were you hoping that there would be a mere technical fall to keep in line with the market situation, without wider consequences?——There were in fact all round the usual classic consequences as we can see; I was wondering what was done to contend with them?——We should have anticipated some classic consequences, but they probably went a bit further than we should have anticipated or hoped when we made this change.

2019. *Professor Sayers*: Treasury hopes were realised and yours were disappointed?——*Mr. Cobbold*: The subsequent development seems to have been more in line with their hopes.—*Mr. Mynors*: Except perhaps on the funding side, where we did get into a situation where we made quite a bit of progress.—*Mr. Cobbold*: In the succeeding months we did improve our position considerably on the money supply side.

2020. *Sir Oliver Franks*: It is not infrequently the case that when Bank Rate is moved in either direction technical considerations are important, and it is also usually the case that general considerations are important. We have been told that by and large the movement of short term foreign funds in or out of London is nowhere near as important as it used to be in connection with moving the Bank Rate, particularly if at the time there are any doubts about the future course of sterling. Now if the technical considerations essentially relate to what is to be paid for short term money in the money market and so forth, which is itself a reflection of the intentions of the Bank generally, because it is within the Bank's power to alter what is actually being paid for the money, are not the technical considerations normally of relatively subordinate importance compared with what the general issues of policy are? As in the whole of the period of the five years, with the exception of its actual beginning, there was open boom in the world, I would have thought that both with raising and with lowering the Bank Rate it was these general considerations which were dominant, and whether or not anything would be done for the rate of interest on long term bonds. Am I mistaken in this, because, when movements have in fact been made, it has more than once been stated that technical considerations have preponderated in the decision?——I would agree at once that the technical reasons are subordinate, and that the general considerations are preponderant and have been throughout this period. Perhaps I would qualify that by saying that I regard a little flexibility both ways whenever you can do it as a general rather than a technical consideration. I have an absolute liking for coming down a little bit if I can see the possibility of coming down a little bit, to keep flexibility, and to keep the possibility of more freedom of manoeuvre to go up and so get one's maximum effect without getting to astronomical levels; obviously if you are always going up you are always going up. So long as we have felt that it was possible not to ease money but to keep a fairly tight hold on bank advances and credit to the private sector, if technical considerations have been moving a little the other way, one general consideration in our minds has been that we should like to come down just a touch in order to keep flexibility and freedom of manoeuvre. Where we have said that a move was made for technical reasons, we have meant there that the general consideration was not that of easing money, though I think I have always emphasised the freedom of manoeuvre. I remember the Deputy Governor doing so in Coventry on my behalf, specifically mentioning that one of the objects of the exercise was to keep freedom of manoeuvre, and that we had by no means abandoned the use of interest rates.

2021. *Professor Sayers*: Has not this desire for flexibility resulted in Bank Rate movements having a weakened effect on long term rates?—If we had not had that flexibility, the general effect of Bank Rate movements would have been much more difficult to achieve. I do not at all regret this particular move in 1953, nor indeed the February, 1957, move. They did provide us with an additional freedom of manoeuvre.

2022. You evidently attach great importance to the jump in the Bank Rate, rather than the absolute level of the Bank Rate?——Both, but I think the jump is often important. I thought the jump important on the last occasion.

2023. *Chairman*: I do not believe, as a tyro, that I really know what "freedom of manoeuvre" covers in this. The purport of what you say seems to be that, accepting that to get maximum effect from a movement of Bank Rate upwards it must be a jump, you like always to jump from as low a point as you can reach beforehand?——I have always in mind the cost to the Exchequer and to the overseas balance of payments. With a persisting inflationary position which sometimes goes a bit more up and sometimes levels down, there will be moments when Bank Rate action taken in conjunction with other things done in other spheres may be extremely effective. Putting those two things together, we have not wanted to get a higher Bank Rate than we felt necessary or justified, or than we felt would do some real good. It is easier to achieve those objectives from 3 per cent. than from 4 per cent.

2024. You always like to start the jump from as low as you can get it beforehand?——"As low as we can get it" is taking it a little too far. We have not dreamt of coming down to 2 per cent., but when we have seen a possibility, without prejudicing general policy, and where it was in line with Governmental action, of just touching down so as to give ourselves a springboard, we have always had that factor very much in mind.

2025. *Professor Cairncross*: Do you regard the rise in Bank Rate as the major element in the situation? Surely your motive in putting up Bank Rate is in large measure to support other action? How does it help that?——It is very general, it has all sorts of factors in it. Overseas confidence is a major factor; and it has a considerable domestic effect on the general view about the domestic economy. The immediate market impact is the impact on the short money rates.

2026. I am puzzled that you put up Bank Rate and then at a later stage judge it possible to bring it down. No one would like to see it maintained at a high level for a long period, but if you bring it down again, in some sense you must feel that you have accomplished the purpose in putting it up. Is that purpose, such as restoring confidence somewhere abroad, something rather intangible, or is it something that involves leaving its mark on the long term rate, or something of that kind? Where are you putting your emphasis?——Throughout this period we have been pursuing in greater or less degree a tight money policy, so far as it was open to us to do so. As I have frequently said, it has been extremely difficult for us to do so because of the additions to the money supply from Governmental and near-governmental sources. Throughout most of the period we have been, to use a phrase Mr. Martin used first, leaning against the wind, both in day to day operations and in the occasional Bank Rate moves. In each of the Bank Rate moves, with the possible exception of the 4 per cent. at the beginning of 1952 and the move to 7 per cent. in September, 1957, we were leaning against the wind in conjunction with other Governmental measures of one sort and another, either in the domestic or foreign exchange fields, or both.

I think, if I examine my conscience, I should find it difficult to feel that we really hoped in any of these Bank Rate moves really to reverse the situation. We have felt throughout this period that we could not reverse the situation by Bank Rate or monetary measures in the private sector unless they were in line with and only used in support of action on a wider field, more particularly on overall Government expenditure. We have felt that it would be not only useless but a mistake to try to overload or overburden the monetary weapon by pushing, for example, to 7 per cent. instead of 5 per cent. We did not feel that the additional rise in the Bank Rate at that stage would have anything like comparable additional advantages; we were not at all certain that it would have any useful effect in reversing boom conditions in the absence of stronger measures all round, and in the absence of a general reversal of the public view about what official policy would be on expansion, employment, boom and other general questions. We have therefore always been anxious not to attempt to play the monetary hand (by monetary I mean in this sense the private sector credit) and the Bank Rate hand to such an extent that it would prove a failure. If we pushed it too far we should obviously be using it in a rather extreme way. We have felt that, if we were to keep the utility of Bank Rate and that section of monetary measures, we must be as reasonably sure as we could be that each time we used them they at least had some effect and were acting as a fairly definite brake against pressures. All the time we have been operating tight monetary policy in that sector. We have always tried to avoid reversing that policy, but we have been moved by that consideration much less at some times than at other times. We should certainly, for example, have thought it absurd to have increased Bank Rate materially over a period when official encouragement was being given to investment.

2027. Any action on Bank Rate has normally been accompanied by action in other directions, and you would wish it to be accompanied by supplementary action, which might in fact be more powerful?——We have always thought that, if it were not so accompanied, if it were, so to speak, spitting into the wind, it would very likely do more damage than good. There have been times when we have been afraid that an increase of Bank Rate by itself would frighten people abroad rather than anything else. There have been many times when we have felt that an increase by itself would have very little effect, and that to have any real effect on the economy it had to be supported by Governmental action of one sort and another.

2028. Action taken in directions other than monetary policy is usually done with the object of moderating the pressure of demand on the resources of the economy. The monetary measures we have been discussing today appear to be directed in part to rather different, perhaps secondary, objectives: to maintaining tight money to help in reducing the pressure on demand, possibly towards moderating inflation and towards stabilising the value of money, possibly towards reassuring opinion abroad as to the future value of the pound. These motives may be of more importance in monetary policy, if you could segregate it from general economic policy, than they are in economic policy itself; it may be that you had throughout this period steady objectives which you wanted to accomplish but which have never been accomplished in effect, because we still have rising prices, and an excess of liquidity. How, given that situation, is it possible to turn back and regard your purposes in raising the Bank Rate as having been in any sense accomplished? What room for manoeuvre have you to decrease Bank Rate if in fact the original purpose in raising Bank Rate has not been achieved, unless of course you are only concerned with moderating demand for the time being?——I think our objectives throughout are almost exactly as you have stated them: moderating demand and maintaining stability in the economy, keeping the value of the pound both internally and externally. I should be the first to agree that the whole of those objectives has not been achieved. I have said many times, both in this room and in public, that I have never believed that the whole of those objectives could be secured through monetary measures and the use of Bank Rate alone.

I would claim a certain limited success for these measures throughout the period. At the end of 1951 and 1952 I think they had a considerable effect in checking demand, and we did in fact get a good deal more stability of the value of the pound both at home and abroad, and, I should have thought, a more healthy economic situation at home. I should have thought that monetary measures over that period were of considerable help.

We then came down a bit over 1953 and then again in 1954. It is awfully difficult to look back at these things. I do not say we have got this absolutely right every time, obviously we have not, and some dates have not been exactly right. But on the whole my belief, looking back at it as objectively as I can, is that our Bank Rate decisions over this period were about right. I am obviously pre-disposed to think that, but, looking at it objectively, I believe that is by and large true. The only possible exception I have in mind is the move in 1954 from 3½ to 3 per cent. It looked right at the time, and, if I were faced to-day with exactly the same conditions as there were then, I think I should probably do it again. But looking at that with the benefit of hindsight, and seeing how the investment boom developed in the winter of 1954-55, I think

that the risk of stoking up the boom a hit by that move probably proved greater than the advantages we achieved from a little economy at that period.

2029. Would you take the same view of the increase of one half per cent. in the Spring of 1955?——I take the view that in those general conditions that was probably correct. We hoped that it would have rather more effect than it did, and be accepted as rather more of a warning signal than it was. We were perplexed at that moment by the problem of the widening spread between the transferable rate and the official rate. Throughout the late autumn of 1954 and the beginning of 1955 I had it very strongly in mind that anything like a sharp rise in Bank Rate would not have very much effect in itself on the internal situation. There was an investment drive going ahead strongly, and we thought a sharp rise in the Bank Rate over that period would probably alarm foreign opinion considerably, and might make our exchange troubles worse.

We made the additional rise to 4½ per cent. at the time when we were able to intervene in the transferable market overseas, bringing those two rates more or less within striking distance of each other, and certain measures were taken on the Government side. I am not saying that it would not have been better to do a number of things earlier over the end of 1954 and beginning of 1955. I think that the Bank, in company with a number of other people, under-estimated the degree of investment boom that was going to happen over that winter and spring. But I do not think, if I had realised in September what I knew in December, that in the purely monetary field I should have wanted to act any differently over those months, unless other things could have been done at the same time.

2030. *Chairman*: I follow the significance of your phrase "leaning against the wind" with regard to the increase of Bank Rate, but I am not sure whether you would apply that to the three decreases that occurred in the period; there is no "leaning against the wind" in those cases?——There is not, and that is why we have tried to emphasise the "technical adjustment", although that may have been a slightly misleading phrase. The point of coming down was in some degree to give us more of a springboard for a subsequent upward move.

2031. *Sir Oliver Franks*: I am not clear how far, if the general considerations are the important considerations when Bank Rate is moved, these relatively small movements of Bank Rate are likely really to be significant. In the old days, when one was simply dealing with the short term money market and the flow and pattern of events in other centres and so forth, a half per cent. or one per cent., would probably be all that was wanted one way or the other. But in the last five years we have been facing, I suppose, an absolutely unprecedented boom in the whole of the free world, which has just gone on and on, with a growing scarcity of capital. Were the movements which were made from time to time in the Bank Rate, whether up or down, thought to be right in their rather delicate modulation, when one remembers that the Chancellor of the Exchequer always pays one half, near enough, and that therefore the incidence on individuals is not very great as between, say, three per cent. and five per cent.? These movements of the Bank Rate have been very like movements in the Bank Rate when the job to be done was rather different; has the tradition been adjusted to the new circumstances adequately, or should we read September 19th as a commentary?——*Mr. Cobbold*: I think you are entitled to read September 19th as *a* commentary, but not perhaps *the* commentary. I agree that it has been clear from the beginning of this exercise that inflation would not be reversed by a fairly moderate use of Bank Rate. In my own view it has been equally clear that inflation would not be reversed by a more forcible use of Bank Rate without more forcible accompanying measures and policies in the rest of the field. My own view, and I think I speak for the Bank here, has been that if, for example, we had gone to 7 per cent. two years ago we could have done very little more than we actually did, unless there had been a considerably greater change of policy in other spheres than there was. It would at the same time have meant very much more expensive rates to the Government, which I agree is not a major consideration but has to be justified.

We have taken the view, rightly or wrongly (I myself think, with the benefit of hindsight, rightly) that it would not do sufficient good to try violent Bank Rate pressure whilst general official policy was perhaps giving the impression to the public that the main objectives lay in slightly different directions.

These smaller movements have had considerable effects, sometimes with limited objectives, sometimes in limited fields. I can remember two occasions when they have saved an overseas sterling crisis. The measures taken at the beginning of 1955 were rather slow. They were certainly not positive in reversing the inflationary trend. My own view is that, coupled with what was done in other fields in February, 1955, and thereabouts, they definitely leaned effectively against the wind; if we had not made those moves the boom would have gone through the roof during the latter part of 1955. It was only towards the end of 1955 or the beginning of 1956 that those measures took more effect and we got a bit of a slow down; but I would myself judge that the absolute level of Bank Rate over the period, and each increase (with the possible exception of the increase of half to which Professor Cairncross referred and which only lasted a month) has had a demonstrably successful effect, not perhaps always in exactly the same field, and with the rather limited objective of braking and leaning against the wind. We never had any illusions that any of those Bank Rate moves were going to turn the inflationary picture. That is perhaps where 19th September is a commentary. We saw an opportunity in the general picture and the general official attitude at that time of coming in with a much more forcible Bank Rate policy, with a more ambitious objective of reversing the inflationary trend, and I would say that that was the first time we had seen a possibility of using the Bank Rate with so ambitious an objective.——*Mr. Mynors*: Perhaps one might add as a footnote that the effect on opinion of changes of Bank Rate is not only a reflection of their size but also of what people think is going to happen next. You cannot be sure that a change of 1 per cent. will have twice the effect of a change of one-half per cent. Otherwise I think I would agree entirely with what the Governor has expressed as his view about this.

2032. *Professor Cairncross*: It is quite clear that, if monetary policy is used in conjunction with various other policies, it is effective; what is not quite clear is whether these other policies would be just as effective without monetary policy. There is an old saying that prayers and incantations, with a little arsenic, will poison a flock of sheep. I wonder whether the Bank Rate plays the rôle of the incantations here. If I may put the question in a slightly different form, just how do you visualise a change in the Bank Rate as affecting the demand in the economy? Is it all a matter of confidence, or is there some simple channel through which Bank Rate takes a grip on the demand for the resources available in the economy?——*Mr. Cobbold*: This is a very arguable subject and anybody can have his own opinion. My own view is that it has still a quite considerable effect both in its general psychological influence, and on reality. On reality it has a far heavier effect when you get towards the higher rates. I regard the 7 per cent. Bank Rate, particularly in conjunction with the trend of emphasis of policy in general, as being in its own right a very effective weapon in reducing demand.

2033. Which kind of demand; stocks?——No, investment demand; but stocks too, I think, to some extent. At these kinds of levels, particularly if there is a slight change of emphasis of general policy and you get people wondering whether it is really an economic proposition to go ahead with plans if they are not absolutely certain about profits, I think you get a moderation of demand.

2034. Clearly a rise of two or three per cent. in Bank Rate has a very real effect?——Not always.

2035. I should have thought that in almost any circumstances a rise in Bank Rate of two or three per cent. would have a marked effect; but would variations of half per cent, or one per cent., if taken slowly and gradually, necessarily have much influence?——*Mr. Cobbold*: This is very much a question of timing at particular moments. It is a field in which it is difficult to lay down general rules. There are so many different considerations to weigh at

different times. There is a good deal to be thought about from the overseas point of view; not only the movements of rates overseas, but the general position of sterling. This differs so much from time to time; at certain moments a half per cent. would have as much effect as one per cent. at another moment.—*Mr. Mynors*: The effect on foreign opinion may vary a good deal. A half per cent. may do what you want to foreign opinion one moment, whereas one per cent. may frighten it; at another time one per cent. may be needed. That is only one facet, but it is a facet one has to consider.

2036. If the policy were deflationary, this is a very expensive instrument, and we have to weigh it up against all the other measures that have already been used, or could be used, to supplement it?——*Mr. Cobbold*: My own view is that it has been demonstrably effective in a rather limited objective over the period, and that if it had not been used roughly on the lines used (I make no claim for particular dates or moves) inflation and the money supply would have been very much more out of hand and we should be in a very much worse situation than we are today. I am talking about monetary measures in the private sector all the time. If I examine my conscience, I should say it has been a little more successful than I should have judged likely in 1951.

2037. *Mr. Woodcock*: What happened in September that made you think there was an opportunity for a substantial increase in the Bank Rate?——The most urgent consideration was that, if we had not done something about it, sterling was heading very rapidly for the rocks, within a matter of weeks.

2038. On what grounds did you say that September marked a change, in that then there was an opportunity for a substantial rise which had not occurred before?——On two main counts; there was a slight change, perhaps more than a slight change, from the flat-out boom throughout the world, not only in this country; and there were some signs of lesser company profits. A high Bank Rate is both in theory and experience much more likely to be effective when profits are a little on the down than when they are up and up. Thirdly, I think, there was a slight shift of emphasis of Government policy to the stability of money as being the first objective; that is relevant both from the point of view of the reality of that shift of emphasis and from the effect of that shift of emphasis on general opinion round the world.

2039. Would the other measures in themselves not have achieved the objectives that will be achieved overall?——My opinion is that those objectives would not have been achieved without help on the monetary side.

2040. That was an indispensable part?——I do not think the other expressions of policy and so on would have saved the pound in the international markets at that stage without Bank Rate action; that is my own judgment.

2041. I take it that your judgment is that neither by themselves would?——Yes.

2042. *Professor Cairncross*: You used the words "at that stage". Surely the great advantage of Bank Rate is that it takes effect quickly. Is this the principal value of monetary policy now?——I do not think so. I think it has a continuing value. I think a statement of change of emphasis in policy has an immediate effect.

2043. *Lord Harcourt*: One of the effects of a change in Bank Rate, taken as one in a large range of items, is that it gives you a breathing space; in other words it is the one thing which can be done overnight, which has an immediate effect, whilst a lot of other measures are working their way through?——I accept that, but I think it only has its force if the public knows the other measures are coming.

2044. *Professor Cairncross*: If policies are pushed farther in other fields, can they not make up for changes in monetary policy?——My view on recent experience would certainly be that such other measures as have been taken or are now being taken would have been very much less effective without the support of monetary measures.

2045. *Chairman*: I just touch again with the phrase "leaning against the wind" when you were answering Mr. Woodcock about last September. You said that there was a marked pause in what had been the boom, with an effect on a large part of the world, that profits were declining in this country. If you put up Bank Rate by 2 per cent. in that situation, are you not following the wind rather than leaning against it?——I should have said that there were still heavy inflationary pressures in this country.

2046. So really the wind there was the price levels?——The wind was still the inflationary wind. I was trying to express the idea that in the circumstances of last September we could do a little more than lean against the wind; we could possibly help to damp down the pressure.

2047. *Professor Sayers*: You implied—indeed you said—that your belief that Bank Rate helps to check demand is based partly on a belief that it checks investment plans. In doing that, does it operate through its effect on the long term market, the bond market and the share market, or does it have some more direct effect?——That depends on the general conditions of the time. Take the present moment, for instance; I would have thought that boards of directors throughout the country are weighing the outlook of the next year or two, taking into account the cost of borrowing, whether short or, if they can get it, long, and attaching considerable importance to the factor of the cost of borrowing in one shape or another. But that may not have the same effect at another time.

2048. If it works that way, is it not rather important that people should not immediately begin speculating, as soon as you put Bank Rate up, about how quickly it is going to come down? If they think it is going to come down quickly they are not going to be checked in their investment plans?——Not if they think it is going to come the whole way down quickly. They might still think that 6 per cent. was a high rate.

2049. I am thinking of this effect of a flexible Bank Rate policy in preventing the long term rate of interest from rising, as it did in 1953-54. The effect of the increases of Bank Rate in 1955 and 1956 upon the long term rate was very much weakened, on the face of it, by knowledge of what had happened in 1953-54. People thought the same thing was going to happen again?——*Mr. Mynors*: I would not have thought that that was quite our position. If we go up from 5 to 7 per cent., and everybody thinks that we are going back to 5 per cent. again in a fortnight, it has no effect. But going to 7 per cent. plus a dimmer outlook for future profits makes people wonder whether a particular investment programme should be pursued; even if after a fairly short period we come down to 6½ per cent., that is still a high rate, and people think that perhaps, if they wait a bit longer, we shall come down to 6 per cent. You are not out of the particular wood, even though you may see some light.

2050. This is a reason for going up by jumps of two rather than 1 per cent.?——This whole line of thought would be more effective in almost any circumstances, I should think, with a jump of 2 per cent., but it does not follow that one should always go up by a jump of 2 per cent.

2051. Jumps of one half or 1 per cent., coupled with a tradition that Bank Rate comes down just as soon as the authorities feel elbow room, are not going to have much effect?——*Mr. Mynors*: It must depend a great deal still on what else is happening, what your Budgetary measures are, and that kind of thing.—*Mr. Cobbold*: You speak of the tradition; but of course we must recognise that the overall level of the Bank Rate over the past two years has been very different from the overall level in the late forties. I would not say that there was a tradition established that we went up by one and came down by a half; we have had a period of definitely rising Bank Rate.

2052. *Mr. Woodcock*: Supposing the other factors weakened in the course of time rather quickly, is it your view then that Bank Rate resumes its previous, what you might call its normal, limited rôle, of merely leaning against the wind?——At occasional moments there is an opportunity to do a little more than that, but I think generally the more normal function, and what I should look to the Bank Rate to do, would be to lean against the wind rather than to be more positive

2067. It is true to say that at that time you had stopped leaning against the wind?——We were a little slow to detect the force with which the breeze was coming up. The policy in the spring of 1954 was to encourage investment; I had great sympathy with that policy, and I had been nervous about the investment situation in the preceding year. That policy was successful beyond many people's dreams. That was under-estimated in a number of quarters; and I think we did not start leaning against the wind heavily until January or February. We started to lean a little before that, because money rates started going up in November and December, with some blessing from us. The Treasury Bill rate rose. The market was tightening, and the Chief Cashier was operating a bit in the market to tighten money.

2068. *Sir Reginald Verdon Smith*: It would be a mistake to take the view that you were taking advantage of circumstances to gain a stronger foot-hold for purely technical considerations?——General considerations came into it as well, certainly. As I have already said, we feel our position stronger if we are starting from a slightly lower springboard.

Chairman: I think we will break off at this point today.

(*Adjourned until Thursday*, 21*st November*, 1957, *at* 10.30 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TENTH DAY

Thursday, 21st November, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

H. C. B. MYNORS, Esq., Deputy Governor, L. K. O'BRIEN, Esq., Chief Cashier, and W. M. ALLEN, Esq., an Adviser to the Governors, of the Bank of England, called and examined.

2069. *Chairman*: May we begin from paragraph 61 of your Paper No. 9.* You are dealing there with the heavy maturities of stock that lay ahead in 1954, and we are told about assents for conversion. Your policy is to buy up pending maturities, in order to prevent all the money required for a redemption being put into the market at one moment, and to enable it to be spread over the preceding period of months, plus what is required when the moment comes?——*Mr. Mynors*: Yes.

2070. We are told that so much was assented for conversion. Does that include all the stock acquired by the Issue Department?——Not necessarily the whole of it. We make up our minds in the concluding stages when final decision has to be given. We might sometimes decide not to convert the whole of it, but, as a general rule, the bulk of it is generally converted and would be included in those assented figures.

2071. That comes about because, for market reasons, you want to keep some non-assented stock to deal with?——*Mr. O'Brien*: A second consideration might be that the maturing stock might be of £1,000 million, and in the ordinary course the Departments would acquire a large proportion of that. When we came to the conversion operation, we might not want the stock we wished to issue in replacement to be as large as £1,000 million. There is no need for it to be if the Departments hold a large proportion of maturing stock, because they then have a choice as to how much they allow to be assented and how much to be paid off, which is a pure book-keeping entry. If we did not want to issue another £1,000 million stock that would be the course we would take.

2072. Could you tell me, on any one particular occasion such as this, how much of the assent came from outside and how much was internal?——Yes, we could tell you on each particular stock. There were two operations. The first, in June, 1954, was the issue of 2 per cent. Conversion Stock 1958-59, partly in conversion of the National Defence Loan and partly for cash. Giving the conversion figures first: the public assented £172 million and the Departments £120 million. On that occasion the Commissioners for the Reduction of the National Debt assented £74 million, so the Issue Department's role was a small one. On the cash side the public took £143 million, the Departments £157 million. As to the later offer, in July, of 2½ per cent. Exchequer Stock, 1963-64, the public assented £58 million and the Departments £216 million on that occasion. Of the long Funding Loan, 1999-2004, the public assented virtually nothing, say, £600,000, and the Departments £138 million of which the C.R.N.D. assented £48 million. That gives total figures for conversion of all those three stocks: the public £230 million, and the Departments £474 million, giving £704 million, virtually the £700 million mentioned here; and the cash comes to £300 million. On that occasion, as you will see, a double-barrelled conversion operation was designed, so far as the Issue Department was concerned, to avoid issuing an overlarge amount of the shorter stock, the 1963-64, and to provide an opportunity of giving us ammunition at the longer end. The fact that the public subscribed very little was not a material factor. It was known when it was done that they would not. It was a device to give us ammunition.

2073. You had potential customers in the future for stock of that kind?——Certainly. Indeed, all that issue has long since been sold.

2074. *Professor Sayers*: Does the penultimate sentence of paragraph 62 mean that the departmental purchases were of the next maturities, and because those maturities were big and the desirability of taking them into the Departments was great, the Government buyer took altogether from the market a much larger volume of all stocks than he would otherwise have done, that is to say, he put back into the market a great deal of cash?——*Mr. Mynors*: Yes; it means that if we had not been buying the next maturities the net sales would have been larger; it does not mean that the gross sales would have been altered.

2075. Is there any effect at all on the amount of bank deposits held by the public, or is the effect via the make-up of the discount market portfolios?——It depends on what the stocks are that we have been selling. We should be buying at the very short end. If to some extent we have been replacing those purchases by sales of something that is only a little bit longer, to that extent we are replacing a very short for a medium-short. If, on the other hand, we have been selling medium-long and long-dated stocks and could have been selling those anyway to the public, then the fact that there may be a switch of short to near-short will not affect the banking figures so much. One has to look at the composition of the change in our portfolio.

2076. So, despite the comparative smallness of the cash raised from the market, there may have been appreciable funding in the sense of replacement of bank deposits by long stocks held by the public?——That could have been going on.

2077. *Sir Oliver Franks*: I would like to ask one very general question. I have always felt that 1954 in this series of years was a very difficult year to appraise, mainly, I think, because it looks so different when you look back on it from what I personally felt when I lived through it. In the early months of the year the immediate external situation was relatively strong, the home situation showed considerable growth in industrial output and productivity, but there was uncertainty as to how the situation would develop. There were prospects of higher home demand, both on Governmental account and by consumers, and for industrial investment. As you say in paragraph 59, you have at the Treasury end policies for expansion, or at least relaxation. By the time we come to the end of paragraph 66 the market has weakened; there are industrial disputes; and there are doubts about the foreign exchange situation, which, in a sense, have not left us from that moment until now; that was the beginning. I think it is fair to say that the various components of policy in 1954, whether fiscal or monetary or those represented by direct controls, were

* Memoranda of Evidence Part 1 No. 9.

2053. If there is an upward swing in world activity, profits begin to rise, and the Government weakens on its declarations of policy, then surely, from what you have said, you would be back in the position that you may increase Bank Rate, but with a limited objective?——I think that, if inflationary policies are pursued everywhere, there is little more the Bank Rate can do than lean against the wind.

2054. You would not be able to recover or offset the deterioration of other factors?——I have never thought it could offset the other factors.

2055. *Sir Oliver Franks*: That is true under certain suppositions; clearly if you quadruple the Bank Rate it would do a lot. A 20 per cent. Bank Rate would be quite a major instrument, but there are certain conditions which make it not practicable to apply it. Is it not fair to assume that in the discussion of the bracket within which Bank Rate can be moved, one limiting factor is the political environment, meaning whatever Government may be in power or whatever views they happen to have; and a second limiting factor is the consequences of an astronomical Bank Rate, say, in terms of unemployment?——Absolutely. I think they may be limiting within slightly different brackets at slightly different periods, but they are definitely limiting factors.

2056. *Professor Cairncross*: You could, I suppose, envisage a country in which Bank Rate and interest rates remained absolutely constant, assuming that other measures of Government policy were devised to take up all the pressures developed. Is it any more difficult to envisage that than a country with a stable exchange rate?——*Mr. Mynors*: I should have thought, very much thinking aloud, that that leads you to a range of other measures which is virtually limitless. I am not familiar with the Russian system, but I would have thought you might have to go a surprisingly long distance in that sort of direction.

2057. You would not feel that, if you pursued the idea of a larger Budget surplus and other restrictions experimented with since the war, that might take up such inflationary pressures as the higher Bank Rate has done?——If you have to keep your interest rates constant at a given level, though they want to rise, you have to buy up just as many securities as are necessary to check the rate, and you lose control over the volume of money. You then try and put restrictions on the use people make of this increasing and by now very large volume of money, and the water, as Sir Oliver was saying, tends to seep round the dam.

2058. It may happen; but on the other hand there have been long periods when they have not moved much and very heavy pressures have been developed against them, for instance, in this country, before the first world war certainly, and even between the two wars. Let me put the question rather differently: the Governor expressed a view earlier about what could be done by monetary policy as an anti-inflationary device on its own and, I think, attached considerable importance to monetary policy as one ingredient in a collection of measures designed to eliminate inflation. Would the existence of a fixed exchange rate be one of the principal reasons for attaching importance to Bank Rate?——*Mr. Cobbold*: The external situation tends sometimes to be the most urgent question for deciding whether something has to be done this week or next week. I think it is probably less important comparatively with other factors over a period. If I may put it in personal and recent terms, when I was contemplating in July and the earlier part of August whether a Bank Rate change would be appropriate, I was certainly in July thinking more in terms of the domestic situation. When I came back from my holiday about the 14th September, I think the decision as to whether something should be done on the 19th September or early in October was probably dictated more by the foreign situation than the domestic one.

2059. Would the situation present itself to you in quite the same way if there was no fixed rate of exchange?——Perhaps not quite in the same way, but I think I should still be very much concerned with the external stability of the pound as well as the internal stability of the pound. If there was a very strong movement out of sterling, either with a fixed or unfixed rate of exchange, there would be times at which we should have to think very seriously of taking some strong measure, the urgency being dictated mainly by these considerations; but I would still say that, if one can really differentiate (it is not easy), it is the domestic value of the pound and the domestic things which occupy the bulk of our thinking on these subjects.

2060. Even if you were not concerned about the external value of the pound, the domestic situation would alone make you wish to make use of the Bank Rate, as one ingredient of a composite dose?——Certainly, as the external value of the pound, whether it is formally fixed or not, is going in the end to depend on the situation at home.

2061. Coming back to paragraph 56, on a question which Professor Sayers raised this morning, are there any figures indicating the extent to which there was an inflow of funds?——I have made some inquiries; they were not very encouraging, I am afraid. The figures are not very good on this, and they are not very good on the borrowing side either, because it is so difficult to see what is foreign. A lot comes in foreign trade bills, and one thing and another, and it is extremely difficult to differentiate the internal from the external. I should have to clear any information I get under exchange control powers with the Treasury. I am afraid whatever I give you may not be very good.*

2062. *Professor Sayers*: In the last two lines of paragraph 56 you say: ". . . the Treasury Bill rate was steadied: there was a small amount of borrowing from the Bank." Does that mean that the authorities saw to it that the market was so short that they had to borrow, and the discount market took the hint and did not let the Treasury Bill rate slide away?——That would have been so.

2063. Paragraph 58 brings us to the reduction of Bank Rate to 3 per cent. in May, 1954. The upshot of paragraph 58 is, if I read it correctly, that there was a balance of considerations and what settled the matter was this desire for flexibility?——We felt that the other considerations were very evenly balanced at that date. I still think that, faced with these considerations again, and without knowing what was going to happen in three months' time, I would take the same decision. If I had known what was going to happen in three months' time I do not think I should.

2064. *Chairman*: I see your position; but I should have thought that to the outsider at that time everything that was done would have suggested that a stimulus was required to the economic set-up. There was the investment allowance introduced by the Budget in April, the reduction in the Bank Rate in May, the removal of hire purchase restrictions in July; and, following the reduction of Bank Rate charges for bank advances were reduced, call money was cheaper, the deposit rate was reduced, and bank advances were rising. Could people have come to any other conclusion?——This change was in line with the official encouragement of investment that was going on; that was one argument for it in the balance of considerations. I accept that view.

2065. But when it came to feeling that things had gone further than was wished, the containing measures did not come until the following year, 1955?——Yes. Although we were conscious in September, 1954, that things were moving in the other direction, and both the Chancellor of the time and I made some fairly definite references to inflationary pressures in October of that year, we tended to under-estimate what did in fact happen, and how successful the investment drive would be. But I do not think, as I said just now, that, even if I had appreciated in October that the boom was going to rise rather faster than I thought, I should have felt that monetary measures by themselves would have been appropriate.

2066. *Professor Sayers*: Not even a 2 per cent. rise in the Bank Rate?——*Mr. Cobbold*: I do not think so, not against the general background.—*Mr. Mynors*: At that time funding considerations were very much in our minds.—*Mr. Cobbold*: They were a consideration, but my major consideration was not to frighten people about transferable sterling. I should have regarded a 2 per cent. rise then as definitely alarmist and rather ineffective without other things.

* See Appendix to Minutes of Evidence.

on the whole being applied on the side of relaxation, possibly on the side of positive expansion, rather than on the side of restriction or restraint of any kind. When the Bank looks back at 1954, does it have any reflections of importance? Does it think on reflection that the "too late" part of the "too little and too late" considerations applies, that the economy was allowed to get under way, without any rein on it, more than perhaps one would think wise on looking back? Or, alternatively, do you think that that was not so, but that the future was so unknown that when you look back on what was done then it seems to have been about right on the whole?——It is a little difficult to remember even over only two years how influenced one was in one's mind by considerations that now look short term but then were very dominating. In 1954 the conversion of maturing issues was bulking very large in our minds, as well as longer range considerations, like the need to have a Bank Rate policy that was flexible; that is to say, in practical terms, where we did not have an inordinately long period between moves, and where moves could be conceived of as being in either direction. I do not think that this is a period about which we feel particularly unhappy; looking back we should probably have done again very much what we did then. We were a little slow, I daresay, to recognise the rate at which things were blowing up.

2078. *Sir John Woods:* In October, 1954, there was the first public statement of doubts about inflation, particularly in the speeches at the Mansion House by the Chancellor and the Governor. In January, 1955, the Bank Rate was moved from 3 to 3½ per cent.; in February it went from 3½ to 4½ per cent.; and still we did not seem to get the thing under control, or it was thought not by the authorities. We then had a disinflationary Budget followed by the October Budget. Apart from the question of perhaps leaving it a little late, would the Bank now feel, as I tend to feel, that the action when taken was in fact not quite sharp or decisive enough, and that, perhaps, if in January, or indeed earlier than January, instead of going from 3 to 3½ per cent. you had gone from 3 direct to 4 or 4½ per cent., we should have got the range? Operating earlier on, when not quite so much action was needed, we might have been spared a lot of the trouble that has come on since, including the 7 per cent. in September, 1957. I realise, of course, this is all an experimental period, and that there are a lot of conflicting and delicate situations which come into this, including the fact that if you move too radically it is taken as a sign of no-confidence rather than of confidence. Nevertheless, the doubt remains in my mind?——There were two things particularly in our minds that autumn. First, general economic policy was directed towards investment for development, and the Chancellor and the Governor both said at that dinner at the Mansion House in the autumn that that was the right policy, but people should see that it did not develop to such an extent as to lead to an inflationary wave. In face of that a moderate rise in Bank Rate, taken by itself, would not have had any wide and serious effect in steadying people's minds, again (I go back to a point which we have made several times already) conceiving of Bank Rate as having a part to play as part of the general economic control of affairs, and not trying to operate by itself. The other thing very much in our minds at that stage was the point raised in paragraph 68, the widening of the discount on transferable sterling and the general feeling that the exchange situation, which was admittedly only an interim situation, with the Government still wedded to eventual convertibility as their ultimate policy, was reaching a stage at which some further move still in that general direction might have to be undertaken. From the external point of view general economic policy did not seem directed to remedying the exchange situation. There was a risk that an unrelated rise in Bank Rate might frighten people more than reassure them. That is another aspect of trying to treat Bank Rate as part of combined operations whenever we possibly can.

2079. *Chairman*: Would you regard the terms of the conversion offers made in that year as being an indication that the authorities wanted money to be cheap?——No, I think not. We always try to pitch the terms of the conversion offer as nearly as we can on the market level at that moment.

2080. In other words, your main concern was to get the money as cheap as you could with the market attitude being what it was?——Yes.

2081. *Sir Oliver Franks*: Perhaps this illustrates a point of importance, that the things which must preoccupy the Bank's attention are very often problems of limited duration, but important, and even acute while they are there. It may be that the use of Bank Rate is better adapted to dealing with short term fluctuations, with these types of preoccupation which have just been illustrated than as a long-term agent for dealing, shall we say, with a persistent tendency to an investment boom in an economy. Is Bank Rate essentially something which should be short-term in its incidence and effect, or is it a good instrument for dealing with the long-term issues which arise in an economy; because that is an issue which arises in 1954 and goes through to 1957?——That is a fairly cosmic question, if I may say so. I should have thought in the nature of things Bank Rate must be regarded as rather more concerned with the short-run adjustments, one of the reasons which would strike one at once being that you get a lot of the effect of Bank Rate by the changes you make in it. One of the reasons why one should regard this as an experimental period is because one does not really know the level around which, year in year out, those variations should take place. I should have thought that Bank Rate affects long-run factors more by its absolute level than by its changes.

2082. How far can one generalise, from what you have just said on the use of Bank Rate, to the instruments of monetary policy generally?——*Mr. Mynors*: Do you mean that they are essentially short-run?—*Sir Oliver Franks*: Yes.—*Mr. Mynors*: I could not conceive of them as operating by themselves, but only in a much more general framework of economic policy, in affecting long-run considerations.

2083. They must always be part of package deals?——I would think so. If you wish to influence the climate of investment there are so many other things that affect it: taxation policy, investment allowances, even Industrial Development Certificates and planning paraphernalia, and so on.

2084. I suppose what has happened in the last three years is an historical commentary on that. We look, as one looks backwards, as if we had been trying to use, say, the Bank Rate not for these relatively short-term purposes but for the longer term purposes, sometimes with other measures, sometimes without. Have we been trying to make the price of money do a job which it cannot really do, or have we been taking too many "bites" before we have used it, or what do you think?——I find that difficult to answer. Generally, it has not operated much by itself. It has not always been exactly synchronised with specific changes in economic policy, but it has always sought not to run counter to the economic policy of the moment, but rather to reinforce it, particularly if there was a change in general economic policy. The attempt to keep the economy at maximum pressure is, I suppose, primarily in its immediate appearance a short-run influence, but in so far as it is an investment programme which is at the bottom of it it has very important long-run effects. I find it difficult to distinguish between the short-term and long-term aspects of the thing.

2085. *Mr. Woodcock*: Would you take the same view if your reserves were relatively substantial?——Yes, I think I should. One would feel a little safer in going a bit further to see how a situation was developing, but in practice, I think, over the past five years we would have done what we did even if we had had considerably larger reserves.

2086. If, for example, we had been strong enough to have free convertibility, would you still hold the same view?——I would rather like notice of that question. I have not thought through Bank Rate policy again in terms of complete convertibility*.

2087. *Professor Sayers*: At the end of 1954 you decided (in fact, each week) not to raise Bank Rate. Twice in this paper there is a reference to "hardening of short-term rates towards the end of 1954". Was that helped by the authorities at all deliberately?——At the beginning of paragraph 69, you will see that it says. "It was felt desirable that market interest rates should be hardened"

* *Note*:—The witness later informed the Committee that he did not wish to add to what he had said.

2088. Yes, but you have not said that you took steps to harden them. Did you?——*Mr. O'Brien*: I cannot remember the actual influences; but if it was felt desirable that market rates should be hardened I should guess that they were hardened to some extent by us.

2089. And you desisted from moving the Bank Rate, although you might have felt that there was something to be said for using it on longer term grounds as well as on short term grounds. If I understood you correctly, your decision not to raise Bank Rate at this time was based on the view that by itself it was no longer of use for short term purposes, but had to be part of a package deal. Is that right?——*Mr. Mynors*: It would certainly be much more effective as part of a package deal, and, as we regarded it as still an effective weapon, we did not want it to lose some of its effect, as it would if it was used in a way in which it came to be disregarded as being out of line with everything else.

2090. Probably all of us under-estimated in the autumn of 1954 the strength of the inflation; but if you did feel there were some longer-term reasons for pushing the Bank Rate up, and that short-term considerations clearly pointed that way, was there not a very strong case for putting it up in isolation and seeing how it worked?——At that point the external situation was the dominating factor; we were not at all clear how it would be received. If the exchange situation was troubling us and we suddenly put up the Bank Rate in isolation, people would say: "What are they playing at?"

2091. *Mr. Woodcock*: You said in effect that the disadvantages outweighed the advantages?——Yes.

2092. *Professor Sayers*: Did the funding problem affect your Bank Rate decision at all?——Not in the sense that one would say to oneself: "We had better keep the Bank Rate down because we have a funding problem." If we know we have to deal with a maturity by a certain date we try not to move the Bank Rate in close association with the timing of a conversion offer. We say to ourselves: "It looks as if we may have to be thinking about raising the Bank Rate; but we must not forget that there is going to be a close period in such and such a month, because we shall have to be dealing with a conversion offer then."

2093. Was the volume of funding that was to be done perhaps to be considered as a reason for raising the Rate?——*Mr. Mynors*: It can be one of the factors that influences one in making up one's mind what ought to happen to the Rate.—*Mr. O'Brien*: This particular funding operation, which was a very large one, happened to be a case where we were able to take a good deal of initiative. Sometimes when a funding operation must be completed, we have to wait until the last moment in order to be sure of doing it satisfactorily. On this occasion, which was the 3 per cent. National Defence Loan 1954-58, the final maturity date was 1958, but we took the initiative as soon as we could in 1954 to convert it into 2 per cent. stock. That was something which we did not need to do, but we did it because we had more initiative than we might have had. The Serial Funding Stock was a November maturity. That was dealt with in July, again several months before the last date when it would have to be done. That indicates that we had quite considerable initiative at that time.

2094. The funding problems really did not enter into the Bank Rate discussion?——No.

2095. *Lord Harcourt*: The funding problem was out of the way by the time the crisis arose?——We got it out of the way while the going was good.

2096. *Professor Cairncross*: In paragraph 69 you say: "It was then open to doubt whether external confidence in sterling might not be further damaged through such action being interpreted to mean that the authorities regarded the internal inflationary situation as grave." Do I take you to mean that you would not have liked to raise the Bank Rate in isolation, but if the Bank Rate had been raised in conjunction with other measures it would not have been open to this interpretation?——*Mr. Allen*: Yes.

2097. That is not what you say?——May I make one comment, in terms of my recollection of that time? Paragraph 69 ends: "It was not felt that in fact the domestic situation warranted a sharp monetary shock." To my recollection, the monetary figures did not show clear signs of inflation until well into 1955; it was from February onwards that the monetary side began to show up. The latter part of 1954 produced something like the usual miscellany of conflicting factors: certain factors of cost which looked inflationary; certain rumours, rather than any statistical information, of growth in investment activity. The situation was also complicated by reactions from the dock strike. There was not a clear situation in the late autumn and early winter of 1954 which would have made it appear that "the domestic situation warranted a sharp monetary shock."

2098. If we were thinking in terms of the classical theory, surely it would have been natural to react to a discount on sterling by putting up the Bank Rate sharply? Are you not saying that that is exactly the thing you would not contemplate?——*Mr. Mynors*: I would not have thought that the classical theory had much to do with the discount on transferable sterling. Up to this point, transferable sterling was a completely unrecognised market.

2099. I will come back to that in a moment. For the present, are we to take it that you would regard a rise in the Bank Rate in isolation as an unsatisfactory reaction to a deterioration in the foreign exchange position?——If it did not appear to be in concert with and in support of other economic policy of a more general character.

2100. And you would say this even more strongly of a large rise than a small one?——Yes.

2101. You did in fact put up the Rate by half per cent., not by one, although later you were obliged to put it up again?——When it went up again, it went up in association with other measures. The half per cent. was an attempt to show that the warning given by word of mouth some two or three months earlier would be supported by other measures, if it were not heeded.

2102. Among those other measures was the support of transferable sterling. This was the measure which, to the outside public, was the most paradoxical in your response at that time. I assume that to have a discount of more than a few per cent. would lead to large scale commodity shunting. Had you any data on the extent to which commodity shunting was occurring at that time?——It is not an easy matter on which to get actual figures, but we had plenty of evidence that it was occurring on a large scale and becoming much better organised, as I recall. That is to say, brass plates were going up, companies were being established which were specialists in commodity shunting, so that you began to get a new technique developing. When that happens margins begin to get cut; you get shunting on a smaller discount on sterling than when the drill for dealing is not accurately known and there is not a specialist at your elbow to do it at a cut price.

2103. Do you assume that it was of larger dimensions than in the late forties?——*Mr. O'Brien*: I should think it would have been greatly developed at the later date, because it was much better understood, and all the commodity markets were open; it was through those that we received most of our information that trade was being distorted into other channels.

2104. Would you take the view that we lost less foreign exchange by supporting transferable sterling than by allowing the commodity markets to continue commodity shunting?——*Mr. Mynors*: That would certainly be my view; but I could not produce figures.—*Mr. O'Brien*: It is impossible to get such figures.

2105. There were indications at one time in the forties of the scale on which it was taking place. Had you no indications here?——The deals were not taking place here in this country, and were naturally difficult things to observe.

2106. *Sir John Woods*: Having listened to this conversation, it seems to me that the effect of paragraph 69 as a whole is to reinforce what Professor Sayers said just now, that everyone, including the authorities, in fact underestimated the momentum of what was behind the total activity and the inflationary possibilities? Is that not so?——Yes.

2107. If you accept that, and now look back with hind sight, do you think that if those possibilities had been realised it would have been a good thing, whether in February or earlier, to have raised the Bank Rate, more

vigorously if necessary, by itself and chance the possible damage to external consequences?——*Mr. Mynors*: I think I should wish the hindsight to have brought forward the action that was taken to an earlier date, not to have moved the Bank Rate by itself and on a larger scale. I should have still wanted the package of measures, particularly the transferable sterling point.

2108. *Sir Oliver Franks*: There seem to me to be two quite distinct reasons for wanting the Bank Rate to be part of a package. One would be that only so used is it likely to be effective in relation to the domestic economy, whatever the purposes to be pursued; and that by itself it is not likely to be effective, and is, therefore, better not used. The other consideration is that, in so far as it is effective, it bites on the private sector, and Government expenditure, which is not therefore directly regulated by the Bank Rate, might, if a Government so wished, go booming along with no difference at all. So, without perhaps intending it or meaning it at all, if you leaned wholly on the Bank Rate you might be depressing the private sector without that being an object of the policy. Those two considerations might easily go hand in hand; but when you were arguing just now that in general the Bank Rate should be moved upwards in association with other measures, had you both in mind, or the first only?——I had both in mind.

2109. *Chairman*: I still have not got to the bottom of this argument, which has been used by the Chancellor once or twice. If you put up the Bank Rate, it is taken externally as a sign that the authorities consider the situation grave. If you put it up with other measures, why does it not suggest that the situation is even graver?——It is partly a matter of the scale of the movement. If we suddenly jumped the rate by 3 per cent. someone would certainly panic, I should think.

2110. It is not the actual nature of the jump?——It is a question of whether you move or not.

2111. Acting by itself or with other things?——Yes.

2112. *Mr. Woodcock*: You are not saying that at all times you would be unwilling to move the Bank Rate by itself?——I am addressing myself to this past period; I do not think it is equally true at all states of the tide. During this period people were frightened of a general inflationary situation associated particularly, I think, with the level of Government expenditure. If they felt that the budgetary situation, both on current and capital account, was well in hand, and if the taking of that in hand was associated with monetary moves in the same direction, they would feel that the British authorities as a whole were watching their own domestic situation and were determined to keep it in check; and any monetary measures associated with budgetary measures and possibly others in the field of taxation would be an encouragement to believe that there was a coherent and understanding policy at work. The risk at the other end is that they begin to be frightened of an inflationary situation developing; no one does anything about it for a time, and then the Bank Rate is put up, but nothing else happens to change the climate in the United Kingdom. The questioo then arises whether the man who is planning an investment policy is going to pay any attention to a rise of 1 per cent. in the Bank Rate. It may still pay him to go ahead with the investment programme he is about to embark on, and then it looks as though it is an ineffectual traditional geature; there is no evidence that it is going to the root of the trouble.

2113. *Chairman*: Does it follow that, if a package deal is likely to be effective for this purpose, a movement of the Bank Rate by itself is not?——Unless it were on a scale which perhaps would be impracticable, if indeed it would be acceptable, which is a further question.

2114. *Professor Cairncross*: The great merit of the Bank Rate is surely that you can move it at any time, whereas the disadvantage of a Budget is that you only have one a year, unless you are very unlucky. If one thinks of other measures, they have to be introduced systematically and not at frequent intervals. If you are telling us that the Bank Rate in general is not likely to be very effective unless taken in conjunction with all the other measures, do you not destroy many of the advantages of moving the Bank Rate?——I would not be held to mean that, as an all time rule, the Bank Rate should only move with other things. I may appear to be criticising Government financial policy, which, naturally, I do not set out to do; but I think the general budgetary situation throughout has been an immense preoccupation from the monetary point of view in these years, as we bave said before. If that were out of the front of people's minds, one would be a much freer agent for moving the Bank Rate for short-run periods of control.

2115. *Lord Harcourt*: You said that in the autumn of 1954 you would have been afraid of the external effect of moving the Bank Rate in isolation. Would you be as afraid now, in 1957, of the external effect of the Bank Rate in isolation? Was the fear in your mind of the external situation then due to the fact that you had not in fact used the Bank Rate for so many years, and that the external world might take an entirely different view from what you hoped; whereas in 1957, you have used the Bank Rate on a number of occasions in the past three years, and the foreign operator is beginning to get used to it, and might therefore pay more attention to a move in the Bank Rate in isolation now and take a different view to the view he would have taken in 1954?——If I may say so, I think there is a good deal in that, though the foreign operator is still interested in the general economic condition of this country. I think he would take much more notice of a move in the Bank Rate in isolation now than he would have three years ago; but he would still judge its local effect more in terms of the budgetary position, the position of wages negotiations and so on, than, say, in prewar years. He is very conscious of the background against which the Bank Rate must operate domestically.

2116. *Sir Oliver Franks*: How far are the considerations now being put to us coloured by taking a very modest view of the range in which the Bank Rate is likely to move; say, from the 2 per cent. that it was at the beginning of this period, to the 5½ per cent. which falls within the period, and taking 19th September as beginning something new? With tax at 8s. 6d. in the pound, I suppose any move between 2 and 5 per cent. tends from the point of view of the industrialist to be trivial. Unless a lot of other things are in his mind, he will not pay much attention to it. If he does, it will be because he is worried about other considerations. Does it not follow that if, taking account of the taxation position, one normally moved the Bank Rate by two points at a go, when it was moved it would be perceptible, and it would not be as powerless as you say if used in isolation? Might it not be that the movements made were rather in line with the traditional movements, but the tax situation combined with the investment boom meant that they did not register, and that therefore you fall back on the theory that Bank Rate must be moved as part of the package deal? Would you like to tear that to pieces?——*Mr. Mynors*: I would accept a good deal of that. We were feeling our way, going back to a tradition which was pretty ancient in the minds of a lot of people, and trying to adapt it to modern conditions in which we were not, of course, entirely free agents; that is to say, we bad to get certain agreement to our particular moves. It would not be untrue to say that, when we started, we did not think we would get as high as we are now.—*Mr. O'Brien*: After all, the 5½ per cent. was once described as a "near-crisis" rate.

2117. *Professor Sayers*: You indicated that you believe that the foreigner would take more notice of Bank Rate changes in 1957 than he would have done in 1954. That seems odd to me, in that it is exactly the opposite of what seems to have happened in domestic opinion. If one takes as an indication of domestic opinion the annual statements of the bank chairmen, one finds in 1952 and 1953 that the revival of the old weapon had very much impressed them. On the other hand, when you come to 1955, 1956 and 1957, their disillusion is almost complete; they do not believe in the old weapon any more. Why should the foreigner have changed in the other direction? If the foreigner had seen the Bank Rate being used without apparently very much effect, why should not he also be disillusiooed?——*Mr. Mynors*: I made an important qualification, that he also has to be assured that the situation on the public expenditure front, on the wages front, and so on, is what he regards as satisfactory; then he will take to the Bank Rate as a normal

means of control in the shorter run more readily than be would have when be did not realise how far it had been restored to our armoury.

2118. *Lord Harcourt*: I think the import of my question went further. I was thinking that, whereas a rise of a half per cent. in 1954 might have tended to frighten the foreigner, a rise of 1 per cent. in 1957 might tend to reassure him about sterling; but that is only a habit, because in the last three years the Bank Rate has tended to be moved in conjunction with other things; a rise now would reassure the foreigner, because he would think something else was coming, and therefore it might be quite effective in isolation.——*Sir Oliver Franks*: Because of its prophetic power?—*Lord Harcourt*: Yes.—*Chairman*: I wonder when this change of attitude came about? I have an eye on paragraph 101, which is dealing with another situation, that of February, 1956. There the Chancellor is quoted as saying: "I believe that all over the world an announcement of a rise in Bank Rate, had it been made a few weeks ago when I first took office, would have been regarded as a sign of weakness and fear; whereas I believe that, combined with these measures, it will be regarded as a sign of strength". Can you comment on that from your point of view?——I do not think that I ought to comment on utterances of the Chancellor of the Exchequer.

2119. It seems to have been the official view in February, 1956?——You must bear in mind the context of that. At the end of 1955 there was a very sticky foreign exchange situation, and at that point, for reasons which had nothing to do with the monetary and economic situation, there was a change in the Chancellorship on about the 20th December. In those circumstances, if the first thing that had happened had been the Bank Rate suddenly shooting up, it would have looked as though it was not part of a coherent programme, but was, as it were, someone pulling down the shutters. We judged that it was much better to let the new Chancellor look round. I think the change of personality, which obviously received notice abroad, was probably quite material.

2120. However it comes back to the same thing in February, 1956, that only if you tie the things together can a Bank Rate move be regarded externally as likely to be effective?——In a situation of that kind you must tie the things together, because, unless you do, it looks like a lone wolf attempt to save the house from burning down.

2121. *Professor Cairncross*: When did the tradition of not putting up the Bank Rate by less than 1 per cent. alter? Surely before 1932 it would have been rare to put up the Bank Rate by a half per cent.?——Some learned person wrote an interesting article on moves of the Bank Rate up by 1 per cent. and down by half. I forget when the tradition may be said to have become fully established, but it certainly lasted until the Bank Rate stopped moving; until the 2 per cent era, a rise by a half per cent. was unusual.

2122. *Sir Oliver Franks*: I think you have said that over this experimental period of the last five years by and large it has been the policy of the Bank that the Bank Rate should be moved only in conjunction with other measures which affected the economy in the same direction, but that such a view does not amount to a principle in the sense in which Mr. Woodcock was describing it; that is to say, it does not hold for all times, but it is a view which has been held on a series of occasions over a number of years. Is that a novel development of doctrine? If you go back to the periods before the "freeze" of Bank Rate, would this view, that Bank Rate is only reasonable or efficacious at home and abroad if used in conjunction with other measures applying to the domestic economy, have occurred to people at that time? Are we looking at something new in the situation, at least as far as this five-year period is concerned?——With the emphasis we have been giving to it in our evidence, I should say it was something quite new. I would not say it was 100 per cent. new; in those earlier periods if there bad been a depression of trade and they had wanted to reduce the Rate, the exchange situation being satisfactory, with the object of giving some stimulus to trade, they might have followed it up with open market activity. They would not have regarded it as entirely independent, but only associated with activity within their own jurisdiction.

2123. *Lord Harcourt*: Would it be fair to say that the reliance on Bank Rate in isolation has been reduced as the importance of the public sector has increased? Is not one of the reasons why ancillary measures are needed that Bank Rate does not operate on the public sector or the nationalised industries?——I would agree.

2124. Therefore, the ancillary measures are made more important?——Yes, certainly.

2125. *Chairman*: Would that not apply to all monetary measures, Bank Rate or others?——Yes.

2126. *Professor Sayers*: So the new conditions are not just confined to 1951-57; a large part of this is something we have to look forward to as part of the system?——Yes.

2127. *Sir Oliver Franks*: Given that an important factor in this rather new view of the uses and utility of Bank Rate is the greatly increased weight of the public sector in the economy, do you think there may be another factor? Since the war full employment, in some sense of the term, has been an accepted measure, and possibly the first article of principle and doctrine, for any government elected. It is clear, I think, that Bank Rate beyond a certain point if effective must bite on employment. Is it therefore reasonable to assume that in this period limits to the employment of Bank Rate have been set by the over-all economic policy of the Government, and that moderation in its use was prescribed from that source? If that is so, it might follow that these very broad considerations made it impossible to use the Bank Rate in a way that it would be effective in the short term by itself, and that, therefore, if it was to have an effect it had to be used in conjunction with other measures which would affect the whole economy. Is it fair to say that the second consideration is also a thread working through the period?——A lot of that, I think, raises questions of general economic policy which is not for me to answer to. But I think that that is perfectly fair comment on Bank Rate as an independent weapon.

2128. *Professor Sayers*: On the question of the rise in whole range of interest rates at the end of 1954 and early in 1955, referred to in paragraph 70, you have indicated that the rise at the short end was somewhat helped by the authorities. May I take it that the authorities' action was confined to the short end?——I think so.

2129. *Chairman*: On paragraph 73; I think you said the other day, when I was asking about the possibility of the Bank pursuing a policy, in order to reduce banks' liquidity, of trying to get Treasury Bills held outside the money market, that it was not a thing you could control, that it came and went rather by forces beyond you?——I think that is right.

2130. *Professor Sayers*: In paragraph 78, you say that "there were clear direct effects upon the external situation"; are you referring there to the changes in the exchange markets, or to something else?——Changes in the exchange markets, and the effect on reserves.

2131. *Professor Cairncross*: Was this the result of independent market forces, or was it the result of the support you introduced?——As I recall, not a great deal of support was necessary. Once it was known that support was there, not a great deal was required.

2132. Was this also affected by the rise in the Bank Rate? I take it that the price of transferable sterling would respond to some extent to Bank Rate and other measures?——*Mr. O'Brien*: Yes.

2133. *Lord Harcourt*: Particularly when the transferable rate became a recognised rate?——Yes.

2134. *Mr. Woodcock*: This seems to contradict what you have been saying. You say the increase in Bank Rate was followed by so-and-so, and "there were clear effects on the situation"?——*Mr. Mynors*: I think that comment in paragraph 78 relates to the measures set out in paragraph 77 as a whole. Perhaps it is not very clearly put.

2135. *Professor Cairncross*: The other measures in February were not very extensive, were they? Do you really feel it was these other ingredients that made the difference in the attitude of the foreign operator?——The decision to intervene in the transferable market was much the most important of those decisions.

2136. In taking that decision you recognised it would be very difficult to back out of it; once in you were in?——Yes.

2137. *Professor Sayers*: It was not necessary to give it great publicity at the time, was it?——I think it was pretty widely publicised at the time, though there was no formal statement, that I recall, except what the Chancellor said in the House of Commons: that he had given authority for the agents who operated the Exchange Equalisation Account on his behalf to intervene from time to time, or some general phrase like that. That "from time to time" is right, of course, because there is a world of a difference between that and the obligations that existed with regard to the official rate.

2138. It must have been extremely difficult to take that decision knowing that it could not be revoked easily. "From time to time" is a good phrase; does it really correspond to the facts?——Yes.

2139. *Professor Cairncross*: In the sense that this gives you a tactical initiative in the market?——Yes.

2140. *Sir Oliver Franks*: Was it not an almost leading case in which the discretion of the language used was in very little relation to the importance of the decision? The language used in this paper before us, where it says that "the Exchange Equalisation Account Authorities were given a wider discretion", comes from the same hand, I think; it always moves me to great admiration!—Thank you.

2141. *Chairman*: In paragraph 80, you say: ". . . outside holdings of Treasury Bills had increased sharply, an increase presumably much influenced by a further rise in the differential between the deposit rate and the Treasury Bill rate".—*Professor Sayers*: Was it desired by the authorities that there should be a widening in the differential and so an increase in outside holdings?——I do not think we actively promoted it; we were happy to see it happen.

2142. *Chairman*: Have you ever considered it as a way to reduce the liquidity which embarrasses you?——If an industrial company has got liquidity which it does not need for the moment, it has always been able to buy short bonds; companies have in fact held a very large quantity of short bonds since the war. To some extent, I suppose, these holdings would be as alternatives to holdings of short bonds.

2143. *Professor Sayers*: There is a much wider range of dates with Treasury Bills?——*Mr. Mynors*: Exactly. —*Mr. O' Brien*: The incentive to hold Bills is increased as market rates at the short end generally are kept tight because then the differential between the bankers' deposit rates and the Treasury Bill rate becomes more apparent.

2144. That differential is, to some extent, controlled; it is subject to your influence?——Yes.

2145. I think the Chairman was wondering whether you had considered the policy of using the differential in relation to the possibility of development of outside holdings?——Not specifically, because the pattern of rates could easily become disturbed if the differential as between the rate on the Treasury Bill and the bankers' deposit rate was consistently very large. The banks might feel that their deposit rate was too low and the margin available to the discount market as the principal purveyors of Bills was too much.

2146. There have been quite considerable periods of wide differential. While the bankers have sometimes reacted by edging up their rates to the discount market, narrowing the discount market's margin, I have not seen any suggestion that they would raise their deposit rate in relation to the Bank Rate?——They have not so far taken that action, although, as you say, they have, in effect, charged the discount market more for their money.

2147. But the differential is relevant?——As between the deposit rate and the yield on Treasury Bills; yes, I quite appreciate that.

2148. *Chairman*: Quite a few times in this paper we come across the statement that the outside holdings of Treasury Bills were much increased, and I think it is always put down as being something which suited the Bank, on the whole. When considering alternative techniques, all of which include putting some compulsion on the banks in one aspect or another, I wondered whether you have thought of requiring them to regulate the rate that they offer for deposits so that it would consistently be below the Treasury Bill rate?——*Mr. Mynors*: We have never considered that.

2149. It would have, I suppose, the usual inducement, that it would favour short term lending to the Government at the expense of other short term lending?——*Mr. Mynors*: Nearly all the alternatives do.—*Mr. O'Brien*: If power were taken to regulate the bankers' deposit rate, supposing, it now being at 5 per cent., it were arbitrarily reduced to 4 per cent., the bankers might be disposed to lend money more cheaply to the discount market to finance their Treasury Bill book, which might have an effect on the Treasury Bill rate, and might make them more anxious to compete for Bills.

2150. *Professor Sayers*: You can offset that? You can keep up the Treasury Bill rate if you want to?——You have to remember that we are borrowing on behalf of the Government.

2151. *Professor Sayers*: In February 1955 the differential seems to have produced a big industrial demand for Treasury Bills; but I gather that during the last six or seven weeks, when the differential has again been unusually wide, there has been nothing like that demand on the part of industrialists?—*Sir Oliver Franks*: Is not the difference that in the earlier period there was a large positive rise from what was usual before, whereas in the more recent period, while the level reached by the previous rise has been maintained, it seems as though something like saturation point has been reached?——I think that is a large part of the explanation.

2152. *Professor Sayers*: Is it not a fact that industrial holdings of Treasury Bills are very much smaller than they were in March, 1955?—*Mr. Mynors*: My estimate, which is just guesswork, is that they would now be substantially what they were early in 1955, having been higher in the interval; they have gone up and come down.

2153. But they are still lower than they were when the differential was much narrower?——They are higher than they were when the differential was narrower.

2154. *Professor Cairncross*: They form a higher proportion of the total liquid assets of industrial companies? ——Yes. There does not seem to be any closer relationship between the differential and outside holdings of Treasury Bills.

2155. *Professor Sayers*: In paragraph 80 you say: "There must have been changes in the Discount Market's assets other than Treasury Bills". Do you not know? ——I am a little troubled by the language used on one or two occasions here. The real answer is that information on the holdings of the discount market is going to be submitted to you by the discount market. We used these words in order that the owners of these figures may have an opportunity of presenting them to you themselves. We do of course know that there were changes.

2156. Referring to the figures at the end of paragraph 82 of maturities and redemptions; if one thinks in terms of the amount of stock held by the public, are these the relevant figures, or were there big changes in the holdings of the Departments?—*Mr. O'Brien*: These are the nominal amounts of the Government securities that matured in this period and were converted.

2157. They tell us nothing of the public holdings?—*Mr. Mynors*: That is a different set of figures, which are, I think, in the appendix to this paper.

2158. In the second sentence of paragraph 85 you say: "There was no conviction among the public that a curtailment of credit would effectively be enforced"? Whose fault was that? Would you say that was the responsibility of the Government?——I do not think that I could very well apportion responsibility for that. The impression we got was certainly that they did not really believe anything troublesome was going to happen.

2159. *Sir John Woods*: Do not all these paragraphs go back to the conclusion that in fact the measures taken did not have the effect of curtailing and restraining activity to the extent one would expect? Indeed, in one of the Treasury papers they quote the Chancellor of the Exchequer as saying in October, 1955, that the measures taken were proved to operate less rapidly "than we either

expected or intended". Do you agree with that?——Yes, I think that is a fair comment. Trying to sum it up, we were all very conscious of the desirability of a large investment development. We were moderately conscious of the risk of inflation, but nothing like so conscious as we are now. One realised that one must look out for price rises, but had not got accustomed to the feeling they were going on in the relentless way in which we have been used to their doing in the past year. It was regarded as a very admirable thing that there should be large scale investment, but that we should see we did not overdo it. The emphasis was on development rather than avoidance of excess.

2160. *Chairman*: Would you agree with the Treasury that there was a failure to appreciate in 1955 what a very large increased demand there would be for stocking up?——I accept that.

2161. *Professor Cairncross*: Was there a fair amount of borrowing in the first half of 1955 in anticipation of restrictions later? Did not some of the increases in advances take the form of advances to businesses that were providing themselves with ample liquidity?——I think that is for the clearing banks to give evidence on. We had no reason to suppose that that happened at all.

2162. *Chairman*: You say in paragraph 86: "Their [the banks'] liquidity ratio was restrained partly through the rise in their advances but equally through limitation on the supply of Treasury Bills"; we must not over-emphasise the word "restrained"? It was because they were making many more advances that their liquidity ran down?——*Mr. Mynors*: Yes. They restrained their liquidity ratio partly through letting their advances increase.—*Mr. O'Brien*: Although at the same time they were selling securities very heavily, which probably about matched their increases in advances.—*Mr. Mynors*: We did remarkably well in keeping the figures for market Treasury Bills in the June quarter so low, because it is a quarter of seasonal deficit.

2163. Appreciating that the banks look to their investments and get rid of some of them in order to make more advances, were there cases of commercial and industrial people who were asking for advances but who could not get them because of the position in which the banks found themselves?——I do not really know how far there were actual refusals during that period. I should have thought that for an approved type of advance, for export and so on, they would have been getting what accommodation they asked for.

2164. *Professor Sayers*: In paragraph 87 you refer to big sales of securities, both by the authorities and by the clearing banks, totalling £300 million. That was one of the really surprising features of that period. People had said years before that the market just could not absorb £50 million or £100 million in such a short period if both the authorities and the clearing banks were selling; and here we have £300 million in the quarter! Who absorbed those?—*Professor Cairncross*: I think one should take that in conjunction with paragraph 86, because it is there pointed out that the financial requirement of the Exchequer and nationalised industries was £304 million, and only £2 million was contributed through expansion of Treasury Bills*.——*Mr. O'Brien*: I do not think we have any detailed information about who took up this large amount of securities.

2165. *Professor Sayers*: It must have whetted your appetite quite considerably. Have you any guess as to where these went?——I think that possibly the discount market took quite a lot.

2166. Do you not know that?——*Mr. Mynors*: I shall have to look that up. I do not remember how much the market took.

2167. I do not think they took anything like that amount?——Nothing like the whole; they may have taken some of it. For the rest, I do not think we really know in detail.

2168. *Lord Harcourt*: Must it not have gone to pension funds and life funds?——I would think so; but I am afraid that we have no figures.

2169. *Professor Cairncross*: This all happened on a falling market?——*Mr. O'Brien*: No.

* The figures in this question have been revised so as to be consistent with the revised versions of Memoranda of Evidence Part I No. 9 and Appendix 2.

2170. *Chairman*: But in paragraph 87 you say: "Prices, as a whole, rose between the change of Bank Rate in February, 1955 and mid-April. There was then a new and sharp fall—partly under pressure of sales, partly reflecting renewed doubts about the general situation—but this was followed by a much more moderate downward drift until July." So apart from the first week in April, the gilt-edged market was falling in this quarter?——Yes.

2171. *Professor Sayers*: Looking at the £300 million in three months, you must wish you could recreate that state of affairs?——*Mr. Mynors*: We do. I must confess I am surprised about the impression left by that paragraph. Might I look into this, because this is a point which has arisen in evidence earlier. Here we appear to have done our best work against a new and sharp fall, followed by a much more moderate downward drift.†

2172. Does not the reference to "other accounts" in the middle sentence of paragraph 88 suggest that it would be desirable to have some clarification of this item in bankers' statements? It apparently distorts the run of the figures.—*Chairman*: I have the general impression that covered internal provisions.——That is a point you may wish to take up with the clearing banks.

2173. *Professor Sayers*: Did the authorities agree the phrasing of the first sentence of the clearing bankers' letter to "The Times", quoted in paragraph 88? I am thinking particularly of the point where they deal with "internal demand"?——The letter was written, brought to the Bank, and shown to the Governor and to the Chancellor of the Exchequer, who both welcomed and approved its appearance.

2174. *Chairman*: There is no doubt that the letter is saying that it is the policy of Her Majesty's Government which leads them to restrict advances, and nothing else?——Yes. They would have found it helpful, as I recall what they told us, if they could have said to their customers across the table: "We want to help you, but public policy makes us more restrictive than we wish to be".

2175. *Professor Sayers*: On paragraph 92, with regard to this sharp Stock Exchange fall from July until September, 1955, have you any opinion on the proximate causes of that fall? It has been suggested in an article in one of the learned journals that this is to be associated very largely with the pressure of the banks on their customers to realise securities in order to pay off bank advances. Have you any comments on that?——I do not remember hearing that much said at the time. There may have been isolated cases, but that was not regarded as a major factor.

2176. You do not remember having discussed it with the clearing banks at all?——No.

2177. *Chairman*: In paragraph 94, referring to issues of stock by the nationalised industries at that time, you say: "Continued increase, or maintenance, of their bank advances, standing by mid-summer at a high level, was not compatible with the reduction of advances generally which was a main object of policy. Markets however were not receptive to these issues". If they were not receptive, as far as I can see, what would have happened would be that the clearing banks were relieved of a measure of these advances, and the Government took them over; but since they could not float them in terms of stock they had to issue Treasury Bills?——A large part would have gone into the Issue Department, and Treasury Bills would have appeared instead.

2178. And it is only what success was achieved later in getting rid of the stock that made any true difference to the economic position?——Yes.

2179. *Chairman*: You had an autumn budget in October 1955 which put in a number of restrictive measures.—*Professor Sayers*: Why was there not a rise in the Bank Rate as part of that package deal?—*Sir John Woods*: Is that not answered in paragraph 95: "Unless accompanied by still further measures in the field of public spending, the presumption was that a rise of Bank Rate would be regarded as an interim, but incomplete, measure"?——*Mr. O'Brien*: I think we felt at that particular moment that it was the public spending which was the most important aspect.

† See Appendix to Minutes of Evidence.

2180. *Professor Sayers*: Did you not feel that investment was going ahead by this time?——It was in the public sector that it was most troublesome at that time, towards the end of 1955.

2181. *Sir Oliver Franks*: Would it be reasonable to infer from what you said that this was one of the occasions where the alignment of all the views which had to be taken into account in order to get general agreement on public policy was a little more laborious than sometimes?——*Mr. Mynors*: I think it was rather laborious on that occasion.—*Mr. O'Brien*: After all, we must recall that we had had three large issues of nationalised industries stock slightly earlier on in the year which had been noticeably unsuccessful, illustrating how difficult it was to finance these capital requirements by withdrawals from the market.

2182. *Professor Sayers*: Was that not a reason for putting up the Bank Rate?——*Professor Cairncross*: Or do you still work on the supposition that rates of interest do not matter to nationalised industries but only to the private sector?——*Mr. Mynors*: At this stage, it was difficult to see any evidence. I do not say that is true today.

2183. Does it not seem a little curious, if you have difficulty in selling Government bonds and have an opportunity of raising the Bank Rate, that you should have declined the opportunity?——*Mr. O'Brien*: If one thinks a rise in the Bank Rate is not the right way of tackling the question, but that one ought to reduce the expenditure which is causing the trouble, it may not be wise to raise the Bank Rate and leave the other causes untouched.

2184. *Professor Sayers*. Are you suggesting that you refrained from raising the Bank Rate at this time because you wanted to let private investment go ahead, but to make room for it by getting a cut in public expenditure?——*Mr. O'Brien*: I think that is going too far.—*Mr. Mynors*: We got the curtailment of advances going at full speed, which would have tended to restrict excesses in the private sector. I was trying to remember our discussions about the Bank Rate at that stage, but I cannot.

2185. *Chairman*: I am not quite clear when these issues of stock which were unsuccessful were made. If you had them on your books and could not get rid of them, putting up the Bank Rate would have destroyed your last chance, surely?—*Mr. O'Brien*: In June for Transport; in July, for Gas; in August, for the British Electricity Authority; in October, for the North of Scotland Electricity Authority.

2186. So, before the Budget measures came along, you were carrying all this stock?——*Mr. O'Brien*: Yes, and we were very conscious of the fact.—*Mr. Mynors*: And in November, we had the Serial Funding Stock to deal with.

2187. *Professor Sayers*: When you put the Bank Rate up at the beginning of 1955, there followed a period of three months in which, taking the banks and the Bank of England together, £300 million had been unloaded on the public. Here you were in the autumn with terrible indigestion, and you did not follow the recipe of the earlier part of the year?——Putting on a dish with the same recipe would not have revived the appetite necessarily.

2188. Why did you decide not to repeat the remedy?——May I look into that question of no change in the Bank Rate?* We must have thought about it, obviously, but I do not remember the outcome. One can remember reasons why one does things; one can be excused, perhaps, for forgetting the reasons why one does not do things.

2189. *Professor Cairncross*: One consequence of the Autumn Budget was that the price of Government bonds improved shortly after October?——Immediately after the Autumn Budget, but not for very long.

2190. But there was a very noticeable change of trend. It was in fact something like six months before prices came back?——That is right.

2191. *Professor Sayers*: I have a point on paragraph 96 about the information available inside the Bank. You say: "There was a further fall in outside holdings of Treasury Bills, probably due to the run-down of overseas sterling". Was the Bank in a position to know whether or not that was the case?——We would have had a pretty good idea.

* See Qn. 2235.

2192. *Chairman*: On paragraph 97, I am a little puzzled about the rise in overseas countries' long-term investment in the United Kingdom at this particular period. What would be the influences which would have led it to rise?——*Mr. Allen*: A certain amount of that investment was, if I recollect, portfolio investment on the Stock Exchange, and a certain amount direct.

2193. This was a critical period when there was no marked confidence in sterling, if I understand the general statement?——Some of the direct investment resulted from a shortage of credit facilities within the United Kingdom and overseas companies making direct investments in the absence of local borrowing. With regard to portfolio investment, I would like to see whether particular opportunities were available at the time.*

2194. *Professor Sayers*: In paragraph 102 there is quite a big package deal, in which the Bank Rate was included. Would the effects have been the same had these other measures mentioned in paragraph 102 been taken without any change in the Bank Rate?——*Mr. Mynors*: No, I should have thought a change in the Bank Rate was important, at least, from the market point of view. The market gets a sight of the new measures and has a think about them; there is a Bank Rate change, suggesting that the market view of rates can be consolidated, and it helps to get the market off to a better start.

2195. You mean the market generally?——Yes.

2196. *Sir John Woods*: You talked about the market point of view; would it not be your opinion that at 5½ per cent. you are beginning to have a deterrent effect on borrowing for investment?——It is difficult for me to name a specific figure. I would have thought that we were beginning to have an effect. Our most recent experience would have said perhaps it would begin to have an effect at 6 rather than 5½ per cent. One cannot be within half a point.

2197. I am referring back to Sir Oliver's point earlier on, that between 2 and 5 per cent. you are not likely to have much effect on the country's investment: what about 5½ per cent.?——You are getting within reach, I would think.

2198. *Professor Sayers*: When you talk about the market effects of the Bank Rate change, are you thinking that the market's appetite for long bonds and medium bonds would now become bigger?——I think paragraph 104 says what was in my mind: "A rise, rather than any fall, in prices was now regarded as the likely prospect".

2199. *Sir Oliver Franks*: I had the impression that in 1956, up to the outbreak of the Suez crisis, in contrast to 1955 and 1954, the economy gave the appearance of coming progressively under control; and I was inclined to think in the early autumn of 1956 that by, say, March, 1957, the objectives of the Chancellor of the Exchequer would broadly have been reached. Is that purely personal view of mine at all the way the Bank were viewing the situation, say, in early autumn 1956? And, if so, is it possible to single out at all what were the factors which were operating over 1956 which did really seem to produce results when the measures taken earlier did not? Or were simply the process of time and accumulation, or were things done at the beginning of 1956 which made a difference because they themselves were different?——I would accept that as a general feeling about the way things were going in that year. The thing most in my mind was the Budget position, which had quite noticeably improved. Expenditure below the line was much sounder, and the figures throughout the year, even in the earlier months, were better than they had been.

2200. Is it fair to say that, given that eighteen months before this period at least two severe controls were operating on the private sector, the request to restrict bank advances and the limitations on hire purchase, what had prevented the boom appearing to be under some real control had been the public sector; the way in which the money was actually being spent there had not quite marched parallel with what was happening in the private

* See Appendix to Minutes of Evidence.

sector; while in this period, for the first time, the operations were carried out more or less equally on both sectors, and the economy responded? If this is, in general terms, a fair sort of description, may there not be a very important moral in it?——I should have thought there was a good deal in that point. There was a striking difference in the public sector and its effect on monetary conditions which happened during that year, which I think is important.

2201. *Chairman*: A difference in the method by which it was allowed to raise its money, or in its level of expenditure in itself?——It was partly a change in the methods of raising money; the local authorities were going heavily to the mortgage market and, to some extent, to the stock market, which very much reduced the immediate burden of advancing the needs of the Exchequer. That was not the only thing which reduced the needs of the Exchequer.

2202. What was the other thing you had in mind; the actual cutting down of the volume of its expenditure?——It certainly rose more slowly. I do not recall an actual reduction, but it rose very much more slowly.

2203. *Sir Oliver Franks*: Is it fair to say that up to Suez, but not in the period after Suez, the most obstinate of the problems with which the authorities had to deal in coping with the economic situation of Britain in 1954, 1955 and 1956 was how to get Government programmes, both of expenditure and of financing that expenditure, into focus and into relationship with what was required in other parts of the economy; that, when this fell into place, then the economy began to respond, but until it happened, there was really no response?——There are two things: the actual effect of that happening, and also what people thought about the prospects of it happening. Certainly in the earlier years, even if the Government were not running too large an Exchequer deficit, I think there was a very wide feeling that, whatever happened in the private sector, the same sort of level of economy was not being achieved, and was not going to be achieved, in the public sector. The effect on the attitude of people planning investment programmes, and so on, is perhaps greater than the absolute size of the Exchequer deficit might justify.

2204. Because they think that demand is going to be all right anyhow?——That, whatever happens, the Government are going to support it.

2205. *Professor Cairncross*: You are not suggesting that public investment as a whole declined after 1955?——*Mr. Allen*: Both public investment and private fixed capital expenditure rose, though less rapidly, during 1956. Perhaps the most singular change in the private side was the rise in personal saving.

2206. I agree there was a change there; but on the actual outlay of cash was there any change in trend between 1955 and 1956 on the public sector?——To my recollection, there was a slowing down in the rate of growth. Some absolute increase occurred, but smaller in absolute amount and distinctly smaller in percentage amount.

2207. The change was much more on the method of finance and on opinion, rather than in actual expenditure?——*Mr. Mynors*: I think the effect on opinion is not unimportant.

2208. *Chairman*: Paragraph 106 refers to a rise of £54 million in the advances of the clearing banks, and I have noted that in the next quarter, March-June, there was another rise, of £70 million, in their advances. Was it a surprise to the Bank of England to find that bank advances were rising by that measure in those two quarters?——No, I do not really think it was. The clearing banks had kept us advised fairly closely how things were going, and we knew that it is like squeezing a sponge: you go on squeezing it and you get less and less water out each time. There were certain things which were bound to go up, and sooner or later a bottom was bound to be reached where movement was more likely to be up than down.

2209. *Professor Sayers*: At the end of paragraph 109 there is a reference to the relief to the Exchequer following the change in the method of finance of local authorities' capital development. How big is that relief really? These figures indicate the amount that the local authorities raised themselves, for which they would have come to the Exchequer if they had been operating under the old system. If they had, the Exchequer would have had a more receptive market but not so much more receptive as to have taken care of all these amounts. Is that right?——I would say not so much more receptive as to take care of these amounts. These small individual issues tap sources which would not necessarily respond to large Government issues.

2210. You consider that you did, to an important extent, enlarge the sources for central plus local government capital?——Yes, without suggesting that it is equal to the gross figures raised in that way.

2211. *Chairman*: How much did they get in the mortgage market in that year? Would you regard that as being virtually a different source?——*Mr. O'Brien*: Yes, and the amounts involved much larger than this £66 million by market issues. I do not think we have anything better than estimates; but some estimates are given in paragraph 9 of our paper 10. The estimate for 1956-57 is about £230 million.

2212. *Professor Cairncross*: Would not a substantial part of the sum raised on the mortgage market come from insurance companies and elsewhere?——*Mr. Mynors*: By no means the complete addition. The Trustee Savings Banks Special Investment Department, for instance, would figure quite largely in the mortgage market.

2213. They might have considered it as an alternative to equities rather than to gilt-edged, in the mood they were in?——*Mr. O'Brien*: They would have averaged a higher yield than gilt-edged, and would, therefore, have a special attraction of their own in small amounts.

2214. But would the insurance companies have bought gilt-edged with the funds they put into the mortgage market for local authorities?——They might have bought real property, leasehold property, or something like that, instead. The paper to which I have referred makes some reservations about the effects on gilt-edged buying.

2215. *Mr. Woodcock*: You say in paragraph 109: "Changes in interest rates and tax liabilities affecting 'small savings' . . . were announced". Have you anything to show what effect this had on personal savings proper, as opposed "small savings", and how far the changes in "small savings" was a real addition of new savings as distinct from a switch?——No, we cannot do that. There must always be an element of switching when you improve the terms and you have somebody not up to his maximum.

2216. A lot was switching in the early days?——Right through, I would think.

2217. *Professor Sayers*: In paragraph 118 we come to the movement at the beginning of 1957. You say that the fall in rates at the very end of 1956 and the first weeks of 1957 "was not opposed by the authorities". Had the authorities already come to the view that interest rates had better come down?——*Mr. Mynors*: I would say that we had not got as far as that. The situation, particularly over Suez, had turned out to be less calamitous than had been thought at first. The general situation was not too bad. For technical reasons the discount market were happy to see rates coming down. They wanted to get the Bills and that reconciled them to the fall. They were avid competitors for Bills at that stage. We saw no particular reason in that situation to prevent that happening. Though it does not always work out that way, you always let the market do what it will do naturally, if you can, and do not always seek to establish how you want it to behave. They had very good technical reasons for bidding more for the Bills every week. We were content to let them do it within limits, but not overdo it.

2218. The limits would be set by what you did about Bank Rate?——Yes, certainly.

2219. In the beginning of February you reduced Bank Rate "as an adjustment to market conditions"?——Yes, and we made rather a song and dance about "adjustment to market conditions" in the hope that it would not be regarded as evidence of an opinion that no further caution or careful action was needed.

2220. This is what made it all so difficult to explain to outside people. You agree that the extent of the fall before Bank Rate was changed was limited by what you did about Bank Rate. In fact, it fell as far as it could, given that Bank Rate was still at 5½ per cent., because people were talking all the time about Bank Rate coming down. Then you justified that expectation by bringing the Bank Rate down, but said you were doing it as an adjustment to market conditions. Would it not have been right to say that you were bringing it down because you thought that on other grounds it should be brought down, and that therefore you saw no reason to oppose the view that the market had taken?——Instead of saying, as we did, that we saw no reason why it should be kept up; putting the same thing negatively, so to speak.

2221. You said you were adjusting Bank Rate to market conditions and said that this was something that had to be done, as though market conditions were something independent of what you were doing and thinking. But market conditions were not independent of what you were doing and thinking. Were not market conditions based partly on the fact that Bank Rate was still 5½ per cent., and partly on the fact the market believed you would come down to 5 per cent., or possibly 4½ per cent.?——You mean that we were appearing to suggest we were bound to bow to technical considerations when we could have controlled technical considerations, and the fact that we had not controlled technical considerations showed we were willing for the Rate to fall.

2222. It showed that you believed on other grounds the rate should come down?——I think I would agree with you, except to this extent: that we believed that on other grounds the Rate need not stay up, which is not the same thing.

2223. Now you are suggesting that Bank Rate should be at such and such a level unless the market thinks that conditions are fit for it to fall?——When I say "need not stay up", I have in mind that a small reduction from the level of 5½ per cent. was a thing we had been wanting to do for a long time, because we never want to have the Rate higher than we can help.

2224. Then why not say you wanted it to come down to 5 per cent., for what would have appeared to be perfectly good reasons?——Perhaps we could have done.

2225. You did say, in fact, that you were bound to a market, which was in fact under your control. I was wondering if there was anything more behind it?——No, there was nothing more behind it, except that we were very anxious for it not to be assumed that we were going further and that this was the beginning of the end of the restrictive period, because we were not clear that some measure of restriction was not still to be required: in other words, we were trying to "play it down".

2226. In the next weeks the market at once began to talk about when it was coming down to 4½ per cent., and so the market stood firm for a few weeks?——Not for very long.

2227. But for a few weeks. And you did not say again at the beginning of March that you were adjusting Bank Rate to market conditions and bringing it down to 4½ per cent., because presumably you thought a move to 4½ per cent. would be wrong on other grounds?——Yes.

2228. *Chairman*: The Governor when he was last here explained that you must always keep Bank Rate, if market conditions allow it, as low as you can to give you a margin for a jump from a lower step when you have to jump. Would that apply in this particular period?——Yes, I think so.

2229. *Sir Oliver Franks*: There was nothing in the short term market considerations which would make it unwise for a small reduction to be made in the Bank Rate; but one had also, I suppose, to think about the general state of the economy, the state of boom, the demand for longer term money, and so on. When it was decided to reduce the Bank Rate by the half per cent., efforts were made, in the words used, to say: "This means nothing in relation to all the important things in the economy" (I am paraphrasing it, but not, I think, unfairly). My experience, which is limited, was that on the whole people paid attention to the action and not to the words used. Most of the people who used money with whom I came into contact thought that this was a small general relaxation; no more, but that much. Was not that the general feeling?——Certainly. I know well what we meant to say. We meant to say: "Don't set any store by this reduction. This is an attempt to bring rates down a little in the interests of getting the Rate as low as does not seem unreasonable and in the interests of movement as such, of flexibility". We used the phrase "technical considerations", I think, on a traditional basis, that in fact small falls of a half per cent. from a fairly high level had always followed changes in market rates. I think we were disappointed to the extent that people did regard a fall of half per cent. as a real though small relaxation.

2230. *Professor Cairncross*: On this occasion you did not have a package deal and you were surprised to find that the movement down had some influence, even though it took place in isolation. Do you not think, in view of that experience, that perhaps movements up in isolation would have unexpected effects, or do you think it is only on the way down?——I should have thought they might on the way up. But I should wish to excuse myself from a general statement on that. We have to look at every situation, and say: "If we have to act in isolation is this going to do more good than harm?".

2231. People did take very seriously a reduction in isolation whereas you were inclined to discount the idea that people would take quite seriously a rise in isolation. I am wondering whether on that point you may not be too pessimistic?——It may be. I am not sure that we do not speak a little with two voices, if I may make a confession. Sometimes we say that, if we were to go up in isolation, nobody would pay any attention; and sometimes we say that we could not go up in isolation because that would scare people frightfully.

2232. *Chairman*: Is it not human nature to act on good news rather than bad?——*Mr. Mynors*: It is difficult to generalise about it, but I accept that that happens sometimes.—*Mr. O'Brien*: It is all too easy nowadays to give an indication that relaxation will come; it is much more difficult to apply effective restriction.

2233. *Sir Oliver Franks*: May there not be another point? If you take the tentative doctrine of the past five years that Bank Rate is best employed, and only effectively employed, when associated with other measures which jointly will affect the course of the economy, then it would seem quite natural for the general public to assume, if the Bank Rate comes down, that that is a reflection on the course of the general economy. Exactly in proportion as you have foregone the right to move independently and insisted on the package deal, you run into difficulty when you come down because people take the same considerations into account?——Fair enough, and not to be affected by talking about technical considerations.

2234. *Professor Sayers*: I remember trying to rationalise the Bank's action in this way: I thought that it was producing a package deal of its own, that it was putting the short rate down by ½ per cent. because it believed it was unnecessary to keep the short rate up as high as 5½ per cent. in the circumstances, but at the same time it was taking deliberate action, in ways which were publicised, to maintain the level of long rates. I thought the Bank of England had come to the conclusion that the relationship between short and long rates was not quite as it wanted it to be, and that this movement of Bank Rate, coupled with the other measures it had taken, was designed to produce a more healthy structure of interest rates in relation to what was happening to the economy. I gather, from what the Governor told us on a previous occasion, that that interpretation is quite wrong, and that what was done about long term rates had only a very incidental and partial relationship to what was done to short rates; is that right?——*Mr. Mynors*: I would say so.

(*Adjourned until* 2.30 *p.m.*)

C. F. COBBOLD, Esq., Governor, H. C. B. MYNORS, Esq., Deputy Governor, L. K. O'BRIEN, Esq., Chief Cashier, and W. M. ALLEN, Esq., an Adviser to the Governors of the Bank of England called and further examined.

2235. *Chairman*: Mr. Governor, the Deputy Governor will have told you that we are just coming to the end of Paper No. 9?——*Mr. Cobbold*: Yes.—*Mr. Mynors*: I had this morning to admit to a blank recollection on the considerations which led to there being no move in the Bank Rate more or less in association with the Budget in the autumn of 1955; on that I think the Governor would like to say a word.—*Mr. Cobbold*: I have refreshed my memory on that. Our main considerations were at that time that the credit squeeze was working in its admittedly somewhat limited field, and that the technical measures which had been taken in the preceding months, as reinforced by the Chancellor's statement of July, could be expected to result in a material reduction of bank advances over the next succeeding period. We took the view that the reduction would be much the same if the Bank Rate were maintained at its then existing figure of 4½ per cent. or raised in conjunction with the autumn Budget. There were, of course, the objections to a Bank Rate rise which always operate, which I have underlined time and time again. We felt, therefore, on technical grounds that the arguments were definitely against a Bank Rate rise at that time. Coming to the psychological considerations, our main feelings were, firstly, that it would be in flat contradiction to the view expressed by Her Majesty's Government at or around that time, that there was no crisis; also that it would be putting the emphasis on entirely the wrong place and encourage the public to think that the answer to the difficulties lay in a further tightening of the credit squeeze, and it would thus deflect attention from what we regarded as the more real problems. At that time, if my recollection is correct, we were thinking that financial opinion both at home and abroad was large focussed on the wages question and on what I may briefly call the public sector questions. We felt that it was towards those problems the next round of attack should be directed, and that Bank Rate should be kept in reserve for a time when it could be more effective in its own right.

2236. *Professor Sayers*: In February, 1956, you regarded the balance as rather different. In what way would you say the balance had shifted?——I would say that by February, 1956, considerable action, both following the autumn Budget and the things which were done in February, 1956, was taken on the other factors which we had in mind.

2237. *Chairman*: Thank you. Then may we take it up at paragraph 121?——*Mr. Cobbold*: May I ask the Deputy Governor to see this paper through?—*Chairman*: Yes. This paragraph brings us to February, 1957. As far as I follow it, whatever the intention of limiting the effect of the reduction, there was an all-round adjustment that followed the Bank Rate reduction; deposit money rates were reduced, call money rates were reduced, the Treasury Bill rate fell; and then you tell us later on that advances rose swiftly, and so did commercial bills?——*Mr. Mynors*: There was an adjustment in market rates; but there was not very much change at the long end of the pattern of rates.

2238. *Professor Sayers*: And you disclaim any action contributing to that steadiness?——That was covered in a previous answer of the Governor's about the steadying influence exerted to see that the reaction at the long end was the right sort of reaction.

2239. *Chairman*: This issue of "Eternity" Stock, of which you tell us in paragraph 122, was sold on the basis, in effect, that there was to be no change?——*Mr. Mynors*: Yes.—*Mr. Cobbold*: As you say, the deposit rate and all the rates closely allied with the Bank Rate certainly moved, as they were bound to move. My belief is that it was generally accepted that that move was not an easing of the credit squeeze, and I certainly feel strongly that, apart from the first week or two possibly, there was no general business feeling around the country of a relaxation which was such as to give rise to a renewed impetus on such matters as stocks and investment.

2240. *Professor Sayers*: Was there not clearly a feeling inside the London money market that this was the beginning of a continuing relaxation?——There was a lot of comment in some sections of the financial press to that effect; the feeling there was stronger, I thought, than the feelings in the market itself.

2241. *Chairman*: I thought we approached this reduction of a half per cent. on the basis that the Bank Rate ought to come down to prevent it needlessly pulling up the short-term market rates towards it; but they in fact went on down?——We expressly said that on this occasion we were rather following the market down. This was a slightly different occasion from some others.

2242. *Mr. Woodcock*: You say two or three times that industrial disputes caused uncertainty. In what respects would they affect the situation?——Particularly the exchanges.

2243. Then it is really linked up with the rather weak nature of our reserves?——It is not unconnected therewith.

2244. *Professor Sayers*: At the end of paragraph 123 it is stated: "it may be presumed that holdings of short bonds by the Discount Market rose". Is this another point on which the Bank knows the facts and knew them at the time, but leaves it to us to find them elsewhere?——*Mr. Mynors*: Yes.

2245. *Chairman*: Was the increase in advances referred to in paragraph 125 an expected or anticipated result?——*Mr. Mynors*: It was somewhat larger than expected. We know they were going to rise in that period, which is the period of revenue collection, but it was rather larger than we looked for.—*Mr. Cobbold*: We expected, having sat rather firmly on the valve, that there would be a pretty heavy tendency at that moment in that direction.

2246. *Professor Cairncross*: When you mention that some part probably arose from export credits, what is this information based on? Is it incidental rather than statistical?——It is information we get from time to time. There is not a regular return of those export credits.

2247. *Chairman*: Are there any more questions? Then I think that concludes our examination of this very valuable paper. Now, Mr. Governor, may we turn to Paper 8: "Principal changes in the British monetary system since 1931".* It does not mean that it is a less valuable paper for us if I say that I do not anticipate, after going through it, that there will be many questions we want to put to you about it. I think it provides us with what we wanted in background information. But may we run through it quickly; there may be one or two things on it? I have one question on paragraph 12. You are talking about Treasury Bills, and you are comparing 1931 with 1951: "Whereas in 1931 a relatively small part of these Treasury Bills" (that is, market Treasury Bills) "can be identified as held by or for account of overseas residents, in 1951 they were chiefly so held. By March, 1957, the proportion of market Treasury Bills held outside the Banking Department, the clearing banks and the discount market had increased to 53 per cent." (by over 40 per cent. I think) "largely as a consequence of a re-expansion in the holdings of U.K. residents since 1951". Is there any primary cause of the re-expansion? Is it a function of the liquidity of business? I suppose businesses were the main holders on the U.K. resident side?——It is mainly a question of holdings by businesses; finance corporations, industrial companies and so on.

2248. If the proportion changes to that extent between 1931 and 1957, it is a marked drawing in of that class of holder into the Treasury Bill field?——We are producing a further break-down which will point that up in still more specific terms.†

2249. *Professor Cairncross*: With reference to paragraph 16; "window-dressing" was referred to in the report of the Macmillan Committee, with the recommendation that it should cease. Was it necessary that it should take so long to get rid of this practice?——*Mr. Mynors*: I could not say it was necessary.

2250. There is no "window-dressing" now?——No.

2251. *Professor Sayers*: In the last line of paragraph 16, when you say: "this reduction was more apparent than real", would it not be fairer to say: "this reduction was apparent, not real"?——I would not quarrel with that.

* Memoranda of Evidence Part I No. 8.

† See Appendix to Minutes of Evidence.

2252. *Chairman*: On paragraph 22 I have just one question: were Treasury Deposit Receipts called for each week?——Yes.

2253. So they would be running off accordingly each week, when their times were exhausted?——Yes; five, six or seven months later, as the case might be.

2254. *Lord Harcourt*: On paragraph 44 I have one small point. You say that the I.C.F.C., when buying securities, "does so, with rare exceptions, to hold not to issue them to the public". If it is to become a long-term holder of those securities, is it not going to lose its value to a certain extent? If it really becomes a perpetual holder, it merely becomes an investment trust company. Must not its object be to use its funds as a revolving fund, even at the risk of treading on the feet of investment houses?——*Mr. Cobbold*: Perhaps this wording gives a wrong emphasis on that. I think this does not mean to hold indefinitely. There is quite a lot of turnover. This means that it is not a direct issuing machine.

2255. *Professor Cairncross*: I would like to raise a general question on this paper. You bring out how far the banks have come to supply finance to the Government rather than to the private sector. You do not say much about the distribution of the deposit liabilities between current and time deposits. Has not there also been a trend there that is also important? Has not there been a movement, on the whole, towards current accounts, perhaps not recently, but in the 20 year period covered?——*Mr. Mynors*: That is not in my mind at the moment, but I could easily get that.*

2256. *Chairman*: Then may we come to Paper 12: "Current monetary policy: some general considerations and the influence of interest rates" † I think there may be some questions on that, though most of the things covered in this paper have been discussed arising out of actual events on Paper 9. On paragraph 3, I want to make sure I have followed your line of thought. In the first sentence you say: "The monetary authorities can do a good deal directly to determine the cost of borrowing, by changes in Bank Rate together with supporting action in the money market and by purchases or sale of securities". The end of it distinguishes the purchases or sales of securities from the money market operations. What had you in mind there as operations by purchases or sales of securities which bore directly on the cost of borrowing?——*Mr. Mynors*: That we could operate not only in Treasury Bills, bringing the market into the Bank or letting the market stay out of the Bank in the narrowest and most technical sense of "market", but that we could also operate as we do through purchases and sales through the Issue Department, in the gilt edged market, not only in money market securities.

2257. But you do not primarily, if I understand it, have a policy of operating by purchase or sale in the gilt edged market generally to affect the cost of borrowing?——Not in order to determine the cost of borrowing; that is true.

2258. Then what does the sentence mean?——*Mr. Cobbold*: The operative phrase is "can do a good deal".

2259. But, for reasons which we have gone through before, as a matter of policy in these years you have not thought it right to do it?——That has been our policy.

2260. *Professor Sayers*: But you do acknowledge that you can do a great deal to determine directly the cost of borrowing?——I gave a definite reply to that the last time the Committee was sitting.

2261. The last sentence of paragraph 8 puzzles me a little. In other papers and in discussion we have had it explained to us that the credit base of the clearing banks is the quantity of liquid assets, the three main groups being cash, call money and Treasury Bills. If that is so, why does it make any difference to the authorities' control whether the borrowing from the Bank is on Treasury Bills or on Ways and Means Advances?——*Mr. Mynors*: As long as the lending is direct by the Banking Department, there may be technical or constitutional differences, but the monetary effect would be the same. There is an immediate effect on bankers' balances on the other side of the Bank Return.

2262. Suppose the borrowing is on Ways and Means Advances, instead of by the sale of Treasury Bills in the market, does it make any difference?——There is bound to be, other things being equal, a corresponding increase in bankers' balances as the money is disbursed by the Exchequer.

2263. And a decrease in the amount of Treasury Bills put out?——The amount of Treasury Bills in the market would be less if expenditure is financed by Ways and Means Advances than it is if expenditure is financed by Treasury Bills. But it would immediately affect the cash base of the banks. Through their 8 per cent. ratio, it would put them immediately in a position to increase their deposits by buying investments and everything else.

2264. I understood their policy of increasing deposit liabilities would be determined by their total of liquid assets, not the amount of cash?——*Mr. O'Brien*: The two things come out to the same, in the sense that the total of liquid assets in either case is affected in the same way; but the composition of their liquid assets would be different. With the Bank of England making Ways and Means Advances, their cash would be inflated. It would be inflated to a point beyond the 8 per cent. they require, and to that extent they would be looking round for earning assets on which they would be able to expend that excess of cash. Cash would not be tight in the market. Therefore it would be difficult to keep rates tight. We could only in fact keep rates tight, as we do in the circumstances from time to time as they occur, by mopping up cash by selling Treasury Bills.

2265. What is it that is peculiarly damaging about expansion of cash?——*Mr. Mynors*: We should immediately put ourselves in a position where we could not avoid taking remedial action.

2266. Remedial action confined to what is happening in the money market?——*Mr. O'Brien*: If we allow cash to slop about, the market does not believe we want to follow a tight policy. That will have an effect on rates in the market. The tender rate for Treasury Bills will come down. If we do not want to have those results we must keep cash short.

2267. Is it going to have an effect outside the little circle of the discount market?——It goes beyond that. If the Treasury Bill rate comes down, the rate for short bonds would come down, and that would tend to percolate through the market.

2268. In spite of the fact that the total of liquid assets of the banks is unchanged?——*Mr. O'Brien*: Yes, I think so.——*Mr. Mynors*: I would not have regarded their liquidity ratio as being rigid enough to mean that, given an increase in cash without any change in liquidity as a whole, they would not feel moved to take any action.

2269. Is not this a different doctrine from what we have been told hitherto?——I do not think so. The cash ratio has always been there, with the liquidity position superimposed on it, as it were.

2270. We are now back on the question of the whole control of the volume of bank deposits; we have been taught hitherto that it is the liquid assets ratio that matters?——*Mr. O'Brien*: Surely we have said there are two aspects of this control. By keeping bank cash tight we keep rates taut, and pressure on rates to keep them higher rather than lower has its own influence on what happens in the market. Separately from that, contraction of the banks' liquid assets, which include the 8 per cent. cash, reduces their ability to extend credit elsewhere, if they do not sell investments. But the two things march hand in hand.

2271. I understand you to say they march hand in hand because you keep the market supplied, either through the front door or the back door, with enough cash to keep their 8 per cent? That is how it has been explained to us before. If that is so, the cash position is a purely passive element in it. The volume of bank deposits affects the cash, but what is done about the volume of cash will not affect the volume of bank deposits?——With respect, we have not said it does. All we have said is that exercising a pressure on cash, keeping it tight from day to day, not allowing it to slop over as it can do, has a tightening effect on rates.

2272. I agree that you have explained that the particular structure of rates at the short end of the market

* See Appendix to Minutes of Evidence.
† Memoranda of Evidence Part I No. 12.

is affected by what you are doing in your operations on cash, by the way in which you are letting the market have cash.——I would say it has an effect on rates which can extend beyond the short end of the market. It may be held to be giving an indication of what the authorities want, of a tendency they will allow to develop.

2273. I agree that the precise way you do things is going to affect the structure of interest rates; but I want to know what it is about the authorities' control that is damaged by financing on Ways and Means Advances, and I am suggesting that, on the basis of what you have told us hitherto, the authorities' control of the volume of bank deposits is not affected?——*Mr. O'Brien*: Let us keep it in two separate compartments: (1) our control over interest rates in the money market, short bonds, and so on, and (2) our control over bank deposits through action on the liquidity ratio. Taking the first, if we proceeded by Ways and Means Advances instead of by selling Treasury Bills to the market, we should provide the cash for the Government, and that would go out into the bankers' balances. Instead of the banks themselves providing the cash against Treasury Bills, we would provide the cash. Therefore their cash would go up rather than their liquid assets. Cash would be slopping about in the market and that would have an effect on rates, an embarrassing effect from our point of view, and we should have to correct it. One way to correct it would be to sell Treasury Bills. Therefore, what is the point of starting with Ways and Means Advances?——*Mr. Cobbold*: In that respect it would be damaging to the authorities' control.

2274. But not in respect of the control of the volume of deposits?——I did not think so, no.

2275. *Chairman*: I had the impression from an earlier day that there were two general reasons that you preferred to go by selling Treasury Bills in the market rather than by direct Ways and Means Advances: that by going through the market there was always a certain number of outside holders attracted, which took the liquidity to that extent out of the banking system; and that it helped you to settle the rate of interest to be charged to the Government, because you had some higgling about the rate at which the Bills were to be issued?——We have also referred to a wider consideration of a psychological nature, that Ways and Means borrowing, on the pattern of some continental systems, is always regarded as more dangerous as a matter of general psychology than other forms.

2276. Apart from that those two reasons are operative with you?——Yes, but we should attach quite a lot of importance to the last mentioned point.

2277. *Professor Cairncross*: The last sentence of paragraph 7 refers to the need for the discount market to cover the tender for Treasury Bills. This was not always so, was it? The system operated throughout the twenties without this condition?——*Mr. Cobbold*: Yes.—*Mr. Mynors*: If we go back to the twenties, from what I have read in our own records, it was a continuous preoccupation whether the tender would or would not be covered. But there was no sort of express, albeit informal, commitment.—*Mr. Cobbold*: May I make a reservation on the word "commitment"? There is an understanding, but I do not think I could say there was a commitment. I do not think that would be fair on the discount market.

2278. *Sir Oliver Franks*: A commitment has a legal connotation, an understanding an informal one; is that right?——That is it.

2279. *Chairman*: On paragraph 11, I must ask you to enlarge a bit on the second sentence: "Experience has shown that, in the general objective of moderating fluctuations in the economy, the Treasury and the Bank, acting together and with the co-operation of the banking community, can do much by formal and informal methods to control the level of advances, the banks' policies towards securities, liquidity and so on". If you eliminate the effect of the appeals to the banks about their policies with regard to advances, what other experience have we got to draw on in the history of these years? Take the banks' policies towards securities?——*Mr. Mynors*: The original issue of Serial Funding Stocks was done with their foreknowledge and co-operation on an entirely informal, but understood, basis.

2280. That means that on request being made to them they were prepared to exchange what they held in the way of Treasury Bills for the Serial Funding Stock that was offered?——Yes; I do not recall any other example covering their policy relating to securities.

2281. I had an impression, reading paper 9, that there were occasions when their policy towards securities had not been such as you would wish?——*Mr. Cobbold*: Never in contradiction to any express wishes.

2282. *Professor Cairncross*: Do we take this to mean that the sale of securities by the banks in the second quarter of 1955 was done with your knowledge and without your express dissent?——We could see it happening.

2283. *Chairman*: I would like to make this as concrete as I can. I appreciate that when they have been asked to do things directly results have followed, but when they have not been asked to do things in this category, what dates and events could you point to as showing what could be done?——I would much rather take that in general terms. Although you have before you some instances of specific requests conveyed by the Chancellor of the Exchequer through myself to the clearing banks, there is absolutely continuous contact covering a great deal of this sort of subject between the Chairman and Deputy Chairman of the Committee of London Clearing Bankers and myself, supplemented by talks we have at our quarterly meetings with the Committee of London Clearing Bankers. I would not like it to be felt that co-operation between the authorities and the banks on this sort of subject was purely limited to actions in response to the specific request referred to in these papers.

2284. But for the co-operation—and I follow that that arises from constant discussion and exchange of views—but for the co-operation, what is there that monetary policy in these particular fields has achieved?——Might I refer to the Covering Note I sent to you in June, where I said: "The method of control over bank credit followed since the adoption of a more flexible monetary policy in 1951 has been a conscious mixture of technical measures (i.e., Bank Rate, pressure on liquidity ratios, etc.) and 'persuasion', relying heavily on the co-operation of the banking system. The Bank have felt throughout the period that in the ruling circumstances technical measures could not do the work alone, and also that 'persuasion' could only succeed if technical measures were working in the same direction".

2285. I hope this is not unfair: it puts the main emphasis on the co-operation obtained by voluntary means?——It is intended to.

2286. *Sir John Woods*: You mention in the Covering Note pressure on liquidity ratios and Bank Rate. In the second quarter of 1955 when you were trying to keep pressure on liquidity ratios the banks were at the same time selling investments; you said just now that you were aware of their doing it. Would I be right in thinking that, on the whole, you would have preferred they did not at that time? If it were so (I am not imputing anything wrong to anyone) were they not defeating the object of the Bank Rate?——I would not say entirely, because the sales of securities were having their own effect in some other directions.

2287. It seemed to me that if that were so you might have said in your continuous consultations with the banks: "Would you mind going easy on the selling of securities?", but apparently you did not take any such action?——I was in conversation with the clearing banks at that period and did at one time put it this way, that it would certainly be in line with the authorities' hopes that advances would come down a bit. It was perhaps another way of saying the same thing.

2288. *Professor Sayers*: Have you at any time during the period indicated to the clearing banks the desirability of adding to their investments?——*Mr. Mynors*: There was the Serial Funding issue I have just referred to. I do not recall any other.—*Mr. Cobbold*: I think there was an occasion at one of the meetings between the Chancellor and the clearing banks when some phrase to that end was used; but I think that is properly a question for the Treasury.

2289. *Mr. Woodcock*: I am not sure, reading paragraph 11, whether you are saying that this voluntary co-operation

with the banks can never be in itself enough unless other things are done, or whether it cannot last?——We are trying to convey that we think it would be difficult to work satisfactorily if the technical things were working in the other direction.

2290. Temporarily you can get away with it?——To a large extent I would judge so.

2291. You are rather saying that voluntary co-operation cannot really be carried on too long?——I would think it very difficult, and placing a great strain on that co-operation, to expect it to carry on indefinitely, if the technical arrangements were working in the contrary direction.

2292. *Professor Sayers*: If one looks not just at the last few years but at the next decade, would you say that, given that the technical arrangements are made to work in the right direction, a continuance of the co-operation in a voluntary atmosphere is also necessary?——I think it is very desirable; but I think we are there on Paper 13, perhaps, rather than on Paper 12.

2293. *Mr. Woodcock*: In paragraph 10 there is the statement: "Control by monetary means is more difficult than at times when good and bad trade alternated more sharply". What do you mean by "more difficult"? Does it mean that as long as we have full employment and people are always basically more optimistic about trade you will never have sufficient control, or never be able permanently to get sufficient control? Or does it mean what you call technical considerations?——We have expressed a view that so long as the economy is bursting at the seams, with the present distribution of bank assets largely in the form of Government securities of one sort and another, it would be difficult over a long period to make the exact monetary arrangements work with complete satisfaction.

2294. *Sir Oliver Franks*: I had rather assumed, when these paragraphs were talking about technical considerations, that the chief technical consideration is contained in the last but one sentence of paragraph 11: ". . . the basic need remains the ability to regulate the total quantity of currency and bank deposits". It is the old problem of over-liquidity, and so on. On the hypothesis that these problems of liquidity could really be corrected, and that therefore the liquid assets and the total level of deposits of the commercial banks were under effective control, then it seems to me that a great deal of what has at present to be achieved through co-operation would no longer be needed because, as it were, the rules of the game would supply a basis on which the commercial banks could go to work safely and conformably with the Bank's policy. That hypothesis, that the technical considerations had been altered and put in order, is quite a different consideration from the broad policy reflections about full employment, high level of demand, and so on, though I do not say that there is not, ultimately, a relation; there always is. If the Bank of England had been in the position to squeeze the banks' liquidity so that they had to pay careful attention, then, surely, much of what Mr. Woodcock is asking would obtain already? ——*Mr. Cobbold*: On that hypothesis I think that is accurate. I would make the slight reservation that we have, I think, exerted some pressure on the liquidity.

2295. *Professor Sayers*: It is easy enough to accept the view in the middle of paragraph 14, that it is "not practicable to hold rates at a level below that which market opinion regards as likely to endure", but would you agree that it may still be held consistently with that view that it is practicable to shift the level of rates, and, further, in shifting them to influence the level that market opinion regards as likely to endure?——*Mr. Mynors*: If you are thinking primarily of shifting long term rates in relation to short term rates, we should regard the capacity to do that as pretty limited.

2296. *Professor Sayers*: But there is a capacity?——*Professor Cairncross*: Market opinion, presumably, is influenced by the supply of money. If there is an increase in the supply of money you can certainly hold long term rates lower than you can if money is not increased?——*Mr. Cobbold*: There are many other factors.

2297. *Professor Sayers*: Would not market opinion be influenced eventually by a big shift in the composition of the debt as between long and short?——*Mr. Cobbold*: Gradually, and over a period.—*Mr. Mynors*: You could not do it at great speed.

2298. *Professor Cairncross*: Is it not true that long rates move more closely with the supply of money than any other factor?——You are looking over a pretty long period of time, I would guess, in saying that.

2299. Even in, say, a five-year period?——*Mr. Mynors*: I would have to look at that.—*Mr. Cobbold*: As a general view, I would have thought that other factors, of confidence and all those sorts of things, had more immediate effect than the volume of money, but I could not contradict your view over a period without comparing the graphs.*

2300. *Chairman*: Have you and your advisers any doubt about the validity of your first consideration in paragraph 16?——No doubt.

2301. *Professor Sayers*: In the penultimate sentence of paragraph 20 there is a very definite statement of how business borrowers have behaved. What kind of evidence have you for that statement?——I would say entirely general evidence that comes to us from our contacts; through members of the Court and in many other ways.

2302. The first sentence in paragraph 22 is a very direct and positive statement: "A rise in interest rates has important effects, both direct and indirect, upon those who borrow, those who save" etc. What are those effects? ——*Mr. Mynors*: Paragraphs 27 and 28 are our attempt to answer that question.

2303. But is not their effectual basis the experience on some occasion with regard to National Savings?——It is very difficult to get any other specific effectual basis. We must admit that there is a certain amount of switching from other forms of investment into National Savings, if National Savings are made more attractive in some way; so the gross increase is not the same as the net even there.

2304. *Professor Cairncross*: Is it not a fair comment that even so-called personal saving has risen fastest in periods of greatest inflation in recent years?——*Mr. Allen*: I should have thought that one of the largest increases in personal saving had been in 1956.

2305. Would that not be a period of intense inflation? ——I should have submitted that it was a period in which the economy was more closely balanced than in previous years.

2306. Take the increases in 1951 and 1955-56. No doubt those included the profits of small shopkeepers. Are not those two periods when inflation was almost at its most marked in the postwar period?——I do not recognise that as applying to 1956.

2307. I thought the discussion this morning was about the boom which developed in 1955 and carried on into 1956. Is there a distinction between boom and inflation? ——*Mr. Cobbold*: It was beginning to turn at the beginning of 1956.

2308. At any rate, there has been no marked decline in the rate of savings in periods when, on *a priori* grounds, one would rather have expected to see it decline. Has there not been a continuous increase?——*Mr. Allen*: Statistical evidence about personal savings in the country is certainly deficient, but my impression is that there have been fluctuations in the rate of personal saving and that some of them would be found to match periods in which retail prices were noticeably rising. An expectation of rising prices has shown itself by the behaviour of consumers.

2309. Do you mean that savings rise when retail prices rise, or fall?——Consumers' expenditure in relation to their income rises at a time of rising prices. It is difficult to tell which is the causal factor. But I think there is some evidence that expectations of inflation have caused persons to save less than at other times when prices were more stable or expectations about comparative stability of retail prices were more confident.

2310. *Chairman*: We were trying to relate it more definitely to the move of interest rates. Is that the same thing?——That is what I understood the question to be.

2311. *Professor Cairncross*: I was asking a rather different question, but it is, of course, complicated by

* See Appendix to Minutes of Evidence.

the movement of interest rates in those periods. The interest rate is higher now and has been higher in the last two or three years than it was in an earlier period, and savings are also substantially higher. I take it you would have difficulty in asserting that the rise in savings is due to the rise in interest rates. Conceivably that may affect it marginally; or do you attach more importance to the increase in interest rates as a factor?——It is very much a matter of personal judgment. I think the effect of interest rates has been among the factors present.

2312. *Sir Oliver Franks*: Is there not a very important consideration here which must account for quite a lot? If the ordinary person feels, however vaguely, that the rate at which money value is running away is greater than the increment to his capital to which the interest after tax over the years amounts, he is not going to go in for saving; whereas, if he thinks the balance is moving the other way, he is more likely to. There may be forced saving of another kind, but so far as the ordinary business of saving goes, it depends whether the rate of interest outweighs inflation?——*Mr. Cobbold*: If you are saying that the most important influence on saving is a general view that inflation is being contained, and that that is more important than the gradations of interest rate that could normally be foreseen or expected, I entirely agree.

2313. *Professor Sayers*: Given the view stated in paragraph 22 of the effect of the change in interest rates, why has the Bank not more confidence in the power of a rise in the Bank Rate by itself, without a package deal? From paragraphs 18 and 19 it is apparent that a change in the Bank Rate should be followed by a general rise in the whole structure of interest rates. In paragraph 22 it is said that a rise in interest rates has these important effects upon those who borrow and those who save. Surely this powerful instrument could do something by itself without having to wait upon other measures?——If other factors were in order, to use a general phrase, we should certainly see every possibility of making a Bank Rate rise by itself.

2314. It is still the case that the rise in interest rates has these important effects?——I have always said that in thinking about the Bank Rate the whole time, from week to week, one is always weighing one consideration against another. This is certainly a "plus" consideration in that process. I would like to make it quite clear that it is by no means a question of principle to wait for a package deal. We are always prepared to consider a movement either way on the Bank Rate alone, if we consider that to be the right policy.

2315. *Mr. Woodcock*: We are already on the same point. You say in the middle of paragraph 27: "A rise in the yields on the various securities offered through the National Savings organisation has certainly on occasion shown improved results." As a statement of bare fact, I suppose that is true; but such general evidence as there is seems to show that the bulk of it was switching. Does not a lot move in big amounts earlier on?——*Mr. Mynors*: I think that is the best set of figures available. I do not think anyone has been able to distinguish the full amount of switching. When you get these big blocks, they are probably switches, I would say.

2316. *Professor Cairncross*: Whatever one may think of the effect of inflation on savings, the effect that matters is the effect on the price of bonds and the rates of interest. It is the distribution of savings, the use to which they are put, that is most affected by inflation, not the amount (we are talking now about a creeping inflation, not a galloping one) and the most observable effect is the relation between the yield on gilt edged and equities. Is this not the fact that you are chiefly preoccupied with?——Yes, I think so. Our broad trouble is not the effect on undistributed profits which are reinvested in the business in equity form, but the effect on investment in fixed interest securities.

2317. You use phrases which are liable to misinterpretation. You say: "It is accompanied by damage to personal savings", although official figures show a steady increase, "and to orderly long-term provision for the replacement and expansion of industrial capital"; although both of those things are proceeding rapidly; therefore the phrase must refer to the distribution between different types of asset, the use to which the savings are put, even within a business?——*Mr. Mynors*: Yes, I would accept that.

2318. *Chairman*: Coming to paragraph 32, I should like to fix the periods you have in mind when you say: "In post-war years there have been periods when confidence has been lacking and a level of rates in London higher than in other centres has failed to attract funds from abroad." Can we have a conspicuous case when, although the comparison of rates was noticeably attractive in pure theory, it did not attract?——*Mr. Mynors*: I think we could give some specific evidence on that.*

2319. *Professor Cairncross*: "Funds from abroad" here does not mean funds from the sterling area, but funds from the non-sterling area?——*Mr. Cobbold*: Yes.

2320. *Chairman*: That brings us to Paper 13†, which I think covers all the outstanding papers we are expecting from you. It is in a sense the end of the series, because it relates to possible changes of the system from the point of view of alternative techniques. It is essentially a paper, with the questions it raises, to which we should return towards the end of our inquiry with you, both for our sakes and yours; but that does not mean it is the less useful to have a look at it now and see what questions arise on it, without thinking that they are closed by anything that passes now?——That was exactly how we viewed it. It is perhaps more illustrative in giving certain views and various possibilities; and, of course, if during your subsequent inquiries other possibilities emerge, we shall be only too happy to offer any comments you would like on those other possibilities. I have a few introductory remarks to make, if you will give me leave.

2321. Please do?——Paper 13 deals with a number of possible alternative monetary techniques. There are of course other lines of approach in related fields, which might be followed in order to exercise similar or complementary influences on such matters as the volume of credit and the level of demand. I have particularly in mind fiscal measures and the regulation of the level of hire purchase credit. This paper does not seek to cover these other possible lines of approach, but deals only with the possible alternatives we have considered in the strictly monetary field. Even in the purely monetary field there are doubtless other possible techniques or combinations of techniques. We do not claim to have covered every possibility. I should like first to remind the Committee of the reference which I made to this subject in the Covering Note which I submitted in June. The observations made there still represent the Bank's general view on the main policy aspect, and they are very relevant to our discussion on this paper.

Here the Governor read the section entitled "Methods and Techniques" from his Covering Note, Bank of England Paper 1.

I think some of that is relevant to what Mr. Woodcock was asking.

Then I come to another important point of principle which I dealt with in my reply to Question 1810 on the 25th October, following on the earlier Questions 681 and 682 about Ways and Means Advances. It is, I think, particularly relevant to this paper.

Here the Governor read from the fourth paragraph (beginning "The question in the forefront of my mind is this") to the end of his answer to Question 1810.

2322. I suppose there is no doubt that under the Bank of England Act, 1946, the Treasury could send a direction to the Bank to lend it any sum of money it liked to name?——*Mr. Cobbold*: I would think that is the legal position.—*Mr. Mynors*: Off the cuff, I wonder whether the Act of 1946 completely overrides the Act of 1819, under which the Bank is not to lend to the Treasury without the authority of Parliament first had and obtained, and which lays down the technique to be adopted in regard to loans.

2323. *Professor Sayers*: I forget the exact phrase used in the Act of 1819, but it was directed to the limitation of Ways and Means Advances as they had been used. It naturally did not mention the purchase of Treasury Bills. It has never been interpreted as inhibiting the Bank from purchasing Exchequer Bills in the old days, or Treasury Bills in recent decades?——*Mr. Mynors*: There is a saving phrase in the 1819 Act which was not intended to stop

* See Appendix to Minutes of Evidence.

† Memoranda of Evidence Part I No. 13.

the Bank from buying the securities they normally buy. That has been interpreted to mean that the Bank is still free to go into the market and buy Treasury Bills at its own discretion.—*Mr. Cobbold*: Earlier in my answer to Question 1810 I attempted to answer the question you have put to me: "The intention of the 1819 Act clearly was that the Bank should be under no compulsion to lend. I imagine that it would legally be open to the Treasury, if the Bank were unwilling to make an advance, to direct them to do so under the powers conferred by Section 4 of the Bank of England Act, 1946". It has not been tested in the Courts. I went on to say: "I feel some doubt myself whether this was the kind of subject for direction intended by this Act and whether the Treasury would readily conclude (as they must do before issuing directions) that it was necessary in the public interest to force their bankers to lend to themselves. We certainly treat this matter in practice, and should continue so to treat it unless and until directions were issued, as one to be freely negotiated, both as to amounts and as to rates of interest, in the normal way as between banker and customer. This is how it has always happened and the question is therefore hypothetical. But I would judge that, in a matter which primarily concerns the Bank as a bank rather than as a monetary authority, the Court of Directors would be very reluctant indeed to be pressed against their judgment, either by direction or otherwise".

2324. *Chairman*: I am not sure if you had completed your introductory remarks, Mr. Governor?——Not quite, Sir. I was going on to say that it is emphasised throughout the paper that, both on real and on psychological grounds, a danger lies in the fact that, although first intended as a credit control, most of the devices considered would, in one form or another, involve directions about how much and in what form the banking system should take up Government securities or lend direct to the Government. The most direct form of forced lending to the Government by the banking system, and therefore from this angle the most dangerous, is the Treasury Deposit Receipt system.

If any of these devices were introduced, a further question would arise. It might be possible to work some of these arrangements by the present method of informal co-operation. But it might also be necessary to use statutory powers, more particularly if it were decided to apply the rules to a wider circle of banking institutions than those (such as the clearing banks, the Scottish banks and the accepting houses) with whom the Bank of England is in continuous relations. If powers proved necessary, should they be the present powers (amended if necessary) conferred by section 4 (3) of the Bank Act, 1946, or should the Government seek different and perhaps direct powers? Throughout this paper we emphasise the view that measures of credit control should both seem to be and be measures of credit control, and not directly related to Government borrowing. We therefore believe that the initiative in using statutory powers for this purpose should lie with the Bank (as it now does) and not with the Treasury. This is the practice, not only in this country, but in most of the free world. We believe it is soundly based, because the first preoccupation of central banks is naturally with credit conditions, whilst the first preoccupation of Treasuries is (rightly enough) to pay the Government's way. It could be argued, for instance, that there is little difference between a system under which the Treasury direct the banking system to furnish money on Treasury Deposit Receipts and one where the central bank requires Special Deposits from the banking system and may itself provide almost equivalent finance to the Government in one way or another. In our view there is a very great difference, for the reasons I have just given. It could also be argued that there is not much difference between direct Government powers over the commercial banking system and the present system, in which, as we have explained earlier, the Bank in practice produces the cash necessary to ensure that the Treasury Bill tender is covered. Here again we should see a very great and very real difference. As I have explained, the present system provides certain safeguards. The Bank is, as I have said, always first concerned with the general credit position, in its relation to the domestic economy and to the value of sterling. The Bank, as a separate body, is always able to make representations at any level, and with varying degrees of emphasis, to the Government. There might, as I have suggested earlier, be occasions on which the Bank might wish to seek directions or to take other steps to draw public attention to dangerous situations. In the last resort it would be open to the Bank, subject to directions under the Bank Act, to interrupt the automatic provision of cash to meet Government requirements.

We are far from suggesting that as a matter of policy H.M. Government or H.M. Treasury would subordinate general credit conditions to their own borrowing requirements; or that we foresee a clash of view between H.M. Treasury and the Bank on this subject. But as a matter of long term principle we think it of cardinal importance that the first responsibility for the technical management of the money market should continue to lie as it now does with the Bank of England, subject to the overriding power of Government to secure conformity with general policy; and also that the initiative in giving directions to the banking system should continue to lie with the monetary side rather than the fiscal side of the "authorities".

2325. *Chairman*: Thank you. There is a great deal in that which I should like to be able to read and digest in print.—*Professor Cairncross*: The present system, involving guidance to commercial banks, requires the commercial banks to lend money to the Government and not to the private sector?——It requires the banks to hold Government assets and not to lend to the private sector. It forces them to hold assets of which they can still choose the nature, timing and maturity to a large extent; but that is not quite the same thing as forcing them to lend to the Government.

2326. Not quite; but the difference is relatively minor in relation to the point which you have been making in your statement. Is not the present system subject to many of the objections you are offering against the alternative devices?——I do not think I should go as far as that.

2327. From the point of view of the Government, it can by issuing bonds to the commercial banks procure support for the gilt-edged market and secure additional funds up to a point?——Do you mean in a statutory way?

2328. I was talking with both in mind, because the Treasury Deposit Receipt System was not statutory. Is there such an essential difference between forcing the banks to lend to the Government and forcing them to hold Government assets?——I would say a very essential difference, yes.

2329. You used the phrase in your statement, quoting from your answer to Question 1810 that the effect of some of these devices would be "to enable the Government to extend the floating debt, and borrowing from the banking system, to an unlimited extent." Surely this is not true. The Government could turn the commercial banks into savings banks, if you like, and could procure, if necessary, the whole of their funds, but borrowing to an unlimited extent really depends on borrowing through the central bank and forcing the central bank to create cash. Surely that is a much more dangerous system of enabling additional Government borrowing to take place?——I would say that it would be difficult to set a limit. I used "unlimited" in that sense. For example, if you reintroduce the Treasury Deposit Receipt System, pulling money out and putting it into circulation again, that could be very nearly unlimited in the sense that you could not set a limit.

2330. Only because the central bank is providing the cash, not because of the Treasury Deposit Receipt System?——*Mr. Mynors*: You could not have a Treasury Deposit Receipt system without some adjustment of the cash base: that would be consequential, surely.

2331. This turns on how the system of Treasury Deposit Receipts operates. If it was operated on the system of special deposits, you would merely call on the banks to provide some of their liquid funds?——*Mr. Cobbold*: I was talking about Treasury Deposit Receipts in the same form as they were.

2332. Might they not operate in this way?——I do not think they would then be properly called "Treasury Deposit Receipts".

2333. *Professor Sayers*: Might I put what is fundamental to Professor Cairncross's question? All that you have just said seems to me to have very great force, as compared with a system in which the Government is taking no measures that are not part of the recognised and statutory or conventional part of the system. But if the authorities are restricting advances by seeking voluntary co-operation from the banks, then the objections you have raised to these various proposals seem to apply with almost equal force to the present system. If one is choosing between a system in which the clearing banks are left free to manage their own affairs and a system in which one of these modifications of technique is adopted, then all that you have said points to the first. If, on the other hand, one is comparing the present system, in which there is voluntary control of the volume of bank advances, with a system in which these modifications in technique are allowed, then your objections seem to help us little to make the choice?——I should, as a matter of long term policy, take an exactly contrary view of that.

2334. You would rather have as a long term policy continuance of voluntary control of bank advances, etc., than any of these alternatives?——That is not at all what I said. What I said was that I should see a great difference between the present system and any of these systems.

2335. *Chairman*: How do you see the essential difference between the present system and general alternatives? It is the implications of the present system that I would like you to tell us about. As I understand it, the effect is to say to the banks: "You may have what deposits you like to get, but you shall not use them beyond a certain ceiling in lending money to the private sector". That is the form of the thing. What is the implication? What are they to do with their money?——The implication is, as Professor Cairncross says, that they should in some form or another invest it in Government assets.

2336. Are there any qualifications?——By and large I would say no.

Chairman: Very well; that clears it up for me. I think perhaps it would be convenient if we took this paper as a whole, after having read your introduction, the next time we meet.

(*Adjourned until Thursday, 28th November*, 1957, *at* 10.30 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

ELEVENTH DAY

Friday, 22nd November, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	SIR REGINALD VERDON SMITH
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	GEORGE WOODCOCK, ESQ., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	SIR JOHN WOODS, G.C.B., M.V.O.
PROFESSOR R. S. SAYERS, F.B.A.	

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary, Home Finance, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director of Economic Section, H.M. Treasury, called and examined.

2337. *Chairman*: I think Professor Sayers wishes to follow up a question on the note you gave us on the Parliamentary control of the fiduciary note issue.*—*Professor Sayers*: The note cleared up the details of the legislation, but it did not answer my original question, which had been directed to the reasons why this legislation in 1954 took the shape that it did. It seems from what we have heard that neither the Treasury nor the Bank of England regard the note issue as other than a passive element in the situation; and I asked why, if that was the view in 1954, legislation was repeated in very much the old form of limiting the fiduciary issue although there is now no connection with the gold reserve?——*Sir Edmund Compton*: The note showed, I hope, that the need for the legislation and its main purpose was to put in permanent form the legal basis for the note issue, which from 1939 until 1954 had been a Defence Regulation. That was made clear when the Bill was introduced. At the same time, however, the Government spokesman also made it clear that in the view of the Government at the time of introducing the Bill the significance of Parliament's control over the note issue had diminished. The point is well made in the speech made by the then Financial Secretary to the Treasury when introducing the Bill for second reading on 3rd December, 1953: "At one time very great importance was attached . . . to the size of the fiduciary issue, and it was fairly widely thought that by limiting it in one way or another one could control inflationary pressures or inflationary developments. Today [that was December, 1953], it is fairly generally realised that the size of the fiduciary issue has very little to do with the general broad questions of inflation or deflation . . . real inflationary pressure develops, if it does develop, not from the printing of bank-notes but from the creation of credit." He ended on this point by saying: "The main function of the fiduciary issue today is, as I see it, to ensure that sufficient notes are available for the practical convenience of the public", and so we put on record, in effect, the recognition by the Government of the passive character of the note issue.

2338. *Chairman*: He pointed a contrast by the use of the words "at one time" and "today". Could you, with your experience, identify them?——I should have thought that by "at one time" he meant at the time of the passage of the Currency and Bank Notes Act, 1928.

That leaves Professor Sayers' second point outstanding: if that was so, why was any measure of Parliamentary control introduced in the Bill at all?—Perhaps I may again quote, because this shows the actual thinking at the time. The Financial Secretary pointed to those provisions in the Bill which allowed the Executive, without reference to Parliament, to vary the level of the note issue, but required a Parliamentary Order, which was subject to a negative resolution of Parliament, if the level was increased after an interval of two years. On that he said: "It is desirable that there should be some flexibility in the regulation of the exact size of the note issue, but it is equally right that, if the matter passes beyond the realms of temporary flexibility, and if the general level looks like settling down at a somewhat different one from that laid down in the Bill, then Parliament should have an opportunity of considering it, though, as I have indicated, in my own view—and this is to some extent a matter of opinion—the exact size of the fiduciary issue is not as fundamental to our national finances as used to be believed some years ago." In the course of debate, it was also made plain that the degree of Parliamentary control provided in the Bill, and eventually in the Act as passed, was in fact less than in 1928. In 1928 it had been a question, in effect, of fresh legislation if the level was exceeded. Here, it was a question of reporting to Parliament, in effect, by Order, on which there was an opportunity for debate but no more.

The third point is that in the background of all this there was certainly in the minds of the Government, and of the Opposition at the time, as shown by what they said, that there ought to be some Parliamentary oversight against the eventuality that a Government might use the note issue not in a passive but, perhaps, in an active way: in other words, that while under our system the money supply is increased by a creation of credit, it is possible for Governments to increase the money supply by a deliberate inflation of the note issue. Mr. Jay, who was winding up for the Opposition, referred obliquely to that possibility and to the fact that for that reason among others it was right that Parliament should have these periodical opportunities of, as he put it, seeing what the Chancellor was doing.

2339. *Professor Sayers*: It would seem that Mr. Jay had not grasped the view that the Treasury and the Bank of England took of the place of the note issue and, therefore, of the possibilities of extraordinary use of it by the Government. Does it not seem odd that the Government should legislate in this way without at the same time saying something about limitation of an infinitely more important element in the credit base; the volume of Treasury bills, for instance?——That point was touched upon in the debate, but it was not pursued, for the good Parliamentary reason that it was well outside the scope of the Bill.

2340. Why was it outside the scope of the Bill?——I do not think that that is a question which a Treasury witness could answer.

2341. *Chairman*: If you have to have legislation to continue a temporary rise, the Government are charged with the duty of finding time for bringing a Bill forward and debate is inevitable. If the thing is merely a report which is laid on the Table of the House, and the onus lies on someone, perhaps primarily a Member of the Opposition, to ask for a prayer to annul it or whatever it may be, the Government are not compelled to find time

* Memoranda of Evidence Part II No. 5.

for that, are they?——That is so. In fact, as I understand Parliamentary procedure, time is always found for a negative resolution; but certainly the initiative does not come from the Government. It comes from any Member who wants to move a prayer.

2342. But he has a Parliamentary tradition in his favour that time must be found?——Yes.

2343. *Professor Cairncross*: Is there any difference from the point of view of Parliamentary control between debts incurred by the Government and financed by the issue of notes and debts incurred and financed by the issue of Treasury bills? Is the Government's hand in any way freer in one case than in the other?——That takes me into a rather wider field, which we had hoped to put before you in the paper on debt management, in which we propose to offer you a section on the legal basis of the debt and Parliamentary control over it. As far as finance by borrowing is concerned, Parliament has laid down the limit on the total amount which may be borrowed. As regards borrowing in the form of the note issue, the control is that laid down by this Act: the Executive can raise the limit by an Order, on which Parliament may, if it so thinks fit, pass a negative resolution.

2344. *Chairman*: Is the note issue Government borrowing or Bank of England borrowing?—*Professor Sayers*: Is not the answer that the Government borrows from the Issue Department by selling Treasury Bills to the Issua Department and the Issue Department is thereby enabled to issue notes to the public?——The result of the transaction is, as Professor Sayers has said, that the notes in the hands of the public have increased and correspondingly the Bank of England has lent that much more to the Government in return for the issue to the Bank of England Issue Department of tap Treasury bills.

2345. *Sir Oliver Franks*: The agent is the Bank but the authorising authority is the Treasury?——Yes.

2346. *Professor Cairncross*: It follows that my question was an unreal one, since all Government borrowing on short term would involve an increase in Treasury Bills, whether there was an increase in the note issue or not?——Yes, but this particular increase in Government borrowing, namely, the issue of bills to the Issue Department, is in fact covered by the legal authority of the Currency and Bank Notes Act. In other words, the ceiling on that form of borrowing is the rise in the level of the fiduciary issue, which is controlled by the negative resolution of Parliament.

2347. *Professor Sayers*: But are these Treasury Bills not part of the general issue of Treasury Bills? That is to say, when the fiduciary issue is increased, the Government do not borrow in the technical sense by issuing notes to the public; the Exchequer borrows by selling Treasury Bills to the Bank of England?——Yes, that is so. I should perhaps just qualify that on a technical point; the Treasury Bills are not market bills in the sense that they are not issued at the current market rate. They pay a special rate of interest.

2348. *Sir John Woods*: But that form of borrowing on Treasury Bills is controlled by a different instrument from the rest of the borrowing?——Yes.

2349. *Chairman*: Do tap Treasury Bills held by the Issue Department not get out into the market in the course of the Issue Department's operations?——That is a point on which I would rather you asked the Bank of England, who hold the Bills. I could not take it further than saying that they seldom, if ever, do so. There may be certain transfers of Bills between the Issue Department and the Banking Department, but I believe them to be small.*

2350. *Professor Sayers*: How else is the Issue Department enabled to take up longer-term stocks than by unloading Treasury Bills? Does it do it simply by not replacing Treasury Bills running off?——*Sir Edmund Compton*: Yes; the Issue Department enables itself to buy stock in the market by requiring repayment of its Bills from the Exchequer.—*Chairman*: It runs them off?——*Sir Edmund Compton*: Yes.

2351. *Professor Cairncross*: Is the rate of interest payable on these Bills normally lower than that on other Bills?——Yes; the reason perhaps being that the Issue Department income goes directly to the taxpayer; in fact, it is paid to the Exchange Equalisation Account.

2352. Does the rate vary when the Bank Rate varies? Is it a fairly constant differential?——It is reviewed on each occasion of the Bank Rate change and a new rate is negotiated between the Bank of England and the Treasury.

2353. *Chairman*: Thank you. Then shall we return to Paper 6†, starting from paragraph 50?——*Professor Sayers*: On paragraph 52, does not the Chancellor seem to have been very confident in March, 1952, about the effect of the Bank Rate?——*Sir Robert Hall*: That seems to follow from the language that he used.

2354. *Chairman*: His expectations were directed primarily to its effect on investment, I think, at that time?——Yes, both fixed investment and investment in stocks.

2355. *Sir John Woods*: In paragraph 53, you say that the Bank Rate was raised from 2 to 2½ per cent. Was it seriously thought that a rise of from 2 to 2½ per cent. would affect investment, whether fixed or in stocks, or was that merely a sort of warning signal?——*Sir Robert Hall*: It was just letting in the clutch, so to speak, after the long period during which there had been no change in the Bank Rate at all—*Sir Edmund Compton*: It was a signal that the Bank was no longer prepared as a matter of course to adjust the cash in the market by its other operations, which had been the expectation of the market for the last twenty years.

2356. *Professor Sayers*: Except as a flag, there was no point in doing this, was there? Was not the effective Bank Rate reduced from 2½ to 2 per cent.?——*Sir Robert Hall*: It was a flag; that is the way to think about it. I remember the discussions at the time. The previous Government had not wished to use changes in interest rates. The sort of thing that was said to us was: "People will not take your desire to use monetary policy seriously unless they think that you are going to use interest rates also." It was the first step, you might say, in the somewhat uncharted field into which we were moving.—*Sir Edmund Compton*: And in absolute terms, the difference would be considerable. The market had been used to borrowing more or less when they wanted from the Bank at ½ per cent.

2357. *Sir Oliver Franks*: That is saying that there were effects in the money market, which is obviously true. Policies designed to make a difference either to fixed investment or investment in stocks presumably require a much more considerable movement in longer-term rates. Would you not agree that the effects of so small a movement in the Bank Rate, apart from putting the public on notice that the Bank Rate would be activated, almost exhausted themselves in the narrower field of the money market?——I do not want to put it too high, except that it did mean an appreciable and immediate rise in interest rates at the short end, and interest rates are not all that compartmented. One's experience is that a rise at one end of the interest rate structure does generate movements in the rest of the structure.

2358. *Sir John Woods*: Would you not think that, from the point of view of investment by industry, what matters is not so much a change in the rate but an absolute level of Bank Rate?——I do not know how precise anyone can be in saying what is of importance to businesses. I should have thought that some businesses were affected by the absolute level and some by the change; but in the main I would agree with Sir John Woods.

2359. *Chairman*: Could you identify the kinds of businesses which are affected different ways, which are concerned with the absolute level and which are primarily influenced by the change?——I should not like off-hand to proceed to such an analysis. We could develop that further if the Committee felt that we should.

2360. We regard this as a question of importance. Would you like to put in a note on it after thinking it over?——Yes.

2361. *Sir Oliver Franks*: One of the views about the effects of Bank Rate was that it moderated people's behaviour about investment, because an upward movement signalled more difficult or stormier weather to come; the upward movement might be succeeded by further upward

* See Appendix to Minutes of Evidence.

† Memoranda of Evidence Part II No. 6.

movements; a whole trend was indicated, and nobody could say when the trend was first indicated how far it would go. The alternative view is that with the very large capital investment programmes in which a great many major companies in this country are involved, where they are planning three, five or seven years ahead, they will expect, now that Bank Rate has been reactivated, that interest rates will change as they go along; and within broad limits presumably they will pay little or no attention. They are like a liner going through the waves, which just cuts through them unless they are too big. From that point of view, if you are concerned with a use of the interest rate which will really make an industrial company engaged on that kind of programme of expansion cut back on the plans which it intends to put into effect over the next period, the absolute rate seems to me probably to be decisive. You are out of the realm of expectations and into the realm of: what does it cost? From that point of view, it might be thought that only on 19th September last did the level of Bank Rate reach the sort of point at which an industrial concern would normally begin to think about it in relation to its capital investment programme. Is not all that involved in the question which has been put to you?——*Sir Robert Hall*: I should have thought it was extremely difficult at any time to differentiate between these two elements, because the long-term plans of even big businesses will be related to some expectation about the future. Looking at the whole period, I would agree with the implication of your question that quite substantial changes in interest rates seem to be required in order to modify at any rate a good many investment plans purely because of the increase in cost involved. If one looks through the different types of investment to see the relative importance of the capital element, one gets an implication that changes in interest rates would be more likely to hit certain types. A current example is the atomic energy programme, of which the capital investment is a very large part, where the interest and amortisation costs are a very substantial part of the total cost. Housing is another example which is often given, of a type of activity which *a priori* appears to be affected by the absolute changes in interest rates. But since in all cases the end of business activity is to sell the product at a profit and the possibility of selling the product at a profit will be considerably affected by one's judgment of the total level of demand, it might still be the case that even with levels not themselves important from the cost point of view, one would have another look at one's investment plans if one assumed that the change in Bank Rate meant that business conditions generally might be becoming more difficult.

2362. *Professor Cairncross*: Would you not agree that nearly all the heavy capital-consuming types of activity have passed into the public sector, so that you are dealing here very largely with public expenditure, with borrowing for local authorities, or for the public corporations, or for the Government's own porposes?——I do not think there is much doubt that the capital intensive kinds of activity are in the public sector, although I expect there are also some in the private sector too, and, of course, building is increasingly moving out of the public and into the private sector.

2363. *Mr. Woodcock*: Can we follow this through by a recent example? I heard yesterday on the wireless that a new foundry costing £7m. was about to come into operation for Ford's. When would that have been started?——My guess would be that they actually started to work on it between two and three years ago.

2364. Would it not have been a little earlier than that?——An integrated iron and steel works as a whole would certainly have been a lot earlier. I do not know how big is the foundry at Ford's.

2365. The Bank Rate would have varied quite a lot in the period since they first made the decision to build this foundry as a matter of policy and then proceeded by various stages. I should have thought that in all that period the absolute level of the Bank Rate had not affected them at all?——Once they had started the work, another consideration would arise. You almost certainly lose a certain amount of money by stopping work which is under construction, so that the nearer a thing gets to completion, the less likely it would be to be stopped.

2366. Yes; but whenever they started they did so in the knowledge that the Bank Rate would fluctuate; and they must have balanced that consideration against the possibility of expanding their trade and selling their products. I should have thought that on the whole that was evidence that they were concerned more with the prospect of selling their products than with the Bank Rate?——We discussed previously the view that, once the Government become committed to full employment, people are likely to have a different set of expectations, because it might be thought that trade will not go violently up and down as it used to do. One explanation for the upsurge in investment in the last few years has been that people were beginning to regard full employment as a normal state of affairs. Once you get that, the expectation outlook is considerably changed, because you can rule out the periods which in the past were associated with substantial losses.

2367. *Chairman*: Does that mean that it is no good flying a storm signal because nobody will think that the storm is really coming?——The more you have not had storms, or the more you think it will be possible to keep out of storms, the less the storm signal means.

2368. *Sir Oliver Franks*: If Government policy, repeatedly announced and reaffirmed by Governments of whatever colour, is full employment, the maintenance of the aggregate level of demand at a level which will eliminate depressions of magnitude and, in addition, a commitment to growth in the economy and a steady raising of the material standard of living, then the manufacturer must be inclined to assume that there will be a good market for his wares if they are comparable in price and quality with those of his competitors in the economy. From that point of view, it seems to be the absolute level of the rate of interest in relation to capital investment that will bite, if at all, rather than simply expectations which by Government policy have been made so much more uniform?——Yes. You get a new set of expectations related to the probable amplitude of future swings as compared with past ones.

2369. But it means that, if you think that the interest rate is all-important, you are likely to be forced to lean more heavily on the actual rate at any given time than on the expectations of change to which the movement gives rise?——Yes, I think that is certainly the case. That is to some extent the thesis of Part II of the paper.

2370. Then you will draw certain conclusions about the kind of movement of the Bank Rate which is likely to have any effect in those changed circumstances. If, for the sake of argument, a half per cent. or 1 per cent. could be a signal and a sign of changed times, altering people's expectations and, therefore, exerting an effect, that is one thing; but if you rely for the major part on the absolute level, it may be that thinking in terms of a half per cent. or 1 per cent. has very little point in it?——I would entirely agree. Comparing the period immediately after 1951 and the period after 1955, I think we are already beginning to feel our way in the second period towards that conclusion. I do not think that in 1951 it was by any means widely accepted that the Government could in fact maintain a steadily growing economy. Without going into political questions, I think many people thought that a Conservative Government either could not or would not adopt exactly the same policy of full employment as the Labour Government had done. The first two years, perhaps, after the 1951 Election were a period when people were considering their general long-term expectations, asking themselves whether the kind of things that you have mentioned were now applicable.

2371. *Sir John Woods*: May I add to Sir Oliver's last question? He was saying that people are inclined to assume a steadily expanding demand for their products; but he spoke of it in internal terms. Would you not agree that it is also true of external demand? There is a general sort of feeling that Governments all over the world now will not, if they can help it, allow big drops in demand and that they have better weapons than they used to have, in that they will develop under-developed countries, and so on. All of this leads to a series of expectations which would seem to me to outweigh any expectations of fluctuations and higher rates of Bank Rate?——That is certainly a factor. After all, one of the

most striking developments of the post-war world has been the success, on the whole, of the United States in maintaining a fairly regular level of activity. Most professional economists did not believe that would happen; in the early years after the war they misjudged what would happen in the United States because they were so much affected by the violent swings through which the American economy had passed in the twenty years before the war. Of course, this is a somewhat delicate plant, as can be seen from the rather lively apprehensions which have been expressed in the course of the last few months about the American economy, but to my mind they were ignoring the experience of the previous ten years to say that the Americans had learnt nothing in this field. That was almost the implication of some of the things which we have read recently.

2372. *Lord Harcourt*: Sir Oliver has been taking this discussion rather on the lines of the possible anticipatory effects of the Bank Rate; but, given the political climate in which we have lived for the last twelve years or so, is it not also true that the actual rate of Bank Rate is diminished in its effect? If a corporation owns a very large plant, and if there is a general expectation that full employment and the maintenance of a high level of consumption throughout the world are likely, the owners of that plant would be prepared to put out a considerable expenditure of money to remove a bottleneck, at almost any cost, because otherwise the rest of the plant would become comparatively useless. Do not the long-term considerations minimise to a certain extent the actual cost of capital, where the actual cost may be large in itself but only a small proportion of the total value of the plant which might be entirely held up by an inefficient part?——I do not think your example of the bottlenecks would be in itself conclusive, but I agree with the general thought behind the question, that if you do not expect large swings in the volume of business that you can do, you have then to think in a different way about interest rates. One of the great problems in making investment calculations has been removed from you. You only have to think about whether you are competitive, not whether you will be faced with over-capacity.

2373. *Professor Cairncross*: Apart from that, it pays you to use more capital intensive methods if you think also that the value of the plant will rise steadily by the wearing away of money?——*Sir Robert Hall*: That is a second element, that the actual rate of interest to be paid has to be modified by the expected change in the price level.—*Sir Roger Makins*: Perhaps we should give some further thought to this. While it may be true that in recent times the absolute level of interest rates is more important than the change, at the same time a change in interest rates is perhaps increasingly taken as an important signal. In the case of the United States economy, changes in interest rates have been one of the instruments employed, and the one to which the greatest attention has been paid. There seems to me to be a contradiction in the argument put forward: the absolute level of interest rates becomes, for the sake of argument, far the most important factor, and yet Bank Rate and changes in Bank Rate are taken more and more as a signal.

2374. *Sir Oliver Franks*: It has this paradoxical character, because one can say that by and large most of the upward increases in this country have not had the characteristics which you describe, but any decrease, however small, has had all these "green light" characteristics which follow from what you say?——*Sir Robert Hall*: One could also add that over a longish period the expectation element will depend on what has happened. If, in fact, you allow business to fluctuate a bit, you reintroduce expectations.

2375. *Professor Cairncross*: There is a note in paragraph 57: "fixed investment in real terms was unchanged". Do not the figures show a slight increase? I do not think that there has been any year since the war when there has not been a slight increase, in spite of changes in the Bank Rate?——The latest Blue Book shows an increase from £1,647m. to £1,671m. It is a slight increase; you are quite right.

2376. *Chairman*: In paragraph 58, the Economic Survey for 1953 is quoted: "Monetary policy undoubtedly played its part in checking the rise in stocks and work in progress"; but in another paragraph you point out that there were a number of possibly equally good reasons for the check in that rise in stocks. Would you accept that?——Yes. We certainly thought at that time and in 1955 that the changes in short-term interest rates would be most likely to affect stocks. That was, I think, very much the traditional view in economic circles. In the course of the period we began to wonder what makes stocks behave in the way that they do. I think that we were perhaps saying: "We have used monetary policy, which is supposed to affect stocks, and stocks were affected".

2377. There is a distinct change of emphasis between paragraph 58 and paragraph 77, where you are discussing the effect of monetary measures in 1955?——Yes. We must have been learning!

2378. *Professor Sayers*: The statement in paragraph 58 is not an historic statement, is it? Is it not a speculative statement?——Yes. The Surveys are written very close to the events.

2379. Was there any kind of factual evidence on which this statement was based?——I do not see how there could have been. Of course, the Surveys also reflect to some extent the views of the Government of the day; at any rate, the adjectives do.

2380. *Professor Sayers*: The statement in paragraph 59: "The higher level of interest rates also encouraged personal saving" is not a quotation from the Economic Survey, but a statement made in 1957 about what happened in 1953 or 1952?——Yes.

2381. Would you like to qualify it at all, or are you sure?——It is very hard to be confident about the factors that affect saving. My own view is that savings will tend to be higher with higher interest rates.

2382. *Professor Cairncross*: You might lay more stress, I suppose, on the fall in asset values at this time, which might check consumption?——Yes. I think that is a significant factor in consumption.

2383. *Sir Oliver Franks*: The tone of the last sentence of paragraph 60 is, of course, more uncertain than that of paragraph 58?——Paragraph 58 is a quotation: paragraph 60 is subsequent comment. I do not think we ought to give the Committee the impression that the apparent success of monetary policy in 1952 was not a factor in subsequent events. There may have been a certain amount of *post hoc ergo propter hoc* in it, but the sort of general feeling after 1952 was that monetary policy had been associated with these changes, although other things were present too; and that it was just as well that we got monetary policy going. I certainly felt at the time that we wanted monetary policy to work with other forces, and I still think that.

2384. *Mr. Woodcock*: In the middle of paragraph 60 you say that investment in stocks of finished goods decreased, but you go on to say that there had been a substantial increase in 1951. Would you not have expected a reduction in 1952 anyhow?——Yes. That is what we meant. In paragraph 60 there is the statement of the Chancellor: "The restraint of demand, working with the tide of economic forces . . ."; the thing was swinging anyway, so that we were perhaps a bit misled by the swing.

2385. *Chairman*: There was a very heavy buying pressure in 1951?——Yes. There was something of a run-down of stocks in 1950; then the Korean war broke out in the middle and there was a sharp rise in prices and a rush to re-stock. Then prices began to fall away again.

2386. There was a fall in raw material prices in 1952 and a noticeable drop in consumer demand in 1951-52: those were no doubt the "tide of economic forces" to which the Chancellor was referring?——Certainly.

2387. *Professor Sayers*: You say in the middle of paragraph 62: "The authorities did not oppose the market movements in the direction of lower interest rates." Did they do anything other than the reduction of Bank Rate to encourage the fall in interest rates?——*Sir Edmund Compton*: No. The process consisted of following the market.

2388. *Sir John Woods*: All the same, you say that these "were years of deliberate reflation and expansion", and "in accordance with this general strategy of expansion and stimulus to private investment, the degree of pressure on the monetary system was somewhat eased." That does not sound to me exactly the same as simply following the market for primarily technical reasons?—*Professor Sayers*: And the Bank Rate was reduced?——We did not deliberately lower interest rates by this instrument, but there were other measures taken during the period which did represent positive measures of reflation. In 1954, for example, there was the introduction of the investment allowance, and the removal of the hire purchase restrictions.

2389. Was the reduction of Bank Rate in May, 1954, deliberately for the purpose of reflating the economy?——No. As I have said, that was a case of following something, an act where the authorities did not oppose the movement of the market downwards.

2390. May I pursue this question of following the market downwards? One sees over and over again the market speculating on what the authorities will do next, and, in particular, what is to be the next movement of Bank Rate. At this time market rates fell because the market was coming to expect a reduction of Bank Rate. If you follow the market every time, will it not take you much further down, or much further up, than general conditions would seem to dictate?——In May 1954 one factor that was undoubtedly in mind was the desire to keep the Bank Rate flexible and not to get the rates frozen into a rigid pattern. The reduction was regarded by the authorities at the time as being not a policy signal but a normal operation of what it was hoped at the time was turning into a flexible monetary instrument. If I remember rightly, there was no announcement associated with that reduction at all. As to the second point, whether one reduction does not generate an expectation of another, as a matter of history, the Treasury Bill rates did continue to ease from that date in May until July, when they settled at about a half per cent. below the level at which they had been at the change of the Bank Rate.

2391. But you did not "follow the market down" again. You sometimes do and sometimes do not follow the market. The same thing happened again in 1957: you "followed the market down," and some statements were made that you were following the market down, in February, 1957, but you did not "follow it down" in March. What is this doctrine of "following the market down"?——The difficulty about answering a question posed in those terms is that to "follow the market down" really depends upon an assumption that the market is continuously moving down, whereas in fact the situation in which it has been appropriate to make a technical downward adjustment of the Bank Rate has been one in which the market has gone down to a point at which Bank Rate can only be made effective without the change by forcing up the rate: in other words, the spread between the market Bill rate and Bank Rate has become too big.

2392. *Chairman*: Is there not a danger of getting into a complete circle in this? The rate falls in the market because of expectations about what will be done in the fairly near future about Bank Rate. Then the authorities say: "The rate is falling; we ought for the sake of flexibility to follow the market down." They are chasing you and you are chasing them?——That would be true if the only thing that influenced the market was the expectation of change in Bank Rate.

2393. I was putting that assumption to you, but you say that that does not really govern it?——No.

2394. *Professor Sayers*: I suggest that this is just a hangover from an earlier period when "following the market down" had a very real meaning for Bank Rate policy. I do not want to go into that story now, although I think that that is the origin of the doctrine and it meant something quite different. But when you say that the market is coming down for other reasons as well as expecting that the Bank Rate is going to come down, you mean that the market is judging more fundamental features of the situation in the same way as the authorities are doing, and the authorities agree with the market, and say: "This is a proper time to bring down the Bank Rate." But the authorities are really making up their minds, as the market has made up its mind, on some other reason than simply what has happened in the market over the last few weeks. I suggest that this phrase "following the market down" is really quite misleading, and does not describe what has been happening in the authorities' minds.—*Professor Cairncross*: May I put it more strongly? The complex of short-term interest rates is not really within the power of the market unless the Government chooses to stand out. The Government may be interested in the market's judgment; it may allow the market's judgment, so to speak, to take precedence over its own; but if it wishes, surely it is in a position to dictate what short-term rates are?——I would say that it is always in the power of the authorities to move up the short-term rate by making the Bank Rate at a given level effective. I am afraid I am not nearly so dogmatic on the proposition that we can at any time regulate the rate at which the Government are borrowing by the issue of Bills in the market; Bills are things for which there is a supply and a demand. We need Bill finance in different quantities at different times, and the readiness not only of the discount market but also of people outside the discount market to bid for those Bills also varies from time to time. There was certainly on this occasion in 1954 and again in February, 1957 a reality about the forces in the market itself which led to a downward trend in the rate for Bills; one saw it week by week. When the discount market would have liked to stay put on the Bill rate, they did not get the Bills they needed for their business. There were, therefore, those forces in the market itself which led to its fall and which put us, if I may take the more recent case of February 1957, in the dilemma that one could only make the Bank Rate effective without a change by forcing the market up to a higher rate than the rate at which the market itself was trading.

2395. *Professor Sayers*: In your last sentence or so you were saying in effect that you could have countered the other forces at work in the market, that were pulling rates down. Of course, you could have countered the expectation, you could have altered the volume of money in the market, and so on; but you did not choose to do so. When you are saying that you decided to reduce Bank Rate, are you not in effect saying that you had good reasons for choosing not to offset the forces in the market that were making for lower rates from week to week?——As the paper says, those forces were not opposed, which is another way of saying that we did not choose to offset them.

2396. Then is it not right to describe the reduction in Bank Rate as occurring because you had those reasons for not opposing the market trend? I am trying to get rid of this idea that you must follow the market?——I do not think there is any question of there being a necessity to follow the market down; it is a choice.

2397. "Following the market" is no explanation of what is being done, because the market is very much what you make it?——It is a matter of choice whether the authorities follow the market or not, because undoubtedly it is possible to counteract the market and to change it by making Bank Rate effective at a level other than that to which the market has gone.

2398. Is it not in these circumstances grossly misleading to say, in explanation of a Bank Rate change, that you have "followed the market"?——*Sir Oliver Franks*: Could we put it this way? If we follow what Professor Sayers is saying, there is one state of mind in the Bank of England which has two effects. One is the non-opposing of the movement of the market; the other is the movement of the Bank Rate. The reasons which are good for the one are good for the other; they are both of them really reflections of the one decision or the one state of mind. Therefore the ground of both phenomena is the same, whereas the language employed suggests that one phenomenon causes the other, which on the argument cannot be the case?——That, if I may say so, is very helpful to me; it puts what I was trying to put extremely well. It is, perhaps, easier to see in this paragraph. At the point of history which we are considering in 1954, I should have thought that the authorities would have put it on the footing that technical conditions were appropriate for the downward adjustment, that there was no reason why the market tendency should be opposed, and

that a reduction in Bank Rate was consistent with the other measures that were being taken at that time to stabilise and to some extent to reflate the economy.

2399. *Chairman*: It was partly a desire to go in with the wish to reflate, and partly flexibility. I should like to be quite clear what you mean by flexibility. Why is it an advantage?——The point is a difficult one, because flexibility can be purchased at the expense of the significance of the Bank Rate change as a change; the more flexibly it is used, the less significance it may have. One has to look at this historically. As I recollect these changes, it was felt both by the Bank of England and by ourselves at the time that we should try to move progressively towards a Bank Rate that was flexible, so that on occasion the public should regard a move either way as being not an earth-shaking move, but as the use of an instrument which was part of the normal operation of the monetary machine. That was perhaps the monetary hope that we had in 1954. Certainly all that hope, while it existed, was encouraged by the atmosphere of inflation at the time.

2400. *Professor Sayers*: Have subsequent events caused the Treasury to modify its desire for flexibility in this instrument?——Flexibility is still something which, if it were possible, one would like to have. There seem to be clear disadvantages about a situation in which we might otherwise get lodged indefinitely at a rate which had started by being thought of as a crisis or near-crisis rate, and had been so represented, and then had to be retained, because any change, if it were not retained, would be interpreted, whether one liked it or not, as a signal to relax.

2401. *Chairman*: If I understand the purpose of aiming at flexibility, it is rather to say to the public: "This Bank Rate is a technical matter and it is concerned with the money market, and its adjustments are relevant to the short-term run of the money market. Do not treat its movements as more important than that." Would that not be the consequence of aiming at and achieving flexibility?——If that were the only consequence, it would destroy a lot of the validity of the Bank Rate and would, therefore, be undesirable. I think that, if one could hope for perfection in this, one would try to get the best of both worlds and have a Bank Rate which was changed sometimes technically and sometimes as a policy signal.

2402. Do you think that you can in this world achieve a double use?——The history of these five years shows that it has been tried.

2403. *Sir Oliver Franks*: The Bank of England attaches very great importance to the use of monetary weapons generally, and Bank Rate in particular, not in isolation but in conjunction with other measures which tend to move the economy in the same direction; for purposes of discussion yesterday, we were referring to this as a package deal in which Bank Rate is one element. It seems to me that, in proportion as you take that view, you must really be looking in the use of Bank Rate for some contribution to an alteration in the general state of the economy. If that is so, what matters for Bank Rate is its effect on investment, on the price of long-term money, and so on; its relation to the short-term money market is essentially important only if that is the means by which it spreads out to and affects investment money. If that is so, then a reduction of Bank Rate must inescapably be taken as a "green light" because its advancement has always been part of a package to deal with a state of relative boom in the economy. If you say that you bring it down for technical reasons, the reason for bringing it down denies the nature of the reason for putting it up. Is there not a dilemma here? The argument on flexibility seems to me to relate to an essentially short-term use of the Bank Rate, where the immediate effects on the money market are what you look to (perhaps you see in the historical context movements of gold in and out, or whatever it may be), whereas if it is part of a package deal, as the Bank insists, it must be one of the policy measures to deal with a general state of things?—— Historically, over the last few years, it is the upward changes in Bank Rate that have been part of a package and the downward changes in Bank Rate that have been done in isolation and represented as technical, and have been declared on occasion specifically not to be signals to relax at all. That distinction has been attempted.

2404. What are your comments on it? One could argue, I think, that there is a formal contradiction between these types of action?——One difference between the two movements has been the difference in the amount and the size of the step. I know that that is not true about the rise in Bank Rate in January 1955.

2405. You cannot argue this one on size, can you?——Yes; if what might be called a decisive downward move, not an adjustment, took place, I should have thought that that was a clear policy signal of a reflationary or relaxatory character, just as we have certainly learnt to regard an upward Bank Rate change of 1 per cent. or more as the sort of contribution that an upward Bank Rate change might make to a package of measures.

2406. *Sir John Woods*: The Bank of England in discussing the question of flexibility took the view that it was desirable to move fairly frequently, but in particular, when circumstances permitted it, to get as low as you reasonably could so as to give yourself a good jumping-off place for a significant increase in Bank Rate without getting to an absolute rate which would be travelling too high. Is that a view which the Treasury share?——Yes; I was trying to reflect that, when I spoke of the disadvantage of being lodged indefinitely on a rate which had been originally represented as a crisis or near-crisis rate. It means that if you have another crisis you must move even higher from the high place where you are. In concrete terms, it might be represented that if Bank Rate had not been reduced to 5 per cent. in February, 1957, the 2 per cent. step which was judged necessary in September would have taken us to a figure higher than 7 per cent.

2407. *Chairman*: But if flexibility means that (I quite follow that it is not the same thing as you were outlining before) it merely is a constant desire to get down as low as you can in the quieter times because you know that in the less quiet times you must jump up, and you want to be able to jump up from the lowest step you can achieve?——I was remembering that. I was also on the point that the conditions for moving down should be those which not only are technically right, but also are consistent as far as possible with general economic policy.

2408. *Professor Sayers*: May I put Sir Oliver Franks's point in another way? If Bank Rate is moved with moderate frequency up and down, and the market comes to think that this is what happens to the Bank Rate, then the effect on long-term rates is reduced to something very small indeed, as was shown by nineteenth century experience and again in the experience of the last few years. After all, the fluctuations in the rate for marginal money in Lombard Street at 2.20 p.m. each day have no effect at all on long-term rates, because everybody knows that they are not going to last. Similarly, if a rise in Bank Rate is soon to be followed by a fall, it will not, for very good reasons, have much effect on the long-term rate. This desire for flexibility would, therefore, seem to indicate that the authorities are depending entirely on the effects of the short-term rate of interest in the economy and do not attach importance to changing long-term rates for purposes of economic control. When flexibility was exalted into an aim of policy in 1953-54, was there a feeling that the long-term rates were not worth bothering about, that they could be left to take care of themselves, and that short-term rates were what the authorities wanted to use as controllers?——Formulated in that way, possibly it suggests a more direct connection between Bank Rate and long-term rates than, I think, we would recognise or than has been shown in the history of this period.

2409. But you can recognise the connection. Just what result the connection produces depends upon the long-term market's view of how Bank Rate is to be moved over the years. If people think that Bank Rate is going sometimes up and sometimes down, then the long-term market is still connected with the short-term market but the rate in the long-term market fluctuates very little. Its stability is based on the view that the short-term rate is a fluctuating rate. Is that not so?——Yes, but that would assume that we had got to the point at which Bank Rate had become something which was flexible to the point of weekly or monthly adjustments. That is neither a view nor an aim of flexibility that the authorities have had.

2410. It is sufficient if you agree that a fluctuation of Bank Rate up or down by steps that come once in six months, or once in two years, will leave long-term rates almost unaffected, if that is what the market expects the Bank Rate to do. That is a matter of mathematics—*Professor Cairncross*: May I put the question slightly differently? Do you regard the influences on the long-term rate as being part of a package deal too? In your conception of the way that long-term rates are influenced, you do not just operate on Bank Rate; you operate on other elements of policy and think that in that way you will affect long-term rates?——I would say that the long-term rate is affected not only by the effect of Bank Rate working through from the short end of the market through the whole of the interest rate structure, but also by the factors in the market itself: the supply and demand for capital, and of course confidence, and the readiness or otherwise of people to buy gilt edged according to their expectations about the future value of money, which is a much wider question than the question of the Bank Rate.

2411. The question is how you control or move the long-term rate, not what are the forces that govern it. Professor Sayers has put to you that if you rely on a flexible Bank Rate, your influence will not be very great. Are there other forces which may be brought to bear by the authorities which may be stronger?——Direct forces, I would say, no. Bank Rate is the direct force that the authorities have to bear upon rates in the market.

2412. *Sir Oliver Franks*: If you are talking here in relation to a major boom, in which the quantity of investment getting under way may be a factor which puts things out of balance, and if, apart from direct cuts and physical controls, Bank Rate is what you use to try to effect the price at which capital development can be carried out, which postulates that it must work through, and work through substantially, to the price of relatively long-term money, then surely this dilemma, which was posed in a logical way, is real? If by "flexible" one means that the Bank Rate is used reasonably often and goes up or down, that must tend to even out and diminish its influence on the long-term rate. A flexible Bank Rate might not be as useful for the part in these package deals which the Bank and you would say that it should play; if, on the other hand, you wish it to play this part and exert this major influence on the price of long-term money, must you not sacrifice flexibility, not in the sense that it must always be advanced, but that you cannot, as it were, flex as an end in itself?——I agree the dilemma is there; and in the light of the experience of the past five years, I think that that dilemma has been solved, if "solved" is the right word, by sacrificing flexibility.

2413. *Mr. Woodcock*: It is a fact that despite such flexibility as we have had, the long-term rate has risen?——Yes, and it has risen very largely, I would say, because of the operation of those other factors: the factor of the demand for capital, and the confidence factor. Those are perhaps the main things which affect the price of longer-term gilt edged.

2414. *Professor Cairncross*: Both of the factors you mentioned are subject to direct Government influence. Is it not apparent that if the Government, at the same time as they put up the Bank Rate, cut their own investment or take measures in the Budget or in other ways, they can affect the long-term rate?——That is so. That is why I confined my answer to the instrument that the authorities have at hand which has a direct effect upon the market. Undoubtedly, if investors can be assured that their money will not lose its value, they will be that much more ready to invest in fixed interest securities; but that is a much bigger question really of the confidence of the investor in the control of inflation.

2415. If one goes back, as Professor Sayers did, to the days in which the Bank Rate was flexible and long-term rates did not change greatly, the significant difference, I think, is that in those days quite a small change in long-term rates had a marked effect on expectations. It was not the magnitude of the change but the expectations that were affected that took effect on the economic situation. We discussed earlier the influence of expectations and came to the conclusion that, in recent circumstances at least, they were probably much less affected in comparison with the size of the absolute movement of the long-term rate. This may be important, because it implies that if we use Bank Rate we have to look forward to much larger absolute changes in long-term rates than were customary in the past. Would you agree with that?——Either to that or to measures to restrict either the amount of money or the access of borrowers to money, such as have been operating at the same time as the approach via the interest rate during the whole of this period: the capital issues control and, in the banking field, the restrictions on bank advances.

2416. I was assuming that we were discussing traditional monetary policy and not the weapons of control which have operated in the recent past. Relying exclusively on the Bank Rate, we would have to envisage some wider swings?——If that was the only instrument, that would follow.

2417. *Professor Sayers*: It is not as though we are regarding the capital issues control and the control of bank advances as possible permanent parts of the armoury?——The capital issues control has been part of the permanent law of the land since 1946. I have no reason to anticipate the repeal of that particular statute.

2418. *Mr. Woodcock*: The point is that you could keep the Capital Issues Committee but your instructions to it could vary, and have varied?——Yes. The extent to which the capital issues control is exercised could undoubtedly be tightened or relaxed.

2419. *Professor Cairncross*: Would you agree that perhaps you misjudged the level around which fluctuation would have to take place if Bank Rate were to play the part assigned to it in the earlier pronouncements of 1951 and 1953?——In the light of the sort of rates that seem to be necessary once the entire public get used to full employment and its implications, probably the answer is "Yes".

2420. *Sir Oliver Franks*: Should we say that in the light of existing Government policy, the answer is "Yes"?——It is not only existing Government policy but the public's expectation of the success of that policy. The country had, after all, had some experience of a recession, or the beginnings of a recession, in 1952, and one has to remember that in relation to what is being done both by the public and by the authorities a year after.

2421. *Mr. Woodcock*: In your view a reduction has less effect on people's expectations than an increase?——Over the whole of this period, every reduction which has been made has been represented as being a technical reduction and not a policy signal, and every increase has been represented as being, in the Chairman's terms, part of a policy package. Whether that has been successfully put across to the public in all cases, I would not be so sure.

2422. I thought you said that in your view it had less effect in the case of a reduction?——*Sir Edmund Compton*: No. The reduction that occurred in May, 1954, for example, did not attract, as I recollect, a great deal of attention and was not regarded as being of great policy significance at the time, probably because it was consistent with the general trend of the time. On the other hand, the effect of the reduction of February 1957, and how it was regarded by the public might be more questionable.——*Sir Robert Hall*: Concerning the reduction in May, 1954, subsequent reflection has led me to feel that we rather misjudged the situation at the time. When changes in Bank Rate are discussed, a number of questions are put forward, including whether it will change expectations, and so forth. I remember that my feeling at the time was that things were going extremely well, perhaps a bit too well; but the prospects at that time on things like the balance of payments seemed reasonably favourable. I feel that if we had been better informed or better judges of the future, we might have realised that the investment boom was running more strongly than we thought it was.

2423. Do you find yourself influenced by the desire to save money on the debt?——*Sir Robert Hall*: We argue about that too but, on the whole, if we intend to use monetary policy, we must not be too much affected by that; the economy in getting it down would be an incidental advantage rather than a reason for moving it.——*Sir Edmund Compton*: We do take note of the effect.

The immediate effect on the Exchequer moves both ways. But, as we shall say in our paper on debt management, we have felt over the whole of this period that it was subordinate to the effect on monetary policy of a Bank Rate change.

2424. *Chairman*: You had very heavy maturities in 1954, which you converted, if I remember aright, on a fairly low rate of interest. Would that not be taken by the public as something like an assurance for expectations that the rate of interest would be low?——Some such view might have been taken if the Bank Rate change had been related very closely in time with the conversion offers.

2425. If you make big conversion offers in accordance with the tone of the market at the time (at that time I think it was something like a 3 per cent. expectation) is that regarded outside as being a sign that the Government expect to maintain money more or less at that rate over the expected future, or is it merely a question of "take your luck when it comes"?——I think it is mainly the latter, although later in that year, if I remember rightly, the Government were under some criticism from the market for having issued a loan quite shortly before the increase in the Bank Rate of January, 1955. As far as that was so, I suppose there was a market expectation, as a result of our issuing loans at that rate, that we expected that rate to continue.

2426. *Sir Reginald Verdon Smith*: Having regard to the discussion we have been having, I should like to know the meaning of the last sentence of paragraph 66, and particularly of the phrase that the Chancellor "taking into account the resources of a flexible monetary policy", reduced rates of taxation?——*Sir Robert Hall*: That was a quotation from the Chancellor's speech. The implication was that, although reducing the rates of taxation might give some stimulus to the economy, monetary policy could, if necessary, be used as a brake.

2427. *Sir John Woods*: As I remember, the signs of a boom running away were noted by the Chancellor of the Exchequer and the Governor of the Bank at the Mansion House Dinner in October, 1954, and they gave a warning about the possibility of inflation. Nothing was then done except making those warning speeches; and then, in January, the Bank Rate was raised from 3 to 3½ per cent. In February it went to 4½ per cent. together with the restrictions on hire purchase sales, and so on. Looking back on it now, would you feel that this is probably an instance where the action taken was too little and too late?——Yes. When I look back at the period, it seems to me that the objective in 1953 and 1954 had been to encourage investment. The feeling was that the strain which had been imposed by the rearmament after Korea was beginning to come off the economy, that total investment in the country was not as high as seemed desirable, either absolutely or in relation to other countries, and the Chancellor felt strongly that he wanted to get the country much more investment-minded; the general outline of his measures and his speeches in 1953 and 1954 was in that direction. It seems to me that he succeeded better than was realised at the time. The fact that from about the middle of 1955 to the Budget of 1956 there was, as it were, a succession of restraining measures really implies that it had not been stopped as quickly as one would have wished to stop it and, therefore, that the earlier action had not been adequate.

2428. *Chairman*: Sir Robert, I want to read a sentence from paragraph 67: "Although the monetary authorities succeeded in reducing the liquid assets of the banks very sharply in the early months of 1955, and the liquidity ratios of the clearing banks fell from an average of 34·3 per cent. at the beginning of the year to 30·0 per cent. in March and 30·1 per cent. at the end of June, the banks met the pressure by selling investments and were able to increase their advances in the first half of the year by the record amount of £289 million." Does that not show that the resources of the flexible monetary policy were not able to achieve the results which were expected?——We tried to make that point in the first sentence, that monetary policy was not doing all that was expected of it.

2429. And could not do it; because there was every reason to try to reduce the pressure that was building up, was there not?——Yes, there was.

2430. The operations on the liquidity ratio were all that theoretically should have happened? They were following the classic model?——*Sir Robert Hall*: This was the beginning of the period which made us more and more wonder about the whole situation.—*Sir Roger Makins*: That is recognised in the first sentence of paragraph 68.

2431. *Chairman*: Was it the appeal to the Banks in July of that year which had the operative effect of reducing the advances?——*Sir Robert Hall*: Yes.—*Sir Edmund Compton*: That has been to some extent qualified by what has been said by the bankers themselves, that before that appeal to them action had been taken to tighten up on bank advances, so that the appeal fell, as it were, on ready ears. They had started to do that in April or thereabouts. In other words, they were by then responding on their advances policy to the policy signal of the Bank Rate change to 4½ per cent., which was of a more decisive nature than the previous move of the Bank Rate from 3 to 3½ per cent.

2432. *Professor Sayers*: Was no word given in the first half of 1955 from the Chancellor through the Governor to the clearing banks, requesting them to be particularly cautious in their advances?——They were not on specific request to reduce their advances, as the paper makes clear, until July. Before then to be cautious and critical about their advances policy was a standing instruction.

2433. Was there no emphasis on this in the first half of 1955?——*Sir Oliver Franks*: My recollection is that the Treasury and the Chancellor were worried about advances in the first half of 1955; that in informal consultation, presumably between the Treasury or the Chancellor of the Exchequer and the Governor of the Bank of England, this worry had been communicated; and that it was communicated in a sort of general way to the banks but rather in terms of, so to speak, qualitative discrimination and care than any question of reduction as such. That did not arise until July, as has been said. Unless my recollection is quite at fault, we had, I think, some awareness that the Government were looking at advances with at least a questioning eye. I have since had the impression that the various persons concerned, whether in the Treasury or the Bank or the commercial banks, were not all absolutely clear in that six months just exactly what degree of concern had been communicated by one to the other?——*Sir Edmund Compton*: I think that that represents the situation. We started, after all, with the experience of 1951-52 and an expectation, falsified in the event, that the same medicine would work again. The rise in Bank Rate to 4½ per cent. was, in the terms of those days, a decisive and, if you like, a near-crisis move. At any rate, it had a marked effect on the whole of the interest rate structure, similar to the rise in the Bank Rate to 4 per cent. in March, 1952. So we were operating a measure in 1955 which, so far as our experience went, had had a measure of effectiveness and success on the last occasion. The first ingredient in the medicine was the signal which had had an undoubted effect upon the borrowing public as well as upon the lending banks the previous time. In the first half of 1955 it had no such effect upon them. Whereas in 1952 the banks' customers had rushed to repay their overdrafts, in 1955 they were continuing to demand increases in them, so that the signal did not work. The second point was that in the meantime, I believe, it had become to some extent common ground between all those concerned that the object of an increase in Bank Rate, and the consequent attraction of the Bill rate to the outside investor, would have its classical effect upon the structure of bank assets: that the result would be that bankers might be free to choose whether they reduced their investments or reduced their advances, and that either way the effect would be to reduce the money supply. The money supply was reduced in terms of the actual quantity, but activity went up. So, once again, the same medicine was applied as in 1952, but the same results did not come. It was a growing realisation that the medicine was not working in the same way that led to what Sir Oliver Franks has described as the increasing anxiety as month by month one saw activity and advances increasing.

2434. What came through to the banks most clearly in my recollection in most of that period was a strengthened view of the importance of the 30 per cent. liquidity ratio

and, therefore, of the necessity to dispose of earning assets, that is to say investments or advances, in order to maintain it. What we did was to dispose of one type of earning asset rather than another. I am not clear that it had been realised by everyone concerned that the banks had quite large quantities of short-term investments which they were in a position to sell, perhaps at a loss, but not at a great loss, and that therefore, from an ordinary commercial point of view, that was the obvious thing to do. Here was this large demand for advances, good advances by commercial standards. It was possible to sell investments at a minor loss. By all ordinary banking considerations, these near-liquid assets only required to be turned into liquid assets and we were away. Am I right in thinking that that was a factor which the authorities had not taken adequately into account beforehand?——Yes. That was yet another point at which we had found that the patient had taken antidotes to the medicine: in other words, that the banks had also profited by their experiences in 1952 and had so strengthened their semi-liquid position that they were able to adjust their balance sheets without the pain that would follow from a forced reduction in advances. Although we had been told from the banking end that they were nevertheless doing their best to review their overdraft facilities some months before the request came to them, the customers at the same time, being anxious to draw as much as they could, responded to that by taking full advantage of whatever limits the banks were already committed to.

2435. *Professor Sayers*: Does not this episode underline the necessity for much more precise knowledge on the part of the authorities of the structure of bank assets and liabilities, including particularly the short bond holdings of the banks and the unused overdraft facilities that they had granted, than the authorities seem to have had at this time?——In retrospect, I think it does, although at the time everyone told us and we believed ourselves that we ought to be looking primarily at the level of deposits. We thought we were doing quite well during those months, at the beginning of the six months' period anyway, simply because the money supply as measured by bank deposits was going down. It was the fact that that had no effect that really caused us to go back to what had been perhaps an earlier doctrine, that the level of advances was decisive, and to ask for that ingredient of the banks' assets to be brought down.

2436. *Chairman*: Supposing you cannot indefinitely maintain the effectiveness of this request based on advances; have you any suggestions for informing yourselves more precisely about the banks' portfolios at any relevant time?——There are two points: information and action. On information, I think it would be right to say the Bank of England, though perhaps not the Treasury, could obtain from any bank at any time information about their portfolio.

2437. Under existing powers?——Yes; on the basis of voluntary co-operation.

2438. *Professor Sayers*: The Bank could call for this information; the question is, has it done so as a result of this episode?—*Professor Cairncross*: And is the information available to you?——Would you object to asking the Bank that question, Mr. Chairman?

2439. *Chairman*: No, not at all. We are investigating the system. There seems in 1955 to have been a deficiency in its operation; that is agreed. I wondered whether you, from the Treasury point of view, wanted to propose any change that would strengthen your hand in case this sort of thing arose again. That is not a question for the Bank; it is a question for you?——I would say that we know enough about the banks' portfolios to know how liquid their investments are.

2440. *Professor Cairncross*: May I ask a question concerning another item of information? The monetary authorities put pressure on the liquidity of the banks and the banks put pressure on the liquidity of the public. You were saying, in effect, that nothing happened because £289 million of investments were sold by the banks. If nothing happened, is that not remarkable? Is it easy to imagine that the banks can dispose of £289 million in any circumstances without affecting liquidity at some point in the system? Do you know who the buyers of any substantial part of this £289 million of investments were? Have you analysed what took place in this quarter in the sale of Government bonds, or what change took place in the liquidity position?——It is largely a question of the response on the part of the large investor, the big business, to the attraction of the higher Bill rate and, with that, the higher short bond rate. The inference that we drew, which is mentioned in the last sentence of paragraph 67, is that the liquid assets that businesses previously held in deposits and then put into investments were on the whole inactive, because they were not for the moment using the money; whereas the addition to the money supply that was created by these advances was active.

2441. I follow the hypothesis; I am asking whether you have any information to indicate who came into possession of the investments that were sold and, therefore, denied themselves the liquidity that they then possessed? If these people came from the same section of the community as were at the same time borrowing from the banks, one effect would cancel the other. If it were a different section of the community, it would be important to establish this?——It has not been possible to analyse that because the owners at a given moment of time of Treasury Bills and of short bonds are for these purposes anonymous. One cannot establish a correlation between the recipients of advances and the holders of Government investments.

2442. I was not suggesting actual identification of the transactions, but rather that you might on analysis be able to determine whether financial intermediaries moved one way or business firms moved in another way. Do you undertake any analysis of this kind? This quarter seems to have been a particularly interesting one, because apart from the sales by banks there were large commercial operations in progress?——It was a most exceptional quarter, or half-year. It might be possible to set up a particular apparatus of enquiry that would have covered it in advance, but one cannot cover it after the event.

2443. *Professor Sayers*: This all bears on the effects of the banks' sales of securities. You have spoken earlier as though the banks, in selling securities in order to make advances, were defeating the constraints which the monetary authorities were trying to exercise. But the classical view on this is that the sales of securities by the banks are effective at a price that induces other people to forgo some of their liquidity, so that some liquidity is taken out of the system by the sales of securities by the banks. Whether it did, in fact, work out like that, and how important that effect was, depends very much on where the demand for these securities came from in this particular instance?——My understanding was that at the beginning of the period, immediately after the Bank Rate change of February, 1955, when the Bill rate rose sharply to the 4½ per cent. level, the first tendency of the business concern with liquid balances was to take the money out of deposits and to put it into Bills. The second phase was that, in their new concern for earning interest on these semi-liquid resources, they went after short bonds; a substantial part of the sales of investments by the banks consisted, as Sir Oliver Franks has pointed out, of short bonds. That was the type of circle that was completed in the process of transfer of money out of bank deposits into securities.

(*Adjourned until* 2.15 *p.m.*)

SIR ROGER MAKINS, SIR EDMUND COMPTON and SIR ROBERT HALL further examined.

2444. *Professor Sayers*: The first sentence of paragraph 68 of this Paper reads ". . . the banks themselves felt that if they were to be successful . . . they would need the support of a Government statement." Did the banks make any approach to the authorities asking for or suggesting that there should be a Government statement?——*Sir Robert Hall*: We and the Bank of England had a discussion on the situation with the banks, at which we expressed our worry about the way things were going. My recollection is that the banks' representatives said that with so many credit-worthy borrowers pressing on them it would psychologically be rather easier to handle the situation if there were a public statement that the Government definitely wished the banks to make a marked reduction in advances.

2445. *Chairman*: They needed a reason to give to potential borrowers other than what their own situation itself required?——*Sir Edmund Compton*: Yes. Perhaps I may interpose a point: before the request made by the Chancellor of the Exchequer there was the letter which the Chairman and Deputy Chairman of the Committee of Clearing Banks sent to *The Times* at the end of June, which was an attempt to drive home to the public that the bankers were restricting advances in response to Government policy. I mention that as evidence that the bankers felt that they needed the support of the Government in reducing bank advances.

2446. *Mr. Woodcock*: Was that letter inspired?——*Sir Edmund Compton*: It was written in consultation with and in agreement with the Government.—*Chairman*: We had an answer [Qn. 2173] from the Bank of England about that letter.

2447. *Professor Sayers*: In the middle of paragraph 69 a rise in Bank Rate from 4½ per cent. to 5½ per cent. is noted. What was expected at that time to result from including in the package deal a rise in the Bank Rate which would not have resulted from the package deal without a rise in the Bank Rate?——*Sir Robert Hall*: As I tried to explain before, I do not feel that we break up the constituents thoroughly in our own minds. We felt that all these things would work in the same direction, and that the total result would probably be larger if we included the Bank Rate rise than if we did not. It would be something plus.

2448. In which directions?——Further restriction.

2449. Of investment and consumption?——Mainly on investment, according to our views.

2450. *Sir Reginald Verdon Smith*: May I draw attention to the remark of the Chancellor of the Exchequer quoted at the end of paragraph 7: "The recent change in Bank Rate was designed partly to emphasise the need for caution in the accumulation of stocks"? I find it very difficult to see how anyone could have been expected to regard that as the particular feature which a change in Bank Rate was designed to effect?——We are now back to the Budget of 1955. The feeling still was that increases in Bank Rate might be expected to have more effect on stocks than on long-term investment.

2451. This morning you were inclined to say that you felt at this point of time less certain about the causes of movements of stocks and causes of rises and falls?——We got it wrong in 1955. We thought that stocks were already at a comfortable level by the beginning of 1955 and that at a time when monetary policy was becoming more restrictive it would be reasonable to suppose that stocks would not grow and that therefore the load which stock building had been placing on the resources would not be increased. The burden on the economy from stocks comes when you are increasing stocks rather than from the absolute level of them. In fact stock building went on at a substantial rate in 1955. It seems to me that we must deduce from this that the view, which was widely held in the pre-war period, that monetary changes are likely to have a marked impact on stock building, was brought under some suspicion by these events.

2452. *Professor Cairncross*: Is this entirely true? In paragraph 71 you point out that there was an error in your deductions from the relevant information and that stocks had not risen in 1954 to the extent that you had supposed. The data on stocks are always suspect; one can never be quite certain how in the aggregate stocks are moving. But possibly you have made another error of diagnosis, in that the level of fixed capital investment rose more steeply within this period than had been anticipated, and in the process working stocks must have risen. Incomplete capital goods must have accumulated. How far those account for the rise in stocks in 1955 is not clear from the account given here. It is not obvious whether stocks accumulated during that year were to any extent associated with the rise in fixed capital investment or how far they were associated with the change in the balance of payments and took the form of imported raw material and foodstuffs. Perhaps I should add that in 1955 you were clearly working against strong inflationary forces in the market for primary produce, which must have provided strong incentives to build up stocks, against which a small movement in Bank Rate was not likely to be very effective. Would you not agree?——If your point is that, since there were other factors in the economy making for a build-up in stocks, it is not fair to deduce that monetary policy alone would always be ineffective, I think that is fair.

2453. *Chairman*: When you included the rise in Bank Rate in the package deal, would there be any reason to think that Bank Rate might operate more quickly than the fiscal and other measures? Has that been an element?——I think it was originally. The short end of the interest rate spectrum is affected at once by the Bank Rate, just as on the external side the change in the interest rate, if it has any effect on the holding of balances in different centres, will go to work automatically. But I do not want to commit myself any further than saying that that is something which you can do at very short notice. Administratively, it is quicker to change the Bank Rate than to do most other things.

2454. It immediately puts up the rate of advances by the banks, I imagine?——*Sir Robert Hall*: It puts them up with the short rate of interest. *Sir Edmund Compton*: I should have thought that that element would arise; but there is the other point, that in this context it was one change in a package, and therefore one has to regard the effect of all measures taken in conjunction.

2455. *Sir Oliver Franks*: May I raise a point on paragraph 75? In 1955 at different times a number of different measures were applied, and almost the most which could be said about them is that they mitigated the supposed increase which might have occurred had they not been applied. When we come to 1956 the story is different. I had the impression that progressively through 1956 the economy was responding and that but for Suez it might have been balanced, or very nearly, by the following March. Just as I think it has been instructive to try to see what went wrong in early 1955 or late 1954, so I think it is instructive to try to be clear about what went right in 1956. Was it simply that by slow accumulation over a length of time things had been working and that effects showed in 1956 which did not show in 1955, or was it that the additional measures of February, 1956, at last reached the critical level which began to have that impact, whereas that had not been the case before? Generally the external world continued more or less in full boom in both years. The conditions of the experiment are fairly reasonable for trying to compare the internal economy, one year against the other. What are your impressions, as you look back, of the causes for apparent gradual success in 1956, when 1955 was as we have been describing it?——*Sir Robert Hall*: My own judgment was that the peak, which you can never identify until after you have passed it, was about January 1956, and that the forward momentum was about spent by then.

2456. That is a statement of history, not a statement of the outcome of controlling effort?——The surge was running more strongly against us than we had hoped it would. We were looking for the gradual influence of the measures which we had already taken. For instance, the reduction of the advances, which the banks set about seriously in the second half of 1955, would take some time to show itself. There was a certain number of complaints by Christmas 1955 about the credit squeeze. Then there was

the change in Purchase Tax, which was beginning to operate, and the further measures taken in February 1956; I felt that they contributed to the easing of the situation and to the fact that instead of running on a flat at the peak level we began to move downwards in an appreciable way. That can be attributed to various things. Quite important factors were changed in the hire purchase regulations and there was the reduction in personal advances by the banks, the effect of which was felt progressively in 1956. One could identify the results of those.

2457. There were monetary measures in a fairly extended sense, but you would pick those two out in significance in this period? Were those more significant than the others?——No, I would not say more significant than the others. We attributed about one-third of the total deflationary effect in 1956 to those two measures taken together. The other factor present in 1956 was that investment in the public sector was somewhat held back by voluntary action.

2458. You were surprised in 1955 that the measures taken did so little. Were you surprised in 1956 that the measures in being plus the additional measures did in fact bite?——No. I should have been surprised if they had not bitten. We were worried in the middle of 1955, in the sense that the first half of 1955 was a defeat from the Treasury point of view. We were applying pressure and nothing was happening. We should have been extremely worried if by the end of 1955 still nothing was happening.

2459. But how do we get more out of it as a lesson than that if one starts to apply pressure through various measures, some fiscal and some monetary, nothing happens for a long time and you simply go on adding pressure until in the end you get an effect? That is the easiest lesson from these two years, but one hoped to learn a little more than that. For example, one hoped to learn that in an economy in fairly full boom there are certain critical levels of interest rates, given existing taxation, and that below them you are unlikely to get any quick response; you must go fairly high in these levels if you are to begin to get results. Is that not fair?——There are some measures whose effects can be identified, such as hire purchase restrictions, or reductions of personal bank advances, or a tax which is clear-cut in operation or a cut in investment by direct means. You can make a reasonable shot at such things as those to decide when they will take hold. In the monetary field there seems to be more elasticity and more play than we had supposed. Professor Sayers and Professor Cairncross referred this morning to the banks' overdraft limits. I wanted to add a point on that: it is much harder to say at just what point you will get an effect there because you seem to be working on something with play and give in it.

2460. *Chairman*: You were very much struck by the increase in private saving in 1956, were you not? £500 million of potential consumer expenditure was not spent; that might make a very big difference to the economy?——Yes. Some of that was the hire purchase changes and the reduction in personal advances. They cut out dis-saving and therefore meant that positive saving had less negative saving to overcome. Part of that is the obverse of these measures.

2461. *Professor Cairncross*: On this question of play; if we look at the full period since the war we find that fixed capital investment grew steadily throughout. It is possible to argue that many of the measures which you took merely threw one awkward variable in another direction, with the expectation that it would spring back and hit you the following year. For instance, you could put up the rate of interest and pull down stocks and so improve the balance of payments, in the knowledge that in the following year stocks would have to accumulate to keep pace with the volume of production and that the balance of payments would consequently deteriorate again. It would be possible to argue that some measures taken to restrict consumer spending merely postponed the day at which the consumer would run into debt for purchases in which he wished to indulge, such as the accumulation of consumer durables. Once you have gone through all these things and taken account of the movements of savings and investment, what do you think were the elements which were not just held back but which were permanently shifted in a new direction by the measures which you took?——You can identify whether some things are merely postponed or not. A tightening of hire purchase regulations, for instance, is a once-for-all change. It does not go on exercising a downward effect. When you let up the regulations, there is a once-for-all upward movement.

2462. Is this quite true? I was putting it to you that if hire purchase regulations were in force one year and withdrawn the next, it might lead to the consumer accumulating assets at exactly the same rate as if the regulations had not been introduced?——I think the consumer skips a year while he is saving the deposits for his subsequent transactions.

2463. You assume that there is a once-for-all effect?——Until you let up on the regulations. I agree about stock accumulation; for the purpose of a production programme there is a particular level of stocks which it is most convenient to hold, irrespective of price and supply changes. If people run down below that level, it will later come back and hit us. Restrictions on bank lending, whether by requests or by orthodox monetary measures, would, I think, tend to hold activity down until you let up on them. By and large, taxes would stay put. Direct Government action on the investment programme would depend on the level at which you held it.

2464. Would not one of the principal elements be the level of output itself?——I think of that more as an end product of the other measures than something which would vary, as it were, spontaneously. It does not seem to be in quite the same class as the other measures.

2465. Is this true? Some of the actions through the Budget were largely concerned with total output rather than with any one item?——Taxes which bit consumers' expenditure would be generalised. If you cut consumers' incomes by taxation, then, unless they react by reducing their savings, the incomes stay cut while the taxes which cut them remain in force.

2466. In 1956 you feel that you effected a permanent improvement, if I understand you correctly, because you induced the consumer to cut his spending in a way which would not be reversed the following year?——Take the hire purchase, for example: we did not think we should get any more benefit in the course of 1957 from what we had already done on hire purchase.

2467. But you expected no rebound?——We thought that the aggregate expenditure on hire purchase would rise in the course of 1957 so that it would get back to the level which it had previously held.

2468. Presumably, had you allowed hire purchase transactions to rise in 1956, a lot of saving would have been done in 1957 to offset the expenditure of 1956; you could no longer reckon on that saving. There is an offsetting factor?——There is an offsetting factor while it is rising from a depressed level to its previous level.

2469. *Sir John Woods*: Would you care to express an opinion on whether, in so far as the Bank Rate contributed to the improvement of 1956, it was due to the cumulative pressure of the rising Bank Rate over a period or to the fact that in February, 1956, you reached 5½ per cent.?——I do not see how there can be a critical level in that sense, not associated with expectations. It would depend on the business; there are different degrees of profitability and different degrees of optimism. It is more a case of the brakes coming on harder and harder than of the wheels seizing at a particular point.

2470. You think that the Bank Rate brake coming on during 1955 would contribute to the total effect?——It is very difficult to distinguish between that and the request to the banks which led to a cutting of advances. If you cannot get a loan from the bank you either cannot go on with your activities or you have to finance them in some other way. If you cannot borrow from the bank at 1 per cent. above Bank Rate, you may have to pay 3 per cent. or 4 per cent. more.

2471. Would you have achieved the same effect in 1956 with no movement of the Bank Rate at all in 1955?——In my judgment, which I cannot support by any facts, it was far more effective because of the use of the Bank Rate in 1955 than if we had not used it in that year.

2472. *Sir Oliver Franks*: In fact when one puts one's foot on the brake pedal, it is depressed to a certain extent before any pressure reaches the brakes. The question is whether a certain amount of the level of the Bank Rate in times of high boom is like that first part of the operation: nothing happens at all; whether it is only at a certain stage that the pressure reaches the brakes at all. No doubt as you press harder after that the brakes go on more acutely. Given the general state of the economy in 1955 and 1956, it could be wondered whether there was any real effect from the levels of Bank Rate in 1955 and whether, on the whole, there was not almost certainly some effect in 1956; the way things went in 1956, although moderate in pace, was quite different in direction?——*Sir Robert Hall*: I would not dissent. I think we are all in the field of conjecture here.—*Sir Edmund Compton*: From the market end the 5½ per cent. Bank Rate was regarded more as consolidating the interest rate at that level and indicating that as perhaps for the time being a peak of severity.

2473. *Professor Sayers*: The expectation was that the next move would be in a downward direction?——That was certainly the immediate reaction to the Bank Rate, combined, as it was, with the other measures in the so-called "little Budget" of February, 1956. That was regarded as the peak of the severity measures.

2474. *Chairman*: Does consolidation mean more than that you are reaching a point which they expect you to maintain?——*Sir Edmund Compton*: The feeling of the market is that the next move is likely to be down rather than up.—*Sir Robert Hall*: You can put that in another way by saying that the feeling of the economist is that that rate will be effective and that therefore you need put it up no more and the next move, sometime, will be downward.

2475. *Sir Oliver Franks*: In paragraph 76 we see the phrase: "the cost inflation continued". Are those four words a rather discreet way of saying that the Treasury regards the movement of prices in this period, in 1956 as well as 1955, as something which was not reached by all the measures which were being applied; that they think that there was a good deal of a spontaneous element in the movement of wages which put costs and prices up, quite apart from those aspects of the economy which the Government's measures, whether fiscal or monetary, reached?——Yes, that was the view; that the balance of payments, which has always been one of the most important criteria, was moving in a satisfactory way, and the movement of employment and unfilled vacancies was in the right direction. The ordinary bottlenecks were less pressing. Our view was that you could be moving in a direction of some easing and yet have an upward movement of costs and prices.

2476. If it was assumed, in a phrase which you used earlier, that there would be indeterminancy, or an element of spontaneity or free play, in the wages-costs-prices situation, then is there not room to infer some change of emphasis in the thinking which produced the decisions in September? It appears from the outside that the measures then were directed immediately at demand; yet the things which were said at the time brought all these into much closer relation with wages, costs and prices than had been done earlier. Has the analysis which has been going on in the Treasury over a period shifted a little in emphasis on this?——The decisions have been so political that they have been Ministerial decisions. I was fairly close to the discussions, and I think I can say that the feeling behind the measures of September was that in conditions of high employment, with no sanction, you can get this continued upward movement of costs and prices. If you look at the measures, apart from the Bank Rate changes, you will find that they are forward looking. I do not want to put words in the Chancellor's mouth, but perhaps I can paraphrase the line of thought in this way: up to that time the policy was: "full employment and stable prices are good things; we will try to maintain full employment and if there is restraint all round you will have stable prices". The later statement is saying: "full employment and stable prices are good things; we will exercise pressure to bring about stable prices, and if there is restraint all round you can have full employment". It is a different way of looking at the situation. The measures then announced were a maintenance of bank advances at the present level, which meant that if the price level rose the volume of transactions would have to come down. The same thing applies to investment in nationalised industries; the statement was that enough money will be forthcoming to maintain the present level of investment at present prices but it will only provide a lower level of investment at higher prices. It is a shift in intention and emphasis.

2477. In 1955 the effectiveness of monetary policies seems to be very small. In 1956 the effectiveness of monetary policies, with others in the package, seems to be reasonably considerable. All through it was a hope rather than the fact that there was any connection between these policies and the operative principle of full employment and stable prices. When in 1957 it was brought home to the nation that that link was not there and that prices were moving ahead despite all the other measures, it was felt that the additional measure of control over the economy would be best secured by a package including an increased use of the Bank Rate. This is despite the relative ineffectiveness of the Bank Rate in 1955. There therefore appears to have been a swing in thought beyond that which you have described. The Treasury seems to be saying: "We have changed our view about the effectiveness of Bank Rate; we think that there is a level at which it will bite home and have a wider range of effect than it had in 1955 or 1956". Is that a fair inference or not?——I read the Chancellor's statement as meaning that in the private sector, as compared with the public sector, he was convinced that monetary measures could be made adequate and was prepared to make them so. I think it must be a deduction from what was done that it was believed that, if you were tough enough on the Bank Rate and the level of advances, you would produce an effect.

2478. I do not want to go into a detailed discussion of September 19th because it lies too near; but is it a further fair inference that the opinions about the utility of monetary policy over the whole of this experimental period from 1951 to 1957 varied quite a lot? There have been times when it was thought that monetary policy in conjunction with other policy could do quite a lot, and times when it appeared that it could do very little. There have been times when there has been almost an excess of confidence that it could do a great deal if put to work. Is it fair to suppose that the official mind of the Treasury is to some extent in a state of suspended judgment between these varying possibilities?——*Sir Robert Hall*: Our minds have been more in the direction of saying that we have to use it decisively if we are to expect results.—*Sir Roger Makins*: Surely some part of the answer to the question has been brought out in the discussions over the last few minutes. There were times when monetary policy appeared to be working reasonably well and times when it did not appear to be working reasonably well. When it appeared to be working reasonably well we were encouraged to go on with it, and when it appeared not to be working so well we cast around for something else.

2479. The periods when it seemed to be working reasonably well were also periods when the Bank Rate was high, as in 1956 and in September, 1957. Does not this come back to the question whether there has to be a certain level before it bites and whether a lot of things which were done with Bank Rate policy do not seem to have had any significance, when we look back, because they were not high enough to affect the economy?——*Sir Robert Hall*: I think that is fair enough; I do not think that the result of our experience has been to lead us to say that monetary policy is no good. It is more in the direction that if monetary policy is to be any good it must be exercised with resolution. Another way of putting it would be to say that the post-war economy is less responsive than the pre-war economy used to be. We began in 1951 with a stock of ideas which had come to us from the pre-war period when less strenuous measures appeared to produce results. Our experience suggests, at least to me (and the Chancellor's statement of 19th September, I think, supports this), that the range of thinking has to be a little wider and the idea of what is tough in the monetary field must be reconsidered

2480. *Chairman*: Is there anything on paragraph 79?——*Sir Roger Makins*: One might say a word about the drop in the Bank Rate in February, 1957. This, and the reasons for it, are perhaps more fully documented than is very often the case, because it was the subject of one debate and one fairly extended interchange in the House of Commons.

2481. *Professor Sayers*: Does that mean that you are not willing to add anything?——No; I was drawing attention to the fact that there is a public document explaining in some detail the reasons for it.

2482. A completely puzzling document, if you are referring to the statement in the House?——I am referring to two statements in the House.

Chairman: May we take next the papers on the external aspect?

(*Sir* Edmund Compton *withdrew*.)

SIR LESLIE ROWAN, K.C.B., C.V.O., a Second Secretary, H.M. Treasury, called and examined.

2483. *Chairman*: I think that Paper 11 serves as a background to Paper 12, so may we take Paper 11 first?*——*Sir Roger Makins*: As you know, Sir Leslie Rowan is head of the Overseas Finance Division. He has been there for many years. I will ask him to be the witness-in-chief.

2484. This Paper is factual. May we run through it in the way we have been adopting in order to see whether any questions arise?——*Sir John Woods*: In paragraph 6 (*f*) you say: "The outflow to the R.S.A. is now distinguished from United Kingdom investment in Canada and other non-sterling countries by being free from the requirement of Exchange Control approval." That does not imply that the R.S.A. had a free access to the London market?——*Sir Leslie Rowan*: No. In the first place, we have certain criteria which we adopt towards an R.S.A. Government that wishes to go into the London market, which are set out in the report of the conference which took place in 1952, which we have circulated with our other paper. It is also noteworthy that with only one exception we have not allowed any subordinate authorities in the rest of the sterling area to raise money by issues on the London market. The second point is that these criteria have been notified to the C.I.C.; so far as C.I.C. approval is required, they would be taken into account in deciding on the raising of new money in London.

2485. *Lord Harcourt*: You say: "London has remained the prime source of new capital for the R.S.A. and a very large outflow has been maintained since the war", and you say that this position has been maintained "despite the emergence of the International Bank". Is it fair to say that in this context we are still making a great contribution to the R.S.A. through the International Bank?——Yes. As I think you yourself in particular will be aware, we agreed three or four years ago to make the major part of what is known as our 18 per cent. contribution, 18 per cent. of our quota in the I.B.R.D., available for lending through the I.B.R.D. to sterling Commonwealth Governments generally. That sum of £60 million was to be spread over a period of about 5 or 6 years. We expect that it will be committed by 1960 or 1961. At the last meeting of the International Bank we agreed to release subsequently the remaining £20 million or so of that total amount over a period of years which we have not specifically defined but which will be a fairly short period.

2486. Only Commonwealth countries; not colonial territories?——I do not draw a distinction. I use the term, "Commonwealth" as covering the whole of the Commonwealth, including both dependent and independent territories.

2487. *Chairman*: You use the phrase: ". . . United States aid in grants and loans and of increasing United States private investment." Could you give some idea of the order of magnitude of that source for development in these areas, contrasted with what comes from the United Kingdom?——I cannot give it in precise figures, but there is no doubt that the total which comes from the United Kingdom is by far the largest. In a recent White Paper (Cmnd. 237) on "The United Kingdom's Role in Commonwealth Development," we quoted an estimate made by the International Finance Section of the Department of Economics and Sociology at Princeton University, that something like 70 per cent. of the external capital for the sterling Commonwealth came from the United Kingdom. I should like to emphasise that that is not a figure which we ourselves have calculated, but one which comes from an international source.

* Memoranda of Evidence Part II Nos. 11 and 12.

2488. That is recent and up-to-date?——Yes.

2489. What is the machinery which regulates the amount of borrowing which can be done by Commonwealth Governments on the London market? To whom do they go and for what purpose?——Since the Economic Conference of Commonwealth Prime Ministers in 1952 we in the Treasury should have a discussion with representatives of the Commonwealth Government concerned, and we should seek to assess broadly whether their development programme fitted into the kind of criterion we had set out. That would obviously have to be a very broad assessment. One of the important factors in it would be whether they were contributing enough from their local savings and taxation to development. On that basis we, as the Treasury, would recommend to the Chancellor whether we thought they had made out a case for borrowing, say, £20 million in the London market. They would then have to discuss with the Bank both the timing and the capacity of the market to absorb the amount which we had agreed was reasonable. There are two stages to go through, and the first stage does not necessarily carry the implication that the total can be placed at any particular time on the London market.

2490. The second stage must obviously be very difficult. Do you have any hand in that?——No. That is a matter which we should regard as one primarily for the Bank, although on the home side of the Treasury there would obviously be informal discussions between us and the Bank because of the importance of maintaining an orderly market and because of the impact which there might be on our internal economy generally.

2491. *Sir John Woods*: The first stage was consultation between the Treasury and the authorities of the country concerned. I take it that when you are looking at their development programme, you look at it over a period of years? Presumably with India it would be the next Five Year Plan?——The period varies with the country concerned. In that case there happens to be a Five Year Plan. In most cases they will be looking forward some years. The Central African Federation would be looking forward certainly two or three years.

2492. *Professor Cairncross*: Do you suggest that they might borrow in some other market when you go over their programmes?——Our attitude on this has somewhat changed in recent years. When I first came to this work, our attitude would have been that we should hope and expect that they would do the maximum borrowing within the sterling area, on the basis that that would not involve continuing external claims on our reserves. Recently, our attitude has been much more to encourage Governments within reason to borrow from outside the sterling area. One point in our minds has been the very obvious point that there is now a shortage of savings and a shortage of capital generally for external investment. Secondly, the sterling area as a whole, or the Commonwealth as a whole, if you like to take it wider and include Canada, is not likely to be able to develop at an adequate pace within its own savings and resources; it is therefore reasonable to look outside.

2493. If any Commonwealth country wanted to borrow outside the sterling area, would it inevitably consult you first?——It is under no obligation to consult us first, but normally we have fairly close contacts with all Commonwealth countries and we should hear of it. On the whole, I would expect a Government to make inquiries about the possibilities of borrowing in the London market before going outside; but they are under no obligation.

2494. Have any public companies in the Commonwealth borrowed in the New York market? Within the limits of their own credit, they are free to do so, are they not?——We can do nothing about it in the United Kingdom as such; but, now that you have put the question, I cannot give a case straight away.*

2495. Would a British company be free to do that?——A British company would require approval.

2496. In this respect, as far as you know, there is not complete equality of status between companies in different parts of the Commonwealth under existing exchange restrictions?——I do not think there is complete equality; but, as you know, by and large the exchange control systems of the sterling Commonwealth are based on a common pattern, and I would therefore expect there to be some similarity between the freedom of private companies within the sterling Commonwealth as a whole, including the United Kingdom, to borrow. I would expect more similarity than dissimilarity.

2497. *Mr. Woodcock*: When you described the position first, I got the impression that in the first stage you were concerned mainly, if not entirely, with the advisability of borrowing from the point of view of the country which wished to borrow, whether they should borrow the amount externally or raise it internally by loans or taxation. Your later answers seemed to indicate that you also concern yourself with the availability of finance here?——Yes. These questions all border on the question of external investment, and it might perhaps help to clarify some of the points if I said something in general about that. As you know, over the last few years we have invested a very considerable sum net abroad each year. The investment is not entirely free from some form of control. Perhaps I could take it in three stages: first, the United Kingdom resident is not subject to any control on the movement of his own funds within the sterling area, though, of course, if he wants to raise new money, the problem of the C.I.C. arises. Second, a resident of the R.S.A. wanting to raise money in this country has to go through the ordinary control of the C.I.C.; but, as I made clear earlier, as far as Commonwealth borrowers are concerned, we have permitted only Governments to borrow in the market. They are not concerned with the C.I.C. The third method in which finance is made available is through the International Bank.

As far as investment in the non-sterling area is concerned, that is subject to specific exchange controls, in each case subject to criteria.

Mr. Woodcock was raising the question whether we look at this from both points of view—what they require and what we require; I think we do. This is a very important change from pre-war policy. It has been our specific aim, as you know, to seek to earn a surplus on our current account of an amount sufficient to cover not only this but also debt repayments, and to build up the reserves. Although we have not succeeded in reaching our objective every year, we have had the attainment of that surplus as part of a conscious policy. The reason that we have done that is not wholly connected with the requirements of the borrowing countries. We have had our own interests in mind. I could put it under a number of headings. First of all, as we point out in the paper, one of the essential features of the sterling area system has been that people look to London as a source of capital. The question which one has to ask oneself, if one is thinking whether that ought to be reduced or stopped, is what impact that would have on the whole system. The impact could be economic and it could be political. I do not want to go into the latter but both impacts exist. The second point is that a good deal of the investment which we do, for instance investment in oil, is to develop new and vital sources of raw materials which are of great importance to this country. Another important point is to maintain and develop assets which we already have abroad. When we are looking at these factors we try to get a balance between those three sides of the question. That is the broad way in which we look at the matter when we come to the first stage.

2498. *Professor Cairncross*: An oil company domiciled in Britain would require your authority before making an issue overseas. Would an oil company domiciled in Australia require the permission of the Australian Government?——Yes. The I.M.F. Report on Australian Exchange Restrictions says that there are no restrictions on the receipt of capital from abroad except that residents must obtain exchange control approval before incurring a liability to a non-resident.

2499. Who assumes the transfer risk when loans are raised in dollar countries on behalf of Commonwealth Governments? Do Her Majesty's Government issue a guarantee of any kind?——No. The loan would be denominated in dollars and would be repaid in dollars.

2500. You rely on the Commonwealth Government to exercise their judgment before making an issue abroad, although you encourage them to go abroad if you do not think they can be accommodated in the London market. But in all these cases the transfer risk ultimately falls on the British Government?——The dollars have to be repaid from the reserves unless they are repaid from the country concerned or in some other way.

2501. *Lord Harcourt*: There is no risk in that. If the borrowing is \$10 million the liability is to repay \$10 million. The only risk falls on the borrower who, if he wishes to borrow that amount in dollars, may have to put up more sterling with which to buy those dollars when he repays?——As long as you maintain the exchange value of the currency, there is nothing in it. If you do not do so, the independent Commonwealth country might have to produce additional resources to supply those dollars.

2502. *Professor Cairncross*: I was contrasting this with the kind of arrangement which exists when we import coal and then re-export it. If we as a country borrowed in the New York market we could clearly raise the money more cheaply than could some Commonwealth Governments. Should we not assume exactly the same obligations in the long run, if we borrowed and then allowed the Commonwealth Governments to borrow here? Have you contemplated that?——No, we have not; so far we have never borrowed in the New York market. We have had other accretions to our reserves but not in that way.

2503. *Professor Cairncross*: You could, of course, contract the size of the sterling area. If a government had borrowed in New York and had contracted dollar obligations, and if subsequently it were expelled from the sterling area, it would fall on that government to find the necessary dollars and it would not have access to the pool?——I do not think you can abstract one particular element from a situation and assume that all the other elements remain the same. If you could do that abstraction, the answer to your question would be, Yes; but I do not think you could do it.

2504. The transfer risk is a very long-term risk. We are assuming an obligation not for a year but perhaps for 20 or 30 years, as long as we assume that the sterling area will be maintained?——Yes.

2505. *Chairman*: In considering whether to encourage these loans from outside the sterling area in dollars or other hard currencies, is it relevant to consider whether the area concerned is itself a dollar-earning area?——On the whole the answer to that is, No. In present exchange conditions, I do not think we could reasonably look at the dollar as something apart. In looking at our position and our reserves, the relevant point is how the sterling area as a whole is doing *vis-à-vis* the rest of the world as a whole. In the totality of the sterling area relationship, I think we should get into great difficulty if we put the fact of dollar-earning as something quite apart from the fact of dollar saving or the fact of earning other currencies.

2506. I had in mind that some parts of the area must be great contributors in hard currency to our total reserves, while others cannot be. But that is not a relevant distinction in whether you encourage them to borrow outside London?——No, Sir.

2507. *Sir Reginald Verdon Smith*: Is your consideration of sterling area Government projects an *ad hoc* operation in relation to each specific project with which they come forward, or is there an endeavour from time to time to bring a number of things into common perspective and then try to sort out possible priorities?——First of all, we look at the country's programme as a whole, in so far as the Government wishes to come to the London

* See Appendix to Minutes of Evidence.

market. We should not be looking at individual projects. The only case in which individual projects are concerned in this way would be through the I.B.R.D., where money is allocated. In so far as trying to make a proper division of the total available money to various countries is concerned (if one can decide what is proper) that is something on which we have to exercise our judgment as we go along, in the knowledge of what we think countries are likely to ask for and what requests are likely to be received. It is a matter in which we have had to exercise a certain amount of judgment in the case of the International Bank money. It would be possible there for some Governments to get more than might seem reasonable, but there is no hard and fast rule about it. It is a question of trying to assess the position as you go along.

2508. *Professor Cairncross*: Paragraph 6 (*e*) deals with the degree of discrimination still remaining within the sterling area. It says: "Hence some measure of discrimination has been for some years (though to a steadily diminishing extent) one of the practices . . . of the Area". Would you say that in the case of any particular sterling area country including the United Kingdom, it amounts at present to something significant, in the sense that there would be a substantial increase in dollar expenditure if the restrictions on imports from the dollar area were further decreased?——There is a substantial measure of discrimination. Naturally it varies from country to country. In our case we have removed all discrimination on basic foodstuffs, raw materials and so forth, but we have not removed discrimination on a large number of manufactured articles. The particular interests of other members of the Commonwealth might be different. They might be more interested in maintaining discrimination against some of the things against which we do not discriminate. They each consider their own point of view and their own interest. We have not done an exercise on the total additional effect; it would be very difficult to do because two things could happen if we removed discrimination, and because it depends on the position of supply and demand in various areas of the Commonwealth. One of the two things which could happen if we removed discrimination is that purchases could be transferred from one source to another. If discrimination is worth its salt and is really justifiable, that would reduce the cost on our balance of payments. The second thing is that it would let in goods the demand for which exists but the supply of which has been frustrated because of the discrimination. If one removed discrimination in the sterling area, in total, I think the second element would be pretty substantial; but I could not give any estimate, and I think it would be very difficult to obtain one.

2509. *Professor Cairncross*: By the same token you could not compare the degree of discrimination practised in the different countries?——No. I think it would be very difficult to do that. One tries, on the whole, to maintain a certain similarity. We have not all let up our discrimination quickly; we have let up gradually from a position of complete control. Although we have all gone forward more or less at the same pace, there have been variations; the items on which we have chosen to go ahead have differed.

2510. *Chairman*: In paragraph 8 you say:

"World trade depends upon an adequate payments mechanism. It is vital to the United Kingdom that such a mechanism should be maintained, both because of our national interest in world economic progress and because of our dependence on international trade. Sterling plays the major role in this, and there is no substitute for it. Certain particular advantages flow from this position of sterling. First, United Kingdom citizens, because they are able to use their own currency over a large part of the world, are themselves saved the inconveniences of operating in foreign currencies, and they have access to vital raw materials on the most favourable terms on the commodity markets established in the United Kingdom."

Would you enlarge on the significance of the second half of that sentence?——The commodity markets are established in this country and our own citizens can purchase on those markets not only for current but also for forward requirements. As we think that these commodity markets provide one of the best and most efficient exchanges of commodities, it means that our citizens do not have to go through any of the problems of currency control which the citizens of other countries have to face or to meet the additional charges which they might have to bear in order to purchase commodities sold in centres outside this country. I am afraid that the amount of space given to these three things might suggest that these particular advantages are of great importance. They are important, but the main importance is in the first half of the paragraph, which is the importance of maintaining sterling as an international medium of exchange.

2511. *Professor Cairncross*: I am afraid that I do not follow this. There is no difficulty about making payment, apart from capital movements, and there are obstacles to capital movements even inside the sterling area. As long as one can pay, does it matter in which currency one pays?——No, I suppose it does not. I should have thought that traders in this country would find advantages in having the commodity markets here.

2512. Do not those markets exist here largely because this is a large market, not because we have a particular payments organisation?——They exist here, too, because sterling is an international currency; and a third reason, I think, is that we do it rather well. I should have thought there were those three elements in the situation.

2513. It is the second I am asking about. Is the existence of sterling as an international means of payment the important consideration? You may say that freedom of trade between Commonwealth countries rests on the existence of a common means of payment, but that would be a different argument?——We say that the United Kingdom depends greatly on world trade, and expanding world trade. The second proposition which we make is that sterling plays a very important part in the processes of world trade, and of expanding world trade. The third proposition is that there is no real alternative to sterling for that role. You could not abstract sterling and the sterling area and the sterling system from that role without doing very considerable damage to world trade.

2514. *Professor Sayers*: I find that puzzling. Is it not conceivable that something else could be used as a means of payment?——It is perfectly conceivable that something else could be used as a means of payment; but we have a system now with sterling which is working, and the difficulty, when you ask whether something else could be used, is to see how that process would come about without a great deal of disruption.

2515. I see that a switch overnight to some other system would cause considerable disruption, but I cannot see why the system could not change over a period of time and people be practically as comfortable afterwards as before, apart, that is, from your three particular advantages, which seem to me substantial points?——When you say "over a period of time" I would not wish to argue, because if you look at developments since 1931 it is clear that the dollar has played a much more important part in trade, and particularly has played a much more important part as a reserve currency. A change is going on the whole time. All this document tries to say is that, as we find ourselves at the moment, sterling is of great importance. I should add that, as far as one can see into the future, sterling will be of very great importance.

2516. *Lord Harcourt*: Does it not go even a little deeper? You say that since 1931 the dollar has increased in importance; I agree with you when you say "as a reserve currency". I am not convinced that the dollar has increased in importance as a trading currency. There were two opportunities, in 1919 and 1946, when one thought that America was in a perfect position to monopolise the whole world trade. In the twenties the New York market made a conscious effort to change the trading currency from sterling into dollars, but it was unable to do so, so firmly entrenched was the habit of a large part of the world of dealing in sterling.—*Professor Cairncross*: Is this altogether fair? I think the question ought to divide the world into countries within the sterling area and countries outside. Clearly, sterling is inevitably used by such countries as are in the sterling area. The interesting point is why they persist in being members of the sterling area. If we take the countries

22 *November*, 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR ROBERT HALL, K.C.M.G., C.B. and SIR LESLIE ROWAN, K.C.B., C.V.O. [*Continued*

outside the sterling area, surely their settlements have to an increasing extent been in other currencies?——I suppose it is true that they have increasingly been in other currencies, depending on the period of time; but the fact remains that a large number of settlements between countries which are not members of the sterling area take place in sterling.

2517. *Professor Sayers*: That is a matter of growth over a time. In the history of world trade many other currencies have been used at different times. What is it that makes sterling so very much more convenient than anything else and which gives ourselves and the world great advantage?——I can only say that a large number of people use it and see great advantage in using it. The practical test is that that is the position. As this Paper tries to explain, this system grew up naturally. The important thing is that the central reserve, or whatever term you like to use, is not something which did not exist before the existence of exchange controls; it was a natural phenomenon which grew up and developed as a system, I presume because the City of London, combined with our overseas development, established throughout the world a system of banking and merchanting which offered better opportunities to people to trade and to hold money than any other system.

2518. *Chairman*: I think you have been more modest than has been suggested. You were saying that, if you want expanding international trade, with which our own interests in the United Kingdom are very much connected, you must at the same time have an effective system of international payment, and that up to now sterling provides that better than anything else?——Yes.

2519. You do not see it being displaced in the future?——I am not saying that it may not be displaced in the future, but that at the moment, and as far as I can see ahead in the future, it does not seem to me that there is a replacement for it.

2520. *Professor Cairncross*: Do you agree that there is a distinction between a multilateral system of trade, from which we derive great advantage, and the existence of a common currency, which might be the foundation of that multilateral system but which could conceivably be some currency other than sterling?——It is perfectly conceivable that it could be some currency other than sterling. All I am saying is that at the moment to a very large degree it is sterling, and that any sudden change would mean a disruption of trade, because the two things go together. It would be difficult to regard a multilateral system of trade as an abstract system apart from the method of settlement. We provide a very important method, sterling, and to change that abruptly for any reason would be a very great disservice not only to world trade but to our interests in particular and to the Commonwealth as a whole.

2521. We have the European Payments Union, with a system of multilateral trade for all countries who are members of that Union. Settlement can be effected there, and is not always effected through sterling. Do not the countries who are parties to that system equally share the advantages?——May I put a question to you? Do you contemplate the European Payments Union working effectively without sterling? Do you not think that sterling is the foundation of the Union, giving some currency which can take you out of that narrow group and enabling settlements to be made with countries outside that group? Sterling comes in and goes out of the group. If you are asking whether E.P.U. is a very good system, my answer is that it would be a small, inward-looking, bilateral group without sterling; it would be a group which in the end would lapse into discrimination without sterling and would not work in a wider system.

2522. I agree that it would not be a very satisfactory system if the sterling area were not in it.——The sterling area is not in it. The United Kingdom is in it.

2523. Sterling Area countries in effect extend the same liberal facilities to members of the E.P.U. as to one another?——Is the converse true? I do not think it is true to say that the sterling area is a member of E.P.U.; sterling and the United Kingdom are.

2524. The essence of a multilateral trading system is to be able to bring all the various dealings with a number of countries to a common settlement. That surely is true of E.P.U., and the currency used for the purpose is not necessarily sterling?——The E.P.U. has been an extremely valuable system in relation not only to Europe but to world trade as a whole, but I think it would have been much less valuable if sterling, one of the major currencies in it, had not been an international currency and instead had been a currency like the Swiss franc.

2525. *Professor Sayers*: Turning to paragraph 8 again, and to the sentence beginning "Finally"; has any estimate been made recently of the value of the City of London as an export industry?——Could we look at that and let you know?*

2526. *Professor Cairncross*: In paragraph 9 you deal with "the counterpart of these advantages," by which I take it you mean the disadvantages of the system. Presumably these disadvantages would not appear if we had full convertibility. They originate in the inconvertibility of currencies. Do you agree that they take the form of a lack of symmetry between the position of the country acting as central bank and the other members of the system, in that there can be no guarantee that any member of the system is a net contributor to the pool of convertible currencies whereas the central reserves cannot be in deficit? Is it not a one-sided obligation on the part of the banker country to maintain its reserves, which has no counterpart in a similar obligation by members to pay in more than they take out over a period of years. This might not matter if there were convertibility, but clearly it does if there is inconvertibility?——We have at times run a deficit. What we say is that, if we run a deficit, then this could have results not commensurate with the size of the deficit, because it would affect confidence.

2527. *Professor Sayers*: The size of the deficit you can afford to run depends on the size of the reserves, and that is where the central country is at a disadvantage compared with the others?——I think that is so.

Chairman: This is very interesting, and we should like to follow it up next week, while it is still hot in our minds.

* See Qn. 2528.

(*Adjourned until Thursday 28th November*, 1957, *at* 10.30 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWELFTH DAY

Thursday, 28th November, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR LESLIE ROWAN, K.C.B., C.V.O., a Second Secretary, of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

2528. *Chairman*: I want to return, before we go on, to the last sentence of paragraph 8 of the Treasury's Paper 11,* to which I think Sir Leslie Rowan promised we might come back, about "the banking, insurance and similar transactions carried out in London." I expect most of us have seen recently attempts to give figures of what I believe has been called the export value of these transactions. If one is going to give figures one has to define the operations to which one's figures are related. One attempt gave a figure of about £30 million attributable to such operations; somebody else, giving a more precise build up, a round figure of £110 million. What is your comment, Sir Leslie, on figures of this kind?——*Sir Leslie Rowan*: Since you asked me this at our last meeting, I have been in touch with the Bank of England who advise us on these matters. If one takes the net earnings of this country arising out of this international business I could give you figures, but I must confess they are approximate figures. They fall under four broad headings; insurance; merchanting; banking services widely defined, such as short-term lending; and brokerage, which includes stock exchange operations. The figures under those heads amount to roughly £125 million. The analysis of that is roughly as follows: insurance, about £40 million, merchanting about £30 million, banking services widely defined about £25 million, and brokerage about £30 million. These figures do not take into account payments of interest on sterling balances; that I would regard as something somewhat different.

2529. *Professor Cairncross*: Are the figures net or gross?——They are net. There might be some more detail; the statisticians might get together on this. There might be certain payments which would be made in other ways; for example, if an oil company were to charter a ship, that might be returned in the oil figures rather than under this; but subject to that they are the net figures.

2530. *Chairman*: That is a current estimate?——These are the figures over the last year or so.

2531. On this matter of maintaining the international character of sterling, I would like to get your view as to what our policy is in seeking to maintain it. One might put it simply on the business ground that it pays us to do it. Again, one might put it, and it is certainly dealt with in your paper, on the wider ground that if you are to have a sterling area at all, or indeed a live political relationship with the Commonwealth, it is one of the services that you must give. Thirdly, one might put it on a purely practical basis that you cannot get out of it even if you wanted to. How would you deal with those three aspects?——Perhaps I could take your aspects as I go through what I want to say about that, which falls under three broad headings. The *first* is: can we wind up the sterling area? The *second* question is: how have sterling and the sterling system served us in the United Kingdom and Commonwealth, and perhaps wider world interests as well, in the period since the end of the war? And the *third* question, depending on one's answer to the second is: can it be made to do so either as well or better in the future? I take the question whether it has served us well in a broad sense, and I think that will cover the points which you raised.

(1) The *first* question is: can we wind it up? The answer to that is, no. One can see that clearly by looking at the balance sheet at the end of our paper, the relation of our assets to our liabilities. I do not think that is the end of that particular question, because we, and I think many other people who discuss this problem, are very concerned to improve our external monetary position, that is, to get our assets into a better relationship with our liabilities. But in our thinking about this, it seems to us that there is the world of difference between the objectives which we seek when we have attained this better relationship. Are we doing this because we think the system is a burden, an incubus, something which does not serve our wider interests; are we really wanting to get out of it? Or are we doing it because we feel it is something which is valuable to ourselves, to the Commonwealth, and to the world? I think a great deal of the foreign opinion will be affected by our attitude on that. If our attitude is that this is something which is not worth while, an incubus, which we want to give up, then I think foreign opinion would be adversely affected. They would not have the same view about our currency, and their attitude of mind would have a major impact on the very important factor which runs through all our paper, namely, confidence.

Before I come to the second question, whether sterling and the sterling system have served us well, I would like to deal with two points. You, Mr. Chairman, I think, raised the question whether it was an important factor in the Commonwealth relationship, including the political relationship. As one looks at sterling policy, it is essential to bear in mind that it is our currency, and it is the reserve currency and the trading currency of all the members of the sterling area. In looking at the problems of sterling one would not make much sense if one did not consider them in relation to the totality of one's policies. Whether our general economy is sound, whether sterling is sound, is something on which must be based our view about what policies we can carry out, political, military or social. The first thing in thinking about the problems of sterling, is that one is bound to think about the problem as a whole. The second thing is that the sterling system is centred on London; therefore when the Commonwealth are thinking about these matters they tend to think a good deal about London. I have myself been to all the Commonwealth Economic and Finance Conferences since 1951, and my experience is that there is a very strong feeling within the

* Memoranda of Evidence Part II No. 11.

Commonwealth, for the kind of reasons which I have given, that sterling is one of the most important links in the Commonwealth; and not merely an economic link, but an important link in the totality of Commonwealth relationships. If one looks at the problems of sterling simply as though they were economic problems, excluding from one's considerations the wider political considerations of what might happen if sterling ceased to be a unifying element within the Commonwealth, then one is not considering the problem in its totality.

The other point I want to deal with is this. Whatever view may be held about the actions that we have taken or the judgment which inspired those actions, one thing is absolutely clear: we have not looked at sterling or the increasing use of sterling as a financial objective standing by itself. This became very clear when we had our 1952 Conference. We have constantly sought to make our financial arrangements serve what we consider to be our major objective, which is the objective of trade. The idea is that financial policy is the handmaiden of trade and not the master. I wanted to make those two matters clear before going on to the second question, because they are important.

(2) Of course it is not enough just to say that we cannot wind up the sterling area. That does not provide any basis for policy. The real question is the *second* one: has it served us well? There are some propositions which there is no need to argue, which one has to take for granted; I hope they are taken for granted. The first proposition is that we live by external trade. The second proposition is that, if that is so, it is a major interest of the United Kingdom that world trade should expand, and that there should be the mechanism to ensure that that expansion takes place. Our view has been that the sterling system has played an irreplaceable part in this process which has gone on steadily since the end of the war. I would like to give you four broad headings under which I think the system has served us well.

(*a*) First, liquidity. It would probably be generally agreed that one of the major problems in the post-war expansion of world trade has been the question of liquidity, or reserves, or whatever you like to call it, outside the United States. In what I am going to say "outside the United States" means "the free world outside the United States and excluding Communist countries," because we have not the figures for the Communist countries. The statistics I am now going to use come from the I.M.F. document of International Financial Statistics. If we take reserves outside the United States, in 1937 the proportion of reserves to imports c.i.f. was 60 per cent.; in 1956 the figure was 35 per cent., a very considerable reduction. As members of the Committee will be aware there has been, at periods, and there is particularly at the moment, a major question of maldistribution. The reserves are not in any way equally spread according to the liabilities which the particular currencies have in relation to world trade. What is the part that sterling has played? Sterling is formally inconvertible at the moment; but it is very important to realise that, so far as the sterling area is concerned, and for this purpose of supporting trade, sterling serves as good a purpose as any of the other currencies can. According to the general policy which we follow, any sterling area country can always change any sterling it has in London for current purposes into any foreign currency. Therefore, for the purpose of supporting trade it is just as convertible as the other currencies. Equally, as you know, other non-sterling countries can use their sterling over a very wide area of the world.

These are the approximate figures. In 1949 the total of reserves outside the United States (as I have defined this) was \$22,000 million, of which gold accounted for 45 per cent., sterling for 45 per cent., and dollars for 10 per cent. In 1956 the total had increased to \$34,000 million; gold accounted for the same proportion, about 45 per cent.; the proportion of sterling had fallen from 45 per cent. to 27½ per cent., though the actual amount, being a smaller proportion of a higher total, was about the same; and the proportion of dollars had gone up from 10 per cent. to 27½ per cent. In passing one can make the point that that indicates the increasing importance of the dollar as a reserve currency. It is also, I think, a fairly clear commentary on the general policies which the United States has followed in relation to international problems, because clearly the United States has not by any means been running a trade deficit.

Those figures show that now, at this time, sterling is providing a quarter of the total reserves in the sense that I have defined them. If one accepts that there has been an absolute shortage, then that is a vital element not only in our future but in the future of the world as a whole; and if one is going to say that we should wind up the system, I think one is bound to ask what is going to replace that element, and what are going to be the difficulties and distortions while that replacement takes place.

(*b*) The second major heading is the centralisation of reserves, which takes place through the processes which we have described in our paper, namely, the gravitation of foreign exchange earnings within the sterling area to London. I do not think that that wants a great deal of argument. It provides an economy in reserves. If everybody had to operate on their own without centralisation of that kind, the total required to support a freer trade policy would certainly be greater.

(*c*) The third major heading, which comes much more closely to the United Kingdom, is the distribution of sterling balances. If one takes the position since the end of the war to the latest date, which is mid-1957, one sees that this has been the broad pattern: the balances of the non-sterling area have fallen by about £600 million, by rather more than a half; the independent sterling area has gone down by about £350 million; and the colonial holdings have gone up by about £900 million. It seems to me that in that there has been an adjustment which has been of great importance and great value to both sides. For the reasons given in our paper, I feel that sterling is much stronger if more of the total is held in the hands of the sterling area. It is also a great advantage to the colonies, which have no means of investing locally, to be able to invest their funds in London.

(*d*) The fourth major heading I have dealt with; it is the point which Professor Sayers raised earlier, the whole question of the United Kingdom earnings, the figures for which I gave a little while ago.

It seems to me that under those four heads sterling and the sterling system have served not only our needs but Commonwealth and world needs, and, despite the difficulties that we have had, and the shortages of reserves in relation to liabilities, it has carried out the job pretty well.

(3) Then the *third* question is: what is our policy as regards the future; how do we look at it? Our main aim, of course, is to improve the relation of our assets to our liabilities. That is the reason we have sought, if not succeeded in achieving in full, since 1952, a surplus on our current external trade of £300 to £350 million. We hope that through that process it will be possible to do two things; first, to increase the reserves, and secondly, to reduce the liabilities, thereby making a better relationship between the two. One sees a certain amount of discussion on the basis that this is almost an impossible task. None of us is under any illusions as to its difficulty. But in the five and a half years including and since 1952, in which we have had a certain amount of disruption, our average annual external current surplus was £175 million. If we had managed to increase that, not to the £300 million to £350 million which we mentioned, but, say, to £250 million, by another £75 million a year on average, which is not an excessively large figure, then during that time our external position would have been strengthened to the extent of £400 million. I only quote those figures because I want to show that, though the problem of dealing with our external monetary position is difficult, it is not by any means insoluble. So I think, as I say, that our policy must be to aim at this better relationship between our assets and liabilities, so as to keep the system going and strengthen it.

One could look at the post-war period as two periods which run into each other, the period of reconstruction, and towards the end of that the start of a period of rearmament. During both, there was expanding world trade, and there was also the problem of inflation. It is, I think, at any rate possible, if we could obtain the kind of surplus we set ourselves, to go into a third

period where we shall be able to invest more in improving our external monetary position. I do not think that is an insuperable task. But, if I may return to what I started with, I believe that this will very much depend upon the view which we ourselves take about the role of sterling and the sterling system as a permanent and useful element in our own economy and in the Commonwealth and world economy.

2532. *Chairman*: Thank you very much, Sir Leslie. Taking the order of magnitude of the export value of sterling as an international currency which you have given us, what kind of proportion does that figure bear to the total value of our export trade?——Roughly 3½ per cent.

2533. One cannot help being struck by the large shift in the overseas sterling holdings, from countries outside the sterling area and the independent countries in the sterling area to those who still have colonial status in the sterling area. It is not a virtual certainty that, as they come forward from colonial status to independent status, there will be larger claims for the use of those balances than we meet today?——Yes. On the whole experience has shown that, as countries become independent, they tend to make larger claims on their balances. Of course there are one or two other factors which are important. Colonies get certain special assistance from this country which is not given to independent Commonwealth countries; to that extent there is an offset. The other factor is that many of these countries want to use their balances for development, and there is a limit on the speed at which useful development can take place. Thus we have recently had a very large run down in the sterling balances of India, for example.

2534. *Professor Cairncross*: Taking your hypothesis of an average annual balance in our favour of £250 million instead of £175 million, and supposing that the whole of that difference had, as it might well have turned out, consisted of additional exports to the colonial countries, would you have regarded the corresponding run down of balances standing to their credit as something of great importance for the strength of sterling?——It depends. In general our objective is to reduce liabilities and increase the assets. But if you ask me whether I should have regarded it as a strengthening of sterling for the colonial balances as a whole to have come down by £400 million during the period of five and a half years, I am bound to say that I should like to see it in much more detail. At first sight I should be inclined to have some doubt, because I should have thought that would have meant a rate of consumption of a character which they would not be able to sustain, and that that would be likely to come back in further claims on our economy later on.

2535. That would not be the most useful purpose to which an additional surplus on our balance of payments could have been put over that period?——It would not be the most useful, and it would not be the least useful. As we have said in our paper, the holdings are in excess of what is really required, and where reductions can be made without falling into dangers, that would be a strengthening.

2536. May I widen the question a little? When you put forward the suggestion for a much higher current balance of payments in favour of this country without reference to the other sterling area countries, there are three purposes to which the favourable balance might be put: an increase in long-term investment inside the sterling area, an increase in the reserves held in London, or a reduction in liabilities; does it not make a great deal of difference to which purpose it is put?——Yes. We have tried to explain in paragraph 26 and the following paragraphs of our paper on Monetary Policy and External Economic Problems* the kind of purposes to which this surplus would go.

2537. I appreciate that; I think the important question is, which do you regard as primary? You have no guarantee whatever it would accrue in one form rather than another?——You cannot say it would necessarily accrue in one way rather than the other. It is clear that we have certain specific repayment obligations.

2538. At the moment the policy declared by the Government is that of seeking to improve the current balance of payments of this country?——It is not quite limited to that; it is part of our Commonwealth policy; it is a question of the sterling area as a whole.

* Memoranda of Evidence, Part II No. 12.

2539. But there is a primary onus on this country. It is we who put Bank Rate at 7 per cent.; as far as I am aware 7 per cent. is not the rate ruling throughout the Commonwealth at this moment?——I quite agree; but some of the other countries have taken fairly drastic steps in relation to their external situation; for example, India. It is a different position there, I know; I agree that we are primarily responsible for our own balance of payments situation, and unless we deal with this then we do not improve the ratio of our assets to our liabilities.

2540. There is no question about the negative proposition; it is the positive proposition I am trying to see my way through. Certain measures which we might take to improve our balance of payments might have the effect of making things more difficult for the rest of the sterling area; in improving our reserves we might be running down theirs. Is not this conceivable, and indeed not unlikely, in certain circumstances?——I agree that there may be a conflict of interests, in the sense that we are seeking to maintain the value of sterling, and it might have a difficult impact on other sterling area countries. But there is a balance of interests, because their interest is not only in their own current balance of payments situations, but in the long-term position of sterling. I should have thought that was their major interest.

2541. But they have not the direct interest which we have in the accumulation of convertible currency in the London reserves. They react to the movement in *their* reserves, which are sterling reserves; we react here largely to the movement in *our* reserves, which are dollar reserves. Therefore there is not, as I was trying to put to you at our last meeting, a complete symmetry in the interests of the two groups, the outer sterling area and the United Kingdom?——There may not be a complete symmetry, but there is one outstanding fact, and that is the maintenance of the value of sterling. Whatever may be the temporary impact on their balance of payments, their major interest surely lies in that.

2542. Do you believe they act as promptly and as decisively when the dollar reserves of the United Kingdom are running down as does the British government?——I do not think they do; but I am not by that saying that they do not have the dollar reserves very much in mind, because they must see their position in relation to sterling in so far as their currency depends on sterling. It is certainly one factor in their consideration. There are obviously two factors, their own reserves and the position of sterling.

2543. But there have been times in the post-war period when they have been interested in retaining the British market and we have been interested in buying from them without any particular regard to what might be the indirect consequence on earnings of foreign exchange outside the sterling area. May I pursue in a more positive way the point I was trying to get to from the discussion on reserves? You put to us quite properly that this is not simply an economic issue but a political issue, and that the association of a large number of countries is to some extent governed by their practice in trading in sterling. It is, as I understand it, the policy of the Government to move towards a closer association with Europe and the Free Trade area. There will then, presumably, be introduced, political considerations affecting the use of sterling and sterling reserves, that might call for further consideration of how the sterling area would work. Has that given rise to any suggestion, for instance, as to a pooling of reserves between the United Kingdom and European countries, or any action of that kind? No one obviously wants to move towards a system in which everybody transfers from sterling to dollars?——I think that the pooling of reserves is only another way of saying that you are going to have a common management of your currency; and if you have a common management of currency you are going to have common management of economic policy; and if you have common management of economic policy then you must have common legislatures, and so forth; therefore pooling our reserves is merely a way of saying federation or confederation. The answer to your question is no.

2544. When you discussed liquidity in some detail earlier, you showed that the use of dollars had increased. There might be, in appearance at least, a prospect of the international liquidity problem becoming in a sense one

not only from the point of view of sterling but much more general. You would agree, I imagine, that the introduction of the European Payments Union increased international liquidity very considerably without doing any damage to sterling?——Yes.

2545. So it is possible to increase international liquidity without either scrapping the sterling area or switching to the use of dollars. Do you not think anything further can be done along those lines, through the International Monetary Fund or in any other way?——A number of things could be done. The International Monetary Fund still have at their disposal a fair proportion of the convertible currencies which are either paid in gold or on call, although they have made very large lendings in the last year, amounting I should think to $2,000 million. It is perfectly possible to think of ways in which that could be increased. For example, there have been discussions from time to time as to whether quotas should be increased; that would take with it an immediate payment of a certain proportion in gold. That would be a pooling of reserves——

2546. Without sacrifice of sovereignty?——with some preliminary sacrifice of liquidity, because it would be taking it away from the individual countries to put it into the pool. There are other conceivable possibilities of increasing liquidity without straining individual reserves, such as that the International Bank might borrow, or the International Fund might borrow.

2547. You gave us the impression that you did not attach importance to these alternative methods of making the existing reserves go further?——I hope I did not; I did not intend to. It would be contrary to my argument, because my argument is that reserves as a total are very inadequate. I also argued that the gravitation of reserves towards London was important, because that provided a help, in the sense that if you have them all together you require less in total than if you have them separately. If I gave you that impression I retract it now. I do not in any way wish to minimise the importance of these considerations, because it would be flying in the face of facts.

2548. The positive suggestion you put was that we should seek to increase our reserves through having a favourable balance of payments?——Improve our external monetary situation by increasing the reserves and by reducing our liabilities; I did not say that the only way was by increasing the reserves.

2549. The means was a larger available surplus on the balance of payments. If there are any other proposals I think we should know?——I do not think there are any other proposals. You asked me whether there were other ways in which international liquidity could be improved, in relation to the International Monetary Fund; there are but they are not absolute improvements. At the present moment the International Monetary Fund has adequate resources to carry out its needs; unless its needs were changed, in which case they would have possibly to increase their resources. As you know they have committed a sum of over $700 million to the U.K. as a standby; apart from that they have uncommitted in gold or U.S. dollars a sum of something over $1,250 million.

2550. In the course of the last six months the balance of payments in this country was favourable, but we were practically obliged to suspend payment of foreign currencies?——I would not accept that.

2551. At any rate we lost very heavily from the reserves which went back to an extremely low figure?——I agree with that.

2552. This is a situation which could clearly recur. If we were to lose another $700 million in the same period as we lost the last, do you see any reason why confidence should be maintained?——Anything is possible in this world; but I do not know if it is very profitable for me to speculate *in vacuo* on what could or could not be lost. We have a policy designed to ensure that that does not happen. But of course if policy were such that external confidence was lost, then quite clearly there could be nothing left.

2553. Could what happened this summer still have happened if the balance of payments had been favourable to the tune of £350 million?——It was favourable, though not to the tune of £350 million, but the overall position of the rest of the sterling area was not so favourable. A favourable balance of payments must help, but in certain conditions of confidence it would not be the determinant. That is what we have tried to say in paragraph 34 of Paper No. 12: "The central feature of 'confidence' has been that, having regard to the limitations of our external monetary position, doubt has existed over our capacity to carry out our domestic programmes without running into inflation. Other factors have from time to time had important effects, but this has been the continuing one." If the situation is one of doubt on our internal position, and superimposed on it there are external factors as well, then we are running into a very serious situation and we shall lose a lot from the reserves.

2554. But the one practical means of improvement is that we should aim at a more favourable balance of payments?——I am here dealing with the external aspect. But it is not right to consider the external position irrespective of the internal; they are part of the same thing. I was looking through the evidence to the Macmillan Committee, and I think Sir Henry Strakosch said there that you cannot separate domestic from foreign policy in monetary affairs. That is exactly our position. In these papers we have called attention to our other paper on monetary policy and the control of economic conditions. I should be extremely unhappy to think that we had given the impression that we, looking at the problem, have said: "If you have £300 to £350 million that is all right," because that is contrary to our view, and contrary to what we have said in the paper. We have sought to point out in paragraph 34 that the most determining element is confidence, and that confidence is essentially related to what we are doing here at home.

2555. You did not point out that the position of the outer sterling area might be even more important?——Whether the position of the outer sterling area would be even more important I myself doubt. I believe that the determinant in this position is the policy of the United Kingdom; it is our currency, and we ourselves are bound to follow policies which take into account the policies of the outer sterling area. That is the object of the £300 to £350 million.

2556. *Chairman*: I am not clear how far the independent members of the sterling area keep reserves other than their sterling reserves in London?——We cannot give any details of their holdings from our own statistics, as there is the banker-client relationship involved in that. Nevertheless most of these countries publish statistics of their own, or relevant statistics are published by the various authorities. A great number of the independent sterling area countries hold gold reserves or dollar reserves of their own.

2557. Is that a growing practice?——It has grown somewhat. We do all we can to resist it, because we feel the policy should be the one which we set out in our paper: if they can meet all their external exchange requirements in London then there is no need to have independent gold reserves. Some countries have them for historical reasons, for example India, dating from the time of independence. Other countries have them for geographical reasons, because they produce gold. As countries have progressed they have established their own central banks, and it has been thought right to endow them with certain reserves. But the process of increase over the last five or six years has been quite a slow one.

2558. *Sir John Woods*: You said that the colonial sterling balances had risen by £900 million, and that you thought that had been of material advantage to us, presumably because the balances were held in more secure hands, and also an economy of reserves. If the Commonwealth have increased their balances by something like that amount, and at the same time the purchasing value of their currency is dropping, is that altogether to the advantage of the colonial countries?——It is an aspect of inflation.

2559. One aspect of confidence in sterling is the confidence of the sterling area holders of sterling; so this great increase of their holdings of a currency which seems to be depreciating in value faster than others seems to have a marked importance?——Certainly. You will have seen the very great importance it has in the statement recently made on the internal value, which is in the long run the same as the external value, of sterling.

2560. *Lord Harcourt*: You have stated that the holders of sterling balances have the right to call on the central reserves for foreign currencies to meet their current requirements. The recently independent territories have all got huge development programmes, so that they will clearly want to use part of their sterling balances. To what extent is a development plan in such a territory looked upon as a "current purpose"?——Entirely, because expenditure on a development plan can only express itself ultimately in their external balance of payments.

2561. The totality of their development programmes may become a charge on the central reserve?——Yes.

2562. *Professor Sayers*: You mentioned the importance of the sterling connection as part of the broad political connection of the Commonwealth. How does Canada stand in relation to this, because Canada, one hopes, is very much inside the political connection?——*Sir Leslie Rowan*: Canada comes to all our discussions, although she is not a member of the sterling area. It is quite clear from her attitude that she considers sterling as being a very important element in Commonwealth affairs, not excluding her own. Sterling is very important economically to Canada, because her trade with the United Kingdom is very important. She sells us much more than she buys from us, and therefore the strength of sterling is something to which she must inevitably attach a great deal of importance in the pattern of her trade. Then Canada, throughout my experience, has attached very great importance not merely to the economic but also to the political aspect of sterling; and we have had evidence of that recently in the desire of the Canadians to have the Commonwealth Trade and Finance Conference in Canada next year.—*Sir Roger Makins*: That is clearly underlined by the events of the recent conference at Mont Tremblant, after which the Canadian delegation gave a picture in the communiqué of the importance they attached to the maintenance of the whole complex of which sterling forms a part.

2563. *Mr. Woodcock*: Could you not say the same of the United States?——Yes, but in much more general terms.

2564. *Professor Sayers*: The fact that London has the central reserve on which the whole sterling area draws means that in a time of drain on those reserves the immediate compulsion to act is on us. You said, I think, that that does not mean the other countries do not do something about it, but they are not under the same compulsion to take immediate action. That means that we have to take the first brunt of a storm?——*Sir Leslie Rowan*: Yes, for two reasons: because it is our currency, and because our external monetary position is much more vulnerable than that of the other countries of the sterling area.

2565. Is that not because we are the centre of the area?——I wonder whether that is important; the ratio of our assets to our liabilities does not arise from the fact of the sterling area. These debts are due, and would be there whether there was a sterling area or not; if it were not we might have had to pay those debts in a different way.

2566. But compulsion arises from the draft on the central reserve of other countries; that is something that is not necessarily related to our debts inside the sterling area, is it?——Not necessarily, no.

2567. You can have in fact very big swings in the capital plus current balance of payments of the whole sterling area with the outside world for reasons quite unconnected with the existence of those sterling area debts?——That is true.

2568. It does mean we may have to stand the immediate brunt of a drain which may result from what is going on in other parts of the sterling area rather than what is happening here?——Yes, that also is true.

2569. In taking this action in a storm, we have in the past had two alternatives: we could let the reserves run down, or we could take action that in fact attracted outside people to the holding of sterling and frightened them off borrowing sterling, and by that means we brought about a very quick change in the capital position of the sterling reserve in relation to the outside world. The position now is that, because we have to stand the first brunt, we must have enormous reserves, as has been shown, unless we can find some way of controlling or influencing very sharply capital commitments, as we used to before 1914, when we operated the system on what has been called a thin film of gold?——With the qualification that, unless you are earning an adequate external surplus, that cannot be done, I agree. The confidence side, as I tried to point out, is a very important element.

2570. But the size of the swing can offset the external surplus at any time. Would you not say the possible swing in a matter of weeks could be hundreds of millions of pounds?——A great deal too much can be made of the impact of the policies of the rest of the sterling area. Over the period from 1946 to the middle of 1957 they have in fact increased their balances and only in one year, 1947, has the net run down of their balances over the whole field been more than £100 million. In relation to the £300 to £350 million a year we have set ourselves to achieve on our current account, that has not been a problem which on its own could have caused us to take very drastic action.

2571. *Professor Cairncross*: I assume this is averaged out, and that there were big differences in the behaviour of different parts of the sterling area in that period?——I have not got all the figures in mind, but obviously there were; one would be going up while the other is going down.

2572. Without looking at the figures in detail, from what you told us at the beginning some countries were consistently earning a surplus, and others were consistently, or almost consistently, in deficit?——I think that is going too far. For example, during the first period of her first five-year plan India practically made no drawings, and in certain years increased her balances; and Australia is a country where there have been great ups and downs.

2573. Are the figures that you gave us net of any capital movement out of this country to these areas?——They represent their total position on external account, current and capital.

2574. *Professor Sayers*: Coming back to my point about the swings, confidence in sterling may be lost for reasons to do with the outside sterling area, or for reasons to do with ourselves; but when confidence is lost the swing that is possible in sterling is not determined by the leads and lags that are possible just in United Kingdom trade, but the leads and lags possible in the whole of the sterling area's trade with the outside world?——I entirely agree with that; we have made the point in our paper that quite small changes can lead to very large results. This is what is sometimes called a marginal problem: it always seems to me that our position is that, if we have a margin on the right side, then it is fairly good; if we have a margin on the wrong side, we can go a long way down.

2575. This is something that did not bother us at one time, because although we had infinitesimal gold reserves we were able to influence the leads and lags very quickly indeed, by changing the rate of interest. Is that not right?——Yes, I think that would be right.

2576. I am coming now to the question of how far we have lost our power to do that, and therefore have to have bigger reserves today. In considering how far we have lost our power, one meets the argument that, when rates are put up, although some money may be attracted, the money that comes in is covered for exchange rate movements by the forward sale of sterling coincidentally with the transaction. If all transactions in the forward market offset each other, and then an overseas bank decides to put £1 million into new U.K. Treasury Bills, and it protects itself against an exchange rate movement by simultaneously selling the sterling forward, then that, coming through the banking system, will penetrate to the Exchange Equalisation Account in the shape of an addition of $2·8 million spot to the E.E.A., and a sale by the E.E.A. of the same amount of dollars three months forward. Is this an important modification of the power of high interest rates in London to attract accretions to the reserves?——We are getting into the field of the management of the market, where I think that the questions would be very much better addressed to the Bank of England. Another point I must make on this is that we do not discuss in public the operations of the Exchange Equalisation Account. In so far as it is discussed in Parliament, it

is discussed in secret before the Public Accounts Committee. If there are to be detailed questions about the policy for the management of the E.E.A., I should like to consider them with the Bank of England from that point of view.

2577. *Sir Oliver Franks*: This is a question which affects general policy, because it leads to the question of how relevant the movement of the Bank Rate is to the inflow and outflow of foreign funds, and therefore to comparisons with the classical situation. It is not just a question of management, which the Bank of England would carry out, presumably, on behalf of the Treasury; it seems to be a question in which the Treasury is also involved. I think the members of this Committee are making no reference to any transaction or series of transactions, what happened this year or last year, so to speak; they are raising a general question of policy about what tends to happen in the series of years through which we are living. I hope that, when the Treasury and Bank of England have considered the position, as is thoroughly proper, they will be slow to feel that this philosophical issue which is raised is one which they cannot readily answer; because it is very difficult for us to form a view unless the people who are in charge of policy can give us a view on policy?——*Sir Roger Makins*: May we take note of your observations and consider the matter further?*

2578. *Mr. Jones*: We have been told by the Bank that the sterling balances held by us are approximately £3,700 million. Are you able to tell us what proportion of this substantial amount of balances would be deposited in London on a long-term basis, and what proportion might be affected by the circumstances which resulted in the events of September 19th last?——*Sir Leslie Rowan*: That is an extremely difficult question to answer. We have tried to some extent to deal with this point in paragraph 19 of this paper, where we say:

"The liabilities include an incalculable but large amount which is not really a liquid liability as normally understood."

You could regard a Treasury Bill as a liquid, immediately realisable asset; on the other hand, you have to consider what is in the mind of the holder of the Treasury Bill, and what are the intentions of that holder. If it is part of a statutory currency reserve, then unless the legislation is changed one can regard it not as a short-term liability but as a long-term investment, because it will be renewed. It is therefore, I am afraid, very difficult to attempt to give a figure of that kind, beyond saying that one's experience is that a large amount of this capital holding must be of a kind which can be regarded as realisable in real confidence difficulties.

2579. It would bust Britain and the sterling area, I take it, if everybody who had sterling balances sought to realise their assets in terms of other currencies. But would it be right for the Committee to conclude that against the excess liabilities that your balance sheet in paragraph 19 sets forth there are substantial external resources held by Britain, which would more or less put us in balance if it was a question of realising what we owe against what we have?——That is quite true. Since the end of the war, as the paper makes clear, we have invested long-term abroad a substantial amount. We have built up our external capital position in that sense, but the problem is, what is immediately usable. It is a very valuable asset to have an oil refinery abroad, but that is not something which you can realise immediately; certainly one would not want to realise it immediately, especially in times of difficulty, in order to meet a current demand in the market. That is the real distinction.

2580. What proportion of our sterling balances might be used in speculation against this country and against sterling?——I could not give you any figure on that. I think, if I may say so, Sir, that the word "speculation" can sometimes be used in a sense which gives a wrong impression. I am not saying that you are doing so, but I am saying that it can be used in that sense. If you have an international currency, then it is used not merely by the people who are so often referred to as the "bankers of Zurich"; it is used by thousands of people all over the world in their everyday transactions. There are some people who move money for the sake of making money out of the movement of money, but it seems to me that the vast majority of leads and lags comes not from that, but from the ordinary daily processes of trade: from people taking a view about what it is reasonable to do in their everyday trade, about their own livelihood. I would not regard that as speculation. The amount that may move from one side of the account to the other through leads and lags is very large indeed.

2581. Would it be a good thing if we were in a position, from the point of view of the building up of our reserves and improving our balance sheet, to reduce these sterling balances substantially?——I think so. We have said in our paper that they are greater than is required for the normal workings of sterling as an international currency, and our objective is therefore, as I have said, to seek to reduce them without reducing the reserves, and better still while increasing the reserves, so that we may be able to show a better balance sheet between our assets and our liabilities.

2582. *Mr. Woodcock*: I am still not clear about your answer to Mr. Jones. Let us forget that the question really is what the holder ultimately thinks and wants to do, and just take the actual form in which they are held, say Treasury Bills and other instruments. Do we not know the amounts of different securities held in, say, item 4 of your balance sheet [R.S.A. holdings]?——We have not detailed information on that. The best I can say, taking the R.S.A. and the N.S.A. together, is that at present about half is in short-term assets (Treasury Bills and current and deposit accounts), and about half in British Government securities of varying terms.

2583. So about half could realise at once or by letting Bills run out, and the others would have to sell?——Yes.

2584. *Professor Cairncross*: This is a large part of the floating debt problem, which has arisen since before the war, and it is important to us to see it in relation to debt management, and not just in relation to the external position; if there are any details further than Sir Leslie has given about the holdings of sterling balances and the form in which they are held, I think we would like them?——*Professor Sayers*: It would be valuable to us to have also a split by maturities or groups of maturities for the whole of the external sterling holdings. That is the important thing for debt management?——*Sir Roger Makins*: May we look into those questions? I do not know how far we shall be able to go in meeting you.*

2585. *Chairman*: Is it your view that the proportions change materially and quickly?——*Sir Leslie Rowan*: I would not like to give an answer on that without notice.

2586. *Sir Oliver Franks*: Could I go back to try again one or two of the questions which I thought Professor Cairncross was putting to Sir Leslie Rowan, because I am not clear what was the outcome of the discussion. It begins with the view which the Treasury take of the relation between the external and the internal situation, and the extent to which what we succeed or fail in doing at home affects our reserves, and therefore our ability to navigate with the sterling area. If I may illustrate that, in the interesting and able talk that Mr. Alan Day gave on the wireless, there are two sentences which I think are rather crucial. He said:

"Again, it is nonsense to pretend that we can be sure of maintaining the \$2.80 exchange rate indefinitely into the future. Our inflation is likely to go on faster than other people's; and our rate of industrial innovation may turn out to be so slow that we are not introducing new products fast enough to stay competitive at the present exchange rate."

That seems to me to be the statement not of an angry young man but of a despairing young man. Because he despairs of the republic, he therefore despairs of the sterling area. I take it that you say in contrast that the Treasury approaches the problems of the sterling area by not despairing of the possibility of dealing with the internal economy?——*Sir Roger Makins*: Certainly.

2587. You must assume that, whether or not any past practice has been adequate, over future years it is possible and reasonable to assume that we can perform adequately, and that we should approach the sterling area problems with that in mind?——*Sir Leslie Rowan*: As I said, there have been since the war two periods: a period of reconstruction, when in any case you would expect there to be difficulties at home and abroad, and a period when there

* See Qns. 3211-22

* See Appendix to Minutes of Evidence.

was a great burden of rearmament, which, of course, hit us in precisely the areas which would have most helped to deal with this problem of our external monetary position, our technicians, our metal-using industries, and so forth. I cannot make any statement about future military expenditures; all one can say is that one can reasonably expect that they may take a slightly smaller proportion of the increase in the national product in the years to come than they have taken in the past five years, and to that extent give us the elbow room and the support which we require to invest more in our external monetary position.

2588. Given that in that way, and in general, it may be reasonable to assume that the state of the internal economy could be more helpful to the running of the sterling area than it has been throughout the past period, the chief policies, as I understood it, which you put forward to make the whole sterling area run, and run better, are to use the accumulation of this large trading surplus which you want to see on U.K. current account, primarily in reducing sterling balances, also in building up the reserves, and then, thirdly, in investment in the sterling area. Is that right?——You used the word "primarily"; I am not certain that I would put it in that way.

2589. Let us leave it at three possible uses then. It seemed to me that Professor Cairncross was asking two questions, and it was to them that I wanted to be clear about the answers. The first question, I think, was one of factual trend; the second was one of policy. The question of factual trend, I thought, was whether, looking at the next few years, the kind of demand which sterling area countries were likely to put on the reserves, through their use of the sterling balances, was likely to be so large that it would outweigh anything that we could do in the way of securing a favourable trade balance here. You replied to that, I think, by pointing out that in the past period this had not been the case; that by and large the extent to which the sterling area countries on average had drawn down sterling balances in any one year had not exceeded £100 million. But when you look to the future you have got all these countries in the fashion of development, with the political issues on the home side that depend on the rate of development, and so on. It may lead to internal difficulties such as India now has, but more are coming along all the while. Is it safe to assume that the kind of demand, and therefore the rate of use of their balances in the next half-a-dozen years, can safely be argued from the last half-a-dozen years?——I said that total sterling balances have not, in point of fact, much changed; I also said that despite difficulties we had, in point of fact, earned an average annual surplus of £175 million, and that, if the totality of our policies had been such as to enable us to earn on average not £300-£350 million but £250 million, which is only another £75 million, that would have made a very great difference. It would have made a total difference of £400 million over the period. You ask me if I think that in the years to come we face the prospect of a run-down of the sterling balances held externally, and whether it is wrong to think that we shall have to face that position. My answer is no, I do not think it is. We have been fortunate that there has not been a running down of sterling balances in the past years. What is needed is an adequate external surplus on our part; but we must, it seems to me, provide, and we do provide in the £300-£350 million target, for a substantial running down of the sterling balances.

2590. *Sir Oliver Franks*: I think Professor Cairncross was wondering, given this increase which you foresee, and the existing statement of British policy in the matter, whether we would get by unless we had views, policies, and programmes beyond those which the U.K. itself could do and contribute. It was in that relation, I thought, that he was raising questions about, for example, the further development of the International Monetary Fund, about whether, for example by pyramiding like another bank on its credit base, it might not be able to do a great deal more in the world than it now does, and in that way take some of the load off our home position. You seemed to be saying that the policies that you had enumerated should, in the Treasury's view, prove to be sufficient; it was there that I was not clear what the proper answer was.—*Professor Cairncross*: There was one additional point which I perhaps did not make very clear. It appears to me that in the post-war period there has been sufficient liquidity in general, but growing pressure on that liquidity; and that this pressure is likely to continue over the next five to ten years, because international trade is expanding and the total reserves of the entire system, as far as one can judge, are not. When I referred to the European Payments Union and to the International Monetary Fund, I was in effect asking whether there are any proposals of which we are not aware, or any suggestion that you would like to put before us, which bear in mind that the total pressure on liquidity may grow more severe as time goes on?——Sir Oliver Franks said that the totality of the policy which we put forward was the earning of an adequate surplus by the U.K. That is so. I was talking, of course, about our own policies; it would be a complete misapprehension to think that that was the totality of the policies within the sterling area as a whole. I said at an earlier discussion that one of the great problems was the shortage of capital, and of savings for the purpose of development, in the world as a whole; and when I was asked whether we encouraged or discouraged lending from outside the sterling system, I said that we encouraged it. It is an aspect which we certainly discuss among ourselves, with the members of the Commonwealth. It is not only a question of saying that it would be nice to have investments from outside, but also of providing conditions inside which are conducive to that money coming in. That is another way in which we seek to do what I think we are all really seeking after in this thing: to spread the run down (to use a very general term) of excess liabilities over a period in the future, consonant with the possibilities of policy. That, I think, is the broad problem that we are all after; certainly that is what we are trying to do. We are trying to provide it by our own actions. We are trying, certainly, to provide for the encouragement of investment from outside the system to assist the economy. The European Payments Union, as Professor Cairncross quite rightly said, is a method of increased liquidity.

We have not, as of this moment, any proposals to make, nor have we made any proposals for increasing the resources of the International Monetary Fund; but there are possibilities there, which would certainly be pursued if the need for them arose.

I would like to say just one other thing. We have sought, in looking at the problems of Europe, not merely to say that, when convertibility happens, we will look and see what happens. We have tried through the European Monetary Agreement to provide the possibility of an organic move from the E.P.U. system, which is a system of automatic credits, to the system of the Monetary Fund type, where there would be no automatic credit but, at any rate, credit available on demand, on case shown. To sum up what I am saying: the £300 to £350 million is the contribution that we can and should make; there are a number of other matters which, either within the Commonwealth or through regional institutions of that kind, in Europe, or in wider institutions such as the International Monetary Fund, we could pursue, but as of this moment, we have not made any proposals in relation to the International Monetary Fund.*

2591. *Mr. Woodcock*: You can secure a surplus in one or other of two ways; you can secure a surplus by increasing exports from this country or reducing your imports, or, of course, you can do it even though your exports are going down if your imports are going down still further. Are you saying that the achieving of a surplus must be an obligation of ours, whether we earn a surplus or whether we merely create it?——It seems to us very important that one should achieve a surplus, and our objective should be to earn that surplus at the highest possible level, and not at the lowest possible. That is why, in general, our policies have moved towards the freedom of trade, rather than the restriction of trade.

2592. Are you saying in effect that it is fundamental to the sterling area that we must have this surplus of £350 million?——I cannot say that we must get a surplus. It will be a matter of judgment in relation to the total policies which are involved. One cannot say that one must do it, because ultimately it is not within our power to say that it must happen. But we do say that it is very important, not in the interests of others alone but in

* See also Qns. 9610 to 9612.

our own interest, that we should come as near as possible to attaining it, because we are dealing not with other people's currency but with our own. I think that a very great deal of foreign opinion will view the position of our currency in the light of how far we succeed in attaining an objective of that kind, which is not an independent thing by itself, but is part and parcel of the totality of our internal policies.

2593. Are you saying that such difficulties as we have had have arisen not because we operated the sterling area, but because of our own internal domestic situation?——No. I do not think that, quite. The sterling area and the sterling system in the post-war world have not been a fundamental feature of our difficulties, but, as a matter of fact, despite a certain degree of discrimination, have provided a very helpful area of free trade. The earning of the surplus is certainly a matter which depends not only on ourselves but on other factors as well.

2594. Was it not generally assumed to be the case that this summer, for example, our domestic position was fairly sound; and yet we had this difficulty?——I do not agree about that, Sir. I can only tell you how it seemed to foreigners with whom I discussed the matter. I am not trying to make a judgment on that myself; I am merely telling you what they told me, and what they said affects the currency. They told me that they did not think our internal position was sound; that, as far as their observations went, a large number of people in this country did not think that our internal position was sound; otherwise, why were they getting out of Government stocks into industrials? If I might just give you an example of a case in point; when a very large investment programme was announced here, I happened to be sitting next to a foreign banker, and I said: "That is a very good thing. That is going to improve our efficiency". He said: "Yes, but it adds to the total demand on your resources; are you going to be able to meet that total demand without additional inflation?". What we think is very important, because it has an effect on what others think; but in this country what we are dealing with is what others believe, and in my opinion, in the summer they did not think our position was sound. There is also the point that Professor Cairncross was making, that added to that there was great strain coming from the rest of the sterling area. There was a combination of factors, but I do not think the sterling area by itself was dominant; the other factor was dominant, in so far as my judgment goes.

2595. *Professor Cairncross*: I should like to turn to a different subject, and ask whether you have any views as to what level of reserves would be appropriate. I imagine that you would want to think of reserves in relation to liabilities, and, as you have pointed out, liabilities are of very different kinds. One tries to strike a balance between reserves and liabilities in the case of most central banks; perhaps it is impossible in the case of the sterling area. But have you any views as to what sort of relationship between assets and liabilities would be effective, and sufficient to make the system work without the kind of jolts that we have had in the past year, assuming that there is confidence in the pound, and that therefore we do not have to deal with very violent fluctuations of opinion about the external value of the pound?——*Sir Robert Hall*: Are you assuming that year in and year out we are running a surplus on our current trade, because the answer would be different, I think, in that case?

2596. *Professor Cairncross*: No, I do not think that would be possible. I am making the assumption that the world is not, perhaps, quite so stable a world as the one we have lived through in the last ten years, and that therefore the external balance would be subject, perhaps, to more buffetings than it has had.—*Lord Harcourt*: Before you answer that, there is one comment that I would like to make. Professor Cairncross asked you to make your estimate assuming confidence in sterling. I think it is more important to omit that; what causes the buffetings is the periodical lack of confidence in sterling, which may arise from a variety of causes. When we are talking about our absolute level of reserves, what really interests me is what rough proportion of reserves would be sufficient to take care of the periodical buffetings which we get, which arise from lack of confidence. If we predicate perpetual confidence in sterling, I think we can run on very small reserves; is it not this lack of confidence on the part of foreign holders of sterling which causes the need to draw on our reserves?—*Chairman*: Now, Sir Leslie, you have got a question in two compartments.——*Sir Leslie Rowan*: I have doubts whether I can answer in either compartment! We have said that we want reserves adequate to our needs, and we have also said in paragraph 9 of our Paper 12 that our reserves have never in fact been adequate. What are our needs? Perhaps I could cover the differences between the two aspects put to me by trying to define this. We have to think of normal trade; then there may be abnormal movements in trade; and then there are the confidence factors. Therefore there cannot be any absolute figure; it is a relative figure. It is obviously, as Professor Cairncross said, relative to the size of our liabilities and to some extent, I hope, to the composition of our liabilities. It is certainly relative to the volume of trade that we have to support as a whole; and, as Sir Robert Hall said, it depends a good deal on whether we are running or failing to run an external surplus. And that, in itself, with other factors, is tied up with the question of whether we are maintaining confidence in our currency. Then from time to time there are special items which one has to look at, although they are part of the totality, such as our specific dollar repayment obligations.

No figure has ever been given of what would be thought to be reasonable, and I am not in any position, I am afraid, to give you a figure of what I would consider reasonable. I suppose that, if one was going to be very safe one would take the figure which is given in the balance sheet at the end of Paper 11 as our liabilities, and that would be it, so to speak; one could hardly conceive, if we had 100 per cent. cover, that we were likely to run into difficulties under the other heads of a kind which would be likely to cause a great deal of trouble. On the other hand, past experience shows that in mid-1951 our reserves rose to their maximum point in the post-war period, which was £1,400 million. Given that and what followed, one cannot say that that was enough, because quite clearly we have since that time run into difficulties. I cannot go on from that and say that that is a minimum, which was inadequate even in relation to the liabilities which existed at that time, because there are all the other factors which have to be taken into account. It is obvious that our reserves at the moment, in relation to the other factors, are inadequate. As I have tried to make clear our objective is to put this position right, not merely by increasing the reserves but also by bringing down the liabilities, so that the two things meet in the middle, or come nearer together. Those are the sort of things that I have in mind.

2597. *Professor Cairncross*: Does it not make a certain difference, which of these two things you go for first? The liabilities are largely sterling liabilities; your reserves are largely, or almost exclusively, made up of gold and dollars. The situation in which you want to use the reserves may be one in which the current balance of payments of this country, and of the sterling area, is in deficit because of a deterioration in world trading conditions; in that event, the most important thing to have on hand would clearly be gold and dollars. On the other hand, if there were to be some disturbance affecting the outer sterling area and the United Kingdom in such a way that the outer sterling area wanted to realise its holdings of sterling to pay for British exports, the position would be different. I assume, therefore, that it depends on the kind of situation which you are most afraid of, which of the two objectives you would put first?——I think that is so. I think that, on the whole, and particularly having regard to the kind of judgments which external opinion is likely to make, I would in general put first the increase in the reserves.

2598. *Chairman*: Critics of the whole position say that we cannot cope with it over the future, and it is no good trying; your answer to that was, I think, when you first gave us your statement: "We are not in a position to get out of it, having regard to the balance of financial assets against financial liabilities". But I suppose that is plain to them, too; if you merely consider the balance sheets you cannot blow the whistle and pay your creditors off, even if you want to. Are they not thinking more of a policy which would try to negotiate with the different

blocks of creditors, either for an ordered and restricted right of recourse, or something in the nature of what we did with other claims after the war?——I think they are thinking of that. You say: "what we did with other claims after the war". In the 1945 Anglo-American Loan Agreement there was a provision that we should seek to negotiate with major holders of sterling balances, with the object of dividing the holdings into three categories: one part which was to be remitted, another which was to be immediately released, and a third of those which were going to be negotiated and released over a period. In point of fact, very little success attended any of those discussions. As you say it is now being suggested as a possibility that we should have negotiations directed to that end. We have had discussions (I would not call them negotiations) directed to ensuring that the sterling area as a whole sees the importance of not hunching the claims too much; the Mont Tremblant conference was the most recent example of that. But when you come to the question of negotiating a funding, or whatever you like to call it, I think you have to weigh up two things: what more do you gain from that than you have under the present situation, and, on the other hand, what may be the losses. If it is taken as an indication that we have not confidence in our capacity to meet the claims, then people may be inclined either to say: "We had better get out while the going is good", or to say: "Is it a good thing to continue putting our money in?". Those are very important considerations in looking at a matter of this kind.

There is also this point: there are very few sterling balances of any size outside the sterling area. There is a fairly large one for Egypt which, as you know, is subject to special considerations, but apart from that, the remaining £400 million or so is divided over forty or fifty countries. You can see the size of what is involved in that.

2599. I had the impression, I think from the Bank, that these were regarded as down to a normal working level?——"Normal working level" is a relative concept; what is regarded as normal in times of confidence is regarded as abnormal in times of absence of confidence. Although they are low, the experience of the last three months has shown us that we should not be safe in assuming that there is nothing more that can be drawn down from them. But they are spread over a large number of countries.

If you look at the colonial holdings, there again the sum is large, but it is spread over a large number of countries. I do not imagine anybody would suggest that we should fund in their cases. When you get outside that there are not a great number of very large holdings. I cannot give figures apart from what they publish themselves; but Australia has a large holding, and that goes up and down a good deal. I would not think, baving regard to the very good way Australia has behaved in regard to the sterling area, that it would he either an appropriate or acceptable thing to suggest funding that. It then, I think, comes down to the problems, which are raised in discussions like Mr. Day's that Sir Oliver Franks referred to, about Ghana and Malaya; I think one should not assume that they will not bave regard to where their best interests lie, which is in the stability of the very large holding of sterling which they have got.

So I would think, on the whole, that any concept of funding would on average lose us much more than it would gain.

2600. *Sir Oliver Franks*: There seems to me to be a difference between the situation at the end of the war and now. A good deal of the sterling balances which were in existence at the end of the war could be said to have accumulated in war-time conditions, and therefore under special circumstances, so that it was not impossible at least to think of the possibility of doing some sort of deal. By now most of those balances have been drawn off, and the balances which have now accrued are very largely ordinary trading debts. Might it not be that, if you began now to apply a policy which was thought possible twelve years ago in the then existing situation, it would be called by quite a different name, because you are dealing with a different sort of debt?——That is a very good point indeed; I entirely agree.

2601. *Professor Cairncross*: You show in the liabilities: "Non-territorial organisations' sterling holdings". Which organisations are these? Are they the International Monetary Fund and the International Bank?——Yes.

2602. These would not be liable to variation, would they?——Yes, they would; for example, when we make a drawing from the I.M.F.

2603. We can vary them, but can they vary them?——*Sir Leslie Rowan*: I think that they could not vary them without discussion with us, or without our consent. I am not quite certain whether it is discussion or consent. For example, suppose somebody wanted to borrow sterling from the International Monetary Fund; it would have to be discussed with us and probably our consent would be required.—*Lord Harcourt*: I think it is only a discussion.—*Sir Leslie Rowan*: At any rate, there would be a discussion in which our views would he fully taken into account. So far as the International Bank is concerned, our position is entirely different. We have paid up our original 2 per cent. of our quota, and, as I explained, we bave made the next 18 per cent. available to them under certain specific conditions.

2604. *Professor Cairncross*: This means that the figure for the non-territorial organisations' holdings represents a fairly firm holding?——I think so, for the purpose of the sort of problems we have been worried about.

2605. How would it affect the debt management position? Are there sterling Bills corresponding to this, or is this cash, or merely a book entry?——In the case of the International Monetary Fund, which is the largest, it is a non-interest bearing note. I do not think it really affects debt management at all.

2606. *Chairman*: Are there any more questions arising out of the first paper? I think we have covered the substance of it, and I daresay a great deal of the second, too. Are there any other subjects arising out of the second paper?——*Professor Cairncross*: It would be useful to us, in view of the discussion we have had, if we could have some indication of the movements of the balance of payments of the rest of the sterling area on current and capital account, as far as you can separate the two, over a period?——We will do our hest to see what we can get since the end of the war.*

2607. *Professor Sayers*: Could you expand a little on the question of the relation between relative interest rates and the flow of capital in and out of sterling? How far can we expect to influence long-term and short-term capital movements by relative interest rates?——As we have pointed out in the paper, the big question that arises on that is the question of confidence: whether (if we are dealing with short-term) people are going to consider that the advantages which they would get from the higher interest rates are in any sense counter-balanced by their assessment of the future of the currency. That is bound to be a factor which varies from time to time, but it is an important factor. So far as external investment is concerned, I assume that higher interest rates here are going to have a deterrent effect on the outflow of long-term capital; people will he less inclined to borrow from here. How far it will affect firms or industry in this country investing abroad is a question which is very difficult to answer in any specific terms, as it must depend on the general conditions of trade as a whole, and their own trade in particular.

2608. *Chairman*: I have one question on paragraph 31 of Paper 12, where you say:

> "The demand of Sterling Area governments for long-term capital for new issues on the London market is in effect informally rationed in the process of normal market management,"

Does that mean that by one means or another they are prevented from borrowing all the money that they would like to on the London market at all times and on all occasions?——Yes. There are a number of Commonwealth countries who are wanting to borrow on the London market. They cannot all get on to it at once; that would not give an orderly market. Therefore, in the normal course of market management between the Treasury and the Bank of England, there has to be some control or order in the timing of their approaches to the market.

* See Appendix to Minutes of Evidence.

2609. *Chairman*: How far is this relevant to the rate of long-term interest that you want to maintain? I take it that orderliness really merges into the structure of long-term rates that you want to maintain?—*Sir Oliver Franks*: Could I supplement that by asking whether the Treasury has at any time in the last six years had a view about what it wanted the long-term rates to be? Is it one of the things on which the Treasury has a view that it can state?——*Sir Roger Makins*: Does not that come up in another context? Should we not discuss it in that context?

2610. *Professor Sayers*: It is relevant to this point. This orderliness and rationing of the capital market, for issues to the other parts of the sterling area is a comparative novelty; the job used to be done by the rate of interest. Does the Treasury envisage this orderly queueing and rationing as part of the permanent mechanism, or does it envisage a return to something like the old system?——In this context here, we merely had in mind the fact that there has to be some sort of spacing out of the issues.

2611. That used to be done without official intervention. Is it the Treasury view that that spacing out ought to continue to be done by official intervention, or by other means?——*Sir Roger Makins*: I think that is a point which arises not on this paper, if I may say so, but on the general question of debt management.—*Sir Leslie Rowan*: Perhaps I could say one thing from the external point of view. I have said earlier that there is a greater demand for capital than the likelihood of availability; given that fact I should have thought, looking at it purely from the balance of payments point of view, that it is unlikely that we should be able to maintain a reasonable level of demand on the London market unless we used some method like this, without going to rates of interest which I should have thought would have consequences of another kind which would be very undesirable. Therefore from the external point of view I should have thought that this was likely to be, so far as one can see ahead and so far as the capital shortage lasts, a permanent feature of the scene.

2612. *Sir Oliver Franks*: The need for such an arrangement would be accentuated if the policies of the authorities over the past few years had been to keep the rate of interest of long-term borrowing artificially low?——I agree that the rate of interest is a factor in the situation, in which there are other factors as well.

2613. *Professor Cairncross*: Could you tell us a little more about the occasions on which borrowing has been undertaken by Commonwealth Governments outside the London market, say in the last year? Has this been an actual trend?——I do not want to go on record with statements about what they have done which may prove to be incorrect. I will certainly give you what information I can, but I should like to do it in a considered statement.*

2614. *Mr. Jones*: Are the Treasury telling us in paragraph 25 of Paper 12 that there is no measurable certainty of what monetary policy can contribute in its influence on general economic conditions, or even on the balance of payments, so that no quantitative assessment of its value could be made?——I do not think so. We are saying that we cannot make a quantitative assessment but we can give particular qualitative judgments, and we seek to make those in the last part of the paper.

2615. *Sir Oliver Franks*: Would you say that that inability to make quantitative assessments applies to monetary policy, fiscal policy, and direct physical controls in equal measure?——I think they are all so much of the general picture that it is very difficult to pick out the influences. It is like the rungs of a ladder; they are constantly acting and reacting.

Chairman: Perhaps we could break off here. I hope that next time we shall be able to take up the debt management paper?——*Sir Roger Makins*: It is being circulated to you today.

(*The witnesses withdrew.*)

(*Adjourned until 2.00 p.m.*)

C. F. COBBOLD, Esq., Governor, H. C. B. MYNORS, Esq., Deputy Governor, L. K. O'BRIEN, Esq., Chief Cashier, W. M. ALLEN, Esq., an Adviser to the Governors, and J. Q. HOLLOM, Esq., Deputy Chief Cashier, of the Bank of England, called and examined.

2616. *Chairman*: Before we embark on your Paper 13, may we see if there are any questions on the introductory statement to it which you gave us last time*?——*Sir Oliver Franks*: There is one point I would like to raise. When we have raised hire purchase, which the Governor of the Bank referred to at the beginning of his statement, we have been told there are certain discussions going on between the Bank and the Treasury which presumably affect the extent, degree and possibility of some kind of control. There are, I think, quite separate questions from that question of policy, which relate to the part played by the finance houses, the ease with which in recent years they have got deposits and so forth. The question arises how important these para-banking activities are becoming; that is different from whether or not they should be controlled. I wonder if you have views on that?——*Mr. Cobbold*: There is an exercise going on on that subject between ourselves and the Governmental organisations. I assume that the results of that will be made available to you.

2617. *Chairman*: May we turn to the first paragraph of your paper†? I do not think I am clear about the significance of the obligation of being a lender of last resort. You say in this that your "power is limited by the need to be lender of last resort, which in practice today means ensuring that the current requirements of Government are met". In this situation, whether it is satisfactory or not, what place does the understanding that the discount market should cover each week's offer of Treasury Bills play?——That is an essential part of the procedure which we are describing there. The evidence which the Chief Cashier gave to the Committee on the earlier papers showed that, in practice, in one form or another the Bank makes it possible, by supplying the money necessary, for the Treasury Bill tender to be covered. This phrase also covers the fact that, if there is a shortfall in Government requirements on any day, in practice we make up that shortfall by Ways and Means Advances. As you know, we only regard Ways and Means Advances as a very temporary and marginal assistance.

2618. I have not forgotten Mr. O'Brien's evidence; I just wanted to take it a bit further. In your view is it a satisfactory arrangement that the discount market should be expected to cover the weekly offer in this way?——It is an arrangement which has worked extremely well. In certain circumstances, if the public finances became completely out of order, then it might be open to question, but in practice over my experience it has been a useful and helpful arrangement.

2619. *Professor Sayers*: Is it not a comparatively novel one? Which change in the general scene against which the Bank has to work would you say is principally responsible for this having become a desirable feature in a sense in which it was not necessary before?——The size of the Treasury Bill issue.

2620. Not the size of the possible variations in Government needs from day to day?——*Mr. Cobbold*: I would have said more the absolute size of the Treasury Bill issue.—*Mr. O'Brien*: I agree. The variations from day to day are a purely technical matter.

2621. *Chairman*: Does that mean that the more the Government wish to borrow on these short term bills the more necessary it is that the discount market should be able to find all the money?——*Mr. Cobbold*: Before the last war the Treasury Bill issue was considerably smaller, and it was probably of less preoccupation to my predecessors that the Treasury Bill tender should be covered, because there were probably other means by which any shortfall in Government requirements could be more easily covered.—*Mr. O'Brien*: Yes; the size of the Treasury Bill tender each week is so large that unless the arrangements were well organised there could be no

* See Qns. 2321-24

† Memoranda of Evidence Part I No. 13.

* See Appendix to Minutes of Evidence.

assurance that the requirements were going to be provided. —*Mr. Cobbold*: If I were not sure the tender were going to be covered next Friday, I should be in a continual state of anxiety as to how the Government's requirements for finance for the following week were going to be met. I think that would have been less formidable for my predecessors.

2622. *Mr. Jones*: What does Mr. O'Brien mean when he talks about the "arrangements" being "well organised"?——The whole mechanism; the discount market's arrangements with ourselves and with the clearing banks, our own day to day arrangements for the needs of money for the Exchequer, and the whole complex of the money market.

2623. *Professor Sayers*: If this arrangement were not in effect would the Bank feel, first that it had less control over short term rates, and secondly that its hand might be forced on Bank Rate from time to time?——Certainly yes to the first part; and I think yes to the second part too.

2624. *Chairman*: Was I putting it unfairly when I suggested that the more the Government is asking to borrow on these short term Bills each week the more important it becomes that the discount market should be able to find the money?——The degree is so different in present circumstances from what it was in earlier circumstances, that I think is the essential point. If the demand went up or down five or ten per cent. between now and next June, I should not regard that as relevant.

2625. *Professor Sayers*: Does it follow that, if we could get back to a position in which the Treasury Bill tender were appreciably smaller in relation to the national income than it is now, this arrangement with the discount market might well be dispensed with?——The Treasury Bill or other forms of floating debt; I would not accept that if it were merely a substitution for Treasury Bills of Ways and Means Advances, for example.

2626. *Professor Cairncross*: Do you not feel that the expansion of the public sector almost inevitably means a very large expansion in the Government's current requirements for accommodation?——I think it is a question of the size of the floating debt rather than of current requirements.

2627. *Professor Sayers*: Is it not the fluctuation of current requirements?——*Mr. Cobbold*: I would have said that it is more the absolute level than the fluctuation.—*Mr. O'Brien*: I think it is the absolute level of the requirements, which are very large even for our market to absorb week by week. The assumption is that they are large and must be met each week. The second assumption is that they should be met from the market, not from other sources. If they are to be met from the market, not only do the arrangements have to be good technically in order to get that money each week, but an essential part of the arrangement is that the Bill itself should be marketable, because the market would soon get tired of it if it were not; and its marketability is greatly enhanced by the arrangements with the discount market.

2628. If it became possible in the next five years to replace a large part of the existing body of Treasury Bills, say one-third or something like that, by long term bonds right outside the money market, would the Bank not still feel that, although the Treasury Bill issue had become smaller, the possibility of variation in the amount, or the possibility of appearance of a gap between what the market would provide willingly and easily and what the Government needed in any one week in the way of cash, might still be so big as to make an arrangement of this kind a useful device for oiling the mechanism?——*Mr. Cobbold*: If the absolute level were reduced by one-third, my preoccupations would still be very similar, on the absolute figure, as today.

2629. Although the Treasury Bill issue would then be not very different in relation to the national income than it was pre-war?——I am sure you are right about that; but still the absolute figure is very much bigger. I am thinking of my preoccupations of finding the money on each occasion.

2630. And I am suggesting, with all respect, that your preoccupations are due to the possibility of a gap developing between what the Government needs that week and what the market will bear. Comparing now with pre-war I should have thought that that possibility was partly due to a relative increase in the size of the Treasury Bill issue, but also, and in very large measure, due to the greater amount of variable elements in the cash needs of the public sector?——I do not think I am disputing that. I should certainly be preocupied with a total of that sort of magnitude, whether it was one-third less, or the same as today. I quite agree that the fact that there may be heavier variations than in the old days would add to my preoccupations if the present system were discontinued.

2631. How workable would the system be without this convention, if the Treasury Bill could be reduced by that sort of proportion?——*Mr. Cobbold*: If it were reduced by about a third, I would still regard this system as highly desirable.—*Mr. O'Brien*: You could say that, as the amount of the debt was reduced each week so the danger, given present market resources, of a shortfall would tend to be reduced, though I would not necessarily say eliminated.—*Mr. Cobbold*: On any sort of reduction of the floating debt I can foresee I still regard this arrangement as highly desirable.

2632. *Chairman*: The general effect of this system is that, at a time when you want to put pressure on the banks, cash floods back into the market and the liquidity is restored again?——That is correct. We can influence the rates much more easily than the absolute level of cash.

2633. Does not this system amount to the discount market each week by its offer to take up Treasury Bills, as it were, pledging your credit, because they know that, in so far as they get the bills and have to cover them, they can always rely on you providing the necessary amount of cash?——They know they can always re-discount or sell to us.

2634. Is it not really your credit they are pledging, or that of the banks in so far as they are relying on call money?——To the extent that we lend to the market, they are really taking up the bills on money borrowed from us.

2635. So it is really your credit?——Yes. In effect they are certain that we shall supply the money as the lender of last resort, in the system as it is.

2636. *Professor Sayers*: Surely the Bank of England must be the source from which any marginal cash needs of the Government are met?——Yes, otherwise the whole discount market system, the marketability of bills and the certainty of the clearing banks that their call loans are readily recallable would break down.

2637. And there would be very sharp variations in the short-term rate structure generally?——Very.

2638. *Chairman*: Supposing there was not this covering arrangement, and the Government, despite the attractions of its Bills, could not be sure of getting all that it wanted to borrow; it would have to go to you for the balance, as it must have it in that week?——Unless it could be got from any other source.

2639. Would that be fatal?——Fatal is a big word; but we have tried to explain that we do regard regular large borrowing on Ways and Means Advances as extremely unsatisfactory for a number of reasons. It would be direct lending by the Bank to the Treasury.

2640. I think you point out in your introduction, that you are not compelled under your obligation as the Government's banker to find money regularly for the Government's needs?——We are not compelled.

2641. There could come a point at which in the last resort it would be open to the Bank, subject to directions under the Bank Act, to interrupt the automatic provision of cash to meet Government requirements?——That is a situation which neither the Bank nor the Treasury would contemplate with any enthusiasm, but it is a point which could conceivably arise.

2642. But would it not give you a control which it seems that under this automatic system, having your credit pledged, as it were, for you, you do not achieve?——It would certainly give us a theoretical control. Theoretical control in that way could limit our re-discount arrangements and thereby disturb the whole of the present basis. I said in my answer to Question 1810: "whether we should have gained in the end by substituting for our present methods (which admittedly have their risks) a

system which prevails in some countries by which the Exchequer lives from hand to mouth . . . I am not sure ". It comes to that point, I think.

2643. *Professor Sayers*: In the present system you provide the money on the whole without arguing, though you do sometimes make statements in public?——And in private.

2644. Indicating that you are not happy about this situation?——I do, Sir.

2645. This bears on what is said in this paper. We have to compare various possibilities with the present system, in which money goes without any technical obstacles to the Government for current needs?——It does, but there are still safeguards, if the Bank of England took a formal view that the position was developing dangerously.

2646. The safeguards are that the Governor can speak out in private and in public and that there could be an informed public view on it?——Yes, and as I have also said, in the very last resort, which neither Bank nor Treasury would willingly contemplate, there could be some interruption in this automatic arrangement.

2647. *Professor Cairncross*: Where there is no discount market and no automatic obligation on the central bank to lend to the government, say, in the United States, how are those matters resolved?——The system is so different in the United States that I do not believe that it is really comparable. But in certain countries, which I think I need not name, what happens is that from time to time an advance limit is agreed, often with statutory authority, between the government and the central bank. From time to time the government get very close to that limit, or appear in danger of exceeding it, and there are arguments between the government and the central bank.

2648. But I take it that some of this depends on the organisation of the money market; that is, it is not just the expansion of the public sector here that has made a difference, it is also the virtual disappearance of the commercial bill?——I doubt if that makes a difference to the specific point we are talking about.

2649. Does it not? If there were a larger bill market would you not have less compunction in allowing the Government to take their chance in the market than if you were the sole purveyor of bills?——*Professor Sayers*: One of the differences between the United States system and ours in this respect is that in the United States system the government can get a bit more cash out of the system to meet extra large needs by offering just a bit more on the Treasury Bill rate. That attracts institutions of a wide variety to alter their ratios of the different kinds of assets they hold and just squeezes an extra bit out. In our system the asset ratios most relevant to this are pretty rigid, and we have largely lost the squeezable element, which was the commercial bill. These other elements are not readily squeezable, are they; the Bank of England just has to stand behind the Government and meet the marginal cash?——I would put the same thought the other way round: that at least one of the essential differences is that the commercial banking system is so very heavily loaned to Government here and much less in the United States generally speaking.

2650. That meets part of it, but only a part. If the clearing banks' advances ratio were 65 per cent., we should still have this problem?——I would have thought, at first sight, much less than we have at this moment. I agree at once that the United States market is so much wider; and the whole business of Federal funds and the different districts makes the situation very different.

2651. A bit of cash can be squeezed out?——Largely because of the size of the country and the diversification. You can attract money from San Francisco to New York, and from New York to Dallas, and so on.

2652. *Professor Cairncross*: Is not the point this more precise one: that if the private sector and public sector make use of a common instrument there is room for manoeuvre, whereas if they make use, as they tend to do in this country, of different instruments of credit (in the one case using bank advances and in the other case Treasury Bills), the change from the public to private sector is not so easy to accomplish, and the Government can only have the elasticity it needs if the Bank of England stands ready to supplement what the market will offer?——I am afraid that even with more commercial bills, given the present volume of Treasury Bills, we should still be up against much the same sort of difficulties.

2653. Perhaps I might lead on from this, since we have introduced the question of the American system, to the suggested technique at the end of the paper involving the use of special deposits. In this country the discount market so operates that when you restrict credit you hope to force the market into the Bank, and you wait till the market comes to the Bank. In the United States there is at least supposed to be a difference in that the commercial banks are already in debt, or can be made to be in debt, to the Federal Reserve System, and therefore can be in direct constant contact with the central bank. If you introduced a system of special deposits in this country it could be regarded, I suppose, as a step in that direction. You do not represent it as a step in that direction, but it might be operated rather in that way, in the way in which the American system functions?——*Mr. O'Brien*: But that would not put the banking community in debt to the government, if it made deposits at the central bank?

2654. *Professor Sayers*: But individual banks would have the right to come along and argue as to how much was to be called for, and that might be comparable to the occasions for contact provided by the American system?——*Professor Cairncross*: You might have a different relationship, which might in a sense by-pass the discount market?——*Mr. Cobbold*: The two systems have very material differences, but your point is, I think, that it would tend to raise more direct discussion between the central bank and the commercial banks individually over the credit position existing at this moment.——*Mr. O'Brien*: But of course the two systems would run side by side. For the Government's ordinary week-to-week requirements we should continue to have a system of Treasury Bill issues, and a system of special deposits would be instituted as occasion demanded. There would be direct contact with the banks over that, and also, I presume, the discount markets still operating to facilitate the regular arrangements.——*Mr. Cobbold*: We should regard this as marginal, as I see it, beside the more regular and more general operations as they are now.

2655. *Professor Cairncross*: In making this suggestion are you thinking of what I might describe as the emergency situation we are now in (although it has lasted a long time) or are you making a suggestion that you would like to see pursued in the long run even if you can overcome present difficulties?——We are saying rather carefully and definitely that we should not like to see this system introduced, but that, if something had to be introduced, we feel this is the most likely starter. We should not regard it as something we should hope to use every week or every month, but something which might have to be used from time to time (I personally should hope as rarely as possible) to meet a particularly difficult credit situation.

2656. Do you not see some advantages in the American arrangement under which there is automatic contact between the central bank and the commercial banks over the use to which credit is put?——I much prefer our own system for our market.

2657. *Sir Oliver Franks*: In paragraph 2, am I right in thinking that the tradition, which I agree is now established, that the clearing banks' liquidity ratio shall not fall below 30 per cent., is a pure convention? I think, so far as I can find out, that that particular figure, or a figure very near it, is not what would be required for the safe operation of the clearing banks as they emerged after the period of amalgamation, but is inherited from the period of small private banks. Is it not probable that, if it simply went by nature and expediency, it would be a much more elastic figure than the 30 per cent. now established by convention?——That would be mainly a view for the clearing banks to express. I do not think I should dissent if they expressed it.

2658. *Professor Sayers*: In paragraph 8 (*a*) you have to some extent justified the present arrangement by saying that banking conventions "rest upon the traditional and proper attitude of a banker that he must seek to be in all circumstances good for his engagements ", and that

"to modify such conventions from the outside would be to impose on those affected a standard of conduct not founded upon experience of their own business". Does that not suggest that the 30 per cent. has been arrived at and is adhered to for the banks' own purposes?——That is certainly so. It is inherited and has been adhered to as a convention for the banks' own purposes.

2659. Would it not be very difficult to build up a case in history for that, much less to say that, if the banks were left to themselves now, this is how they would behave for their own purposes? Why should a clearing bank hold 30 per cent. in liquid assets?——That is a question for the clearing banks; but we regard it as a convention which has been built up and has not been, at least overtly, changed.

2660. *Professor Cairncross*: It might be different for different banks?——For different categories of banks.

2661. Different banks conducting different types of business?——*Mr. Cobbold*: That is what I mean. I do not think it would be different for the "Big Five" or the eleven clearing banks.—*Mr. Mynors*: There is some variation among smaller clearing banks.—*Mr. O'Brien*: Even if it is argued that 30 per cent. is an artificially high ratio, an even higher one would be more artificial. The merit of the present convention is that it is accepted by all concerned.

2662. The Governor made a statement which may be of some importance; did that imply that, if there were control of liquidity ratios, you saw no reason why the liquidity ratios of the "Big Five" should differ?——*Mr. Mynors*: Their businesses are not identical, but in so far as they are broadly similar one would expect them to work to broadly similar figures.—*Mr. Cobbold*: My present state of mind is that for the big joint stock deposit banks the ratio would in principle have to be the same.

2663. *Chairman*: In paragraph 5, you say: "Whatever the form of securities offered, promotion of the flow of securities into non-banking hands is subject to four important limitations".—*Professor Sayers*: Would you be prepared to add a fifth to the limitations, the limitation that, if the rate of interest is too low in relation to the broad capital situation of the country, the flow of securities into non-banking hands would be limited?——Yes.

2664. *Chairman*: In paragraph 6 you say: "The main monetary weapon for influencing market expectations lies in the Bank Rate", and then you consider the question "whether the customary frequency and scale of changes is best adapted to present day conditions". The alternative thrown out is that you should adjust Bank Rate weekly to market rates, the point being that that would throw into relief that changes in rates were really determined by "the interplay of supply and demand". That would be to adopt in effect a passive attitude towards it?——That was the system recently adopted in Canada, but with no commitment that it would always be maintained.

2665. *Professor Cairncross*: Is Canada the only country which has this floating Bank Rate system?——That is, I am afraid, the only one I am familiar with.

2666. *Sir John Woods*: When you say there is no commitment that that would not be changed in the Canadian system, does that mean that the normal thing is to follow the market week by week, but the Canadian Government might interrupt that process?——The Bank of Canada made it quite clear, when they introduced this new system, that if at any time they thought a larger move, or a reversion to the earlier system, might be desirable, they regarded themselves as quite free to go back to the earlier system.

2667. *Chairman*: Then you say at the end that the main point about moving by steps is that it is a practical way of indicating the wish of the authorities with regard to the situation?——To meet a point Professor Sayers has often made, I believe that in the last line of paragraph 6 we ought to have said "an immediate change in *short term* market rates".

2668. *Mr. Jones*: On paragraph 7, to what extent does liquidity assist the fever of inflation?——We have felt, in trying to deal with credit in the private sector, that it is more difficult to secure the co-operation of the banking system in limiting advances if liquidity is too heavy. I would regard excessive liquidity in the banking system as a contributory factor to having too much credit in the private system; but, as I think we have made clear, though we have tried to maintain and use influences to keep liquidity down so far as we can, we have over this period relied to a very great extent on the co-operation of the clearing banks, apart from the technical measures.

2669. What would be the effect on credit and inflation if the banking system raised the liquidity ratio from 30 per cent. to 40 per cent.?——My own view is it would have very little, because the banks would immediately sell 10 per cent. or thereabouts of their existing investments.

2670. *Professor Cairncross*: You told us that you did not think there was any possibility of the Bank ceasing to be the lender of last resort except in an extreme case. Would there be any case for measures that would stop a little short of that, in which the Bank would make it apparent there would be no automatic supply of cash to the banking system, although it would still be willing to act as lender of last resort?——That would have the disadvantages of transferring into Ways and Means Advances, to which we have already drawn attention.

2671. Would it not, however, tend to freeze some of the liquidity in the system, if the banks were not quite sure whether, if they put pressure on the market, the discount market would automatically get the cash needed?——If the clearing banks once began to think that their call loans were not absolutely liquid, that would change the basis of the system much more widely than you are suggesting.

2672. *Chairman*: Would the first result be that they would not put so much call money into the market?——I would have thought the changes were far wider than that.

2673. *Lord Harcourt*: It would put a stop to the tender arrangements?——It would put a stop to many things.

2674. *Chairman*: Treasury Bills and first-class commercial bills are always discountable with you; does that extend to any other assets?——*Mr. O'Brien*: For all practical purposes it is mainly Treasury Bills, and to a lesser extent short bonds under five years; but it could be commercial bills.

2675. *Professor Sayers*: The Bank is not limited from extending its eligible credit indefinitely?——*Mr. Cobbold*: Not by statute.

2676. *Professor Cairncross*: Does the eligibility of short bonds go back a long way, or is it something fairly modern?——*Mr. Cobbold*. It goes back beyond any of our times.—*Professor Cairncross*: That is far enough.

2677. *Professor Sayers*: The middle of paragraph 7 relates to the informal arrangements with the banks directed to limiting increases in private credit. Much of this paper is devoted to arguing that in various respects these alternative methods are inferior, not to the present arrangement, but to a state of affairs in which there are no controls on bank advances; is that not so?——To be accurate, nothing other than the 30 per cent. convention.

2678. Does that mean that the Bank is looking forward with great expectation to a period in which it becomes possible to dispense with the present control of bank advances?——We have always recognised that the present methods are undesirable as permanent or semi-permanent arrangements. We should certainly hope that other general conditions to which we have referred many times may be so adjusted that a continuance of these abnormal or supplementary measures would not be necessary for all time.

2679. But these abnormal measures, if I may confine myself to the quantitative control of bank advances, have now lasted just about 2½ years, and you will hardly expect them to be gone within a period of three years from their initiation. Is not three years rather a long time? If a period of three years had been envisaged at the start, should not a great deal more attention have been given to alternative methods? If we are envisaging another three years, ought we not to envisage alternative methods more favourably than is done in this paper?——A great deal of attention has been given throughout this period to alternative methods. As I have said, we have come to the conclusion that the methods we have been using were preferable to any of these other ones.

2680. Although these methods include the control of the quantity of advances?——Quantitative control in the sense in which it has been done. Some sort of similar quantitative control, to use your phrase, goes back quite a bit beyond the 2½ years. I think I remember discussions about this in 1949 or 1950.

2681. These controls are getting well whiskered?——As far as I am concerned, they are. I cannot remember when I last expressed in public the view that they could not last too long, but I certainly have expressed that view. I should find it difficult to name any specific period as the limit they could operate; but I do not think they can last semi-permanently, and I think that is why we are at the moment discussing whether anything else should be substituted if the need for some regulation of this sort continues.

2682. If one put the various methods in this paper in your order of preference, we should find quantitative control of bank advances pretty low down?——If you are using it in the sense I think you are, of asking the banks not to compete with each other and holding the level of advances down, yes.

2683. *Sir Oliver Franks*: It is more than that now; it is by arithmetic: "take the average of 12 months and stick to that?"——Yes, but even in the form it was last year the kernel is the agreement between the banks not to compete, which I regard as a disagreeable feature if it has to be continued too long.

2684. *Professor Sayers*: We have it, and yet it is very low down on your list?——Very low as a permanent or semi-permanent measure, but not as a temporary measure. For this last period it has been the top of my list.

2685. You would prefer a very substantial funding of short-term into really long-term debt?——Yes.

2686. That would give you a comfortable position from which you would be prepared to look down on these measures as the undesirable things that had only to be pulled out of the cupboard on emergency occasions?——I have to admit that on funding we have some way to go before we could get to that comfortable position. There are other things in the general economy which I think might make us much less pre-occupied about the level of bank advances than over the last period.

2687. You are not thinking there of a slump?——No, of a less violent expansion. I think we might be less bothered about the level of advances if we were less bothered about inflation, to put it broadly.

2688. But you are bothered; and you had better go on, had you not, bothering about advances?——We are.

2689. Although this is low down on the list?——It is not low down on the list at this moment. As I have said, this is still at the top of my list at the moment, but I am not prepared to say when it changes in the batting order.

2690. It is top of the list as a measure that goes on three or five years, but it is low down on the list for a permanent fixture?——*Mr. Cobbold*: As a statutory or regular measure.—*Mr. Mynors*: We are really saying that we have not yet admitted that inflation is a permanent measure.

2691. *Chairman*: Suppose that within the next eighteen months it was possible to withdraw this; if you had no other weapon you might have to resort to it again?——*Mr. Cobbold*: I should not mind that as a short-term operation. It is the semi-permanence of this I dislike.

2692 Would it not worry the banks very much, once they had been given a freer hand, that they might find themselves put back again?——They would be worried under any of these systems. You would have to ask the clearing banks exactly where the present system would stand on their batting order as compared with the other alternatives here.

2693. *Mr. Woodcock*: If you achieved a substantial funding of short-term debt and consequent reduction in liquidity, would not that inhibit the competition of banks?——*Mr. Cobbold*: I do not think so. You would not have to have an agreement between the banks not to compete; they would be governed by the amount of cash they had to lend, which is perfectly normal. What bothers me is that we have growing up a generation of clearing bank managers whose function is *not* to do business, which seems to me bad for the banking system and for service to the public.—*Sir Oliver Franks*: That is literally true, in the sense that trainee sub-managers have to be given exercises in what they would do if a customer came for an advance, instead of practising on a customer actually coming into the bank; that is a bad thing.

2694. *Chairman*: In paragraph 8 you set out the considerations about the effect of compulsion. You draw attention in paragraph 8 (*a*) to the objections to interfering with banking conventions for non-banking reasons. But would not the object be to secure a more healthy state of the economy? Would it not be one of those more general regulations, like those imposed on a man running a factory, which are imposed for the general health of the community, but do not contribute to the purely efficient running of his business?——I think it would look suspiciously like the Government wanting to borrow money which it found difficult to get from other sources.

2695. Limiting advances to the private sector has something of the same flavour?——Certainly.

2696. *Professor Sayers*: It might be said that the present arrangements between the discount houses and the Bank of England were designed to facilitate the financing of the Government deficit. If you impose a measure for the control of the credit situation and you say that it is for that purpose, surely nobody has any particular reason, other than what already exists, to say that this arrangement is for the more convenient financing of Government deficits?——I do not agree with that view. I believe that if liquidity ratios were prescribed by statute, although it was primarily and genuinely intended as a credit control measure, a lot of people would see in it an eventual risk that the use of powers in that way might be intended to increase Government borrowing from the banking system.

2697. I know my imagination is not a rich one, but if I were trying to think of some credit system which would make as easy as possible the financing of the Government's cash requirements, I do not think I could imagine a better one than the present one. I have never felt called upon to write a pamphlet explaining that this is how the present system works. If I wrote a pamphlet saying that the present system was designed to make the financing of the Government's cash needs just as easy as possible, I think it would be misleading and would grossly misrepresent the intentions of the people who run it. I should consider it no less misleading to represent a measure of the kind we are looking at here as a measure the purpose of which was to finance the Government's cash needs. Surely it would be more properly described as a measure for the better control of credit in relation to the Government's whole economic policy. Why should we suppose that people would seek to twist the whole intent of the system?——Perhaps that is largely a matter of view; but I should foresee a great risk that a measure of this sort would be so interpreted. I would see a greater risk that, once the ratio had moved to 33 per cent, it would move to 36 per cent. and then move to 40 per cent. It is very difficult to see where the limit would come.

2698. Although there would be a Governor of the Bank of England who would feel it his duty to speak up and say this was being abused, and although you might have facts published so that there could be an informed public opinion to see just what was being done?——*Mr. Cobbold*: I accept that the present system is an extremely competent one for financing cash requirements; I myself think it would be an error as a long-term principle to make that easier than it is now. It is very questionable whether it would be wise to interfere with the very competent present arrangements to make it more difficult. —*Mr. O'Brien*: It is true that the present system of financing the Exchequer's cash requirements is, if I may say so, a very efficient one, supposing those cash requirements to be entirely seasonal, pending the receipt of revenue, so that at the end of the financial year the Government has borrowed temporarily only by this means from the market. But once the amount of the floating debt is shown to be increasing, so that in effect the Government is going beyond its purely seasonal needs in financing itself by these means, a red flag goes up If at a third stage, because the red flag has gone up, it is trying to

make it into a white flag by making the ratio 35 per cent., is that not an abuse distinct from the system? It would be making use of the efficiency of the system by saying: "We are financing ourselves on the floating debt more than seasonally; we will legalise that by putting up the liquidity ratio of the banks."

2699. *Chairman*: It is a distinction I find difficult to follow. Would it not be true that any measure which seeks to restrain credit to the private sector at a time when the Government itself is a large competitor for borrowing money for the public sector could be said to be a measure that was intended to facilitate the Government's obtaining of the money?——*Mr. Cobbold*: That is broadly true, but, as we have tried to set out in this paper, we think it to be less true of the special deposit arrangement suggested at the end here, because that is more demonstrably linked with the credit situation and further away from the Government borrowing.

2700. *Professor Cairncross*: Is not the Bank the principal source of cash to the Government in the sense that there is an obligation on the Bank of England, as a last resort, to see than the Government's cash requirements will be covered?——*Mr. O'Brien*: In that sense.—*Mr. Cobbold*: I do not think "principal source" is correct; that is the basis which ensures the working of the system. As I was trying to say a little earlier, one would, I think, radically alter the whole basis of the system, if one removed that obligation

2701. The commercial banks at this moment cannot lend one penny more to the private sector; they are bound hand and foot. Therefore the Government gets the benefit of a restriction which it can tighten without justification If it wanted to force the banks to lend less to the private sector, it could do so?——In the first instance only with the agreement of the clearing banks. Subsequently, if the clearing banks did not agree to it voluntarily, it would bring the statutory processes into operation, which rest on the initiative of the Bank of England and subsequent approval of the Government. I am now talking in rather formal terms.

2702. You rest the distinction on the informality of this arrangement? I am comparing the present request to the banks to observe a ceiling with the kind of situation envisaged in which there are compulsory ratios either for liquidity, or later for advances?——The present arrangements are voluntary and informal arrangements operated with the full and willing co-operation of the banking system which, despite the traditions of the banks in this country, might not be forthcoming in the same way if statutory powers were used in any of these arrangements.

2703. Would you regard as a major easement, from the point of view of the running of a cash deficit by the central bank, the transition from a system such as we now operate to a system such as this describes?——*Mr. Cobbold*: If the Government had direct powers to use this, it would depend to what extent they used it.—*Mr. O'Brien*: It could remove the existing incentive to correct an increase of the floating debt.—*Mr. Cobbold*: I have said that I regard this 30 per cent. as a very useful flag to give a warning about undue increases in the floating debt and in Government short-term borrowing from the banking system. If, when the ratio was getting too high, it could be altered to 35 per cent., the effect of that warning flag would be very much prejudiced.

2704. The critical factor is surely not the degree of liquidity in the system, but the degree to which control of the whole operation of the monetary system is getting out of hand through rising prices?——I am very conscious of frequently being moved by the degree of liquidity.

2705. But only because you expect that to have repercussions later on the whole economic system?——Not entirely; I am concerned about the absolute level of and increases in the floating debt which I regard as, on the whole, an unhealthy method of Government borrowing in too great quantity.

2706. Is this necessarily so? It happens that most of the increase in the floating debt is in the banking system but a substantial part may be held in firm hands. Though it may be that the hands are not firm in the long-term sense applicable to funding operations; the debt may be firmly held for a requirement which is quite specifically a floating and not a long-term requirement?——I should have thought that by its nature the floating debt was less firmly held than long-term, and that it was always more liable to float back into the monetary system than firmly held long-term debt.

2707. I was thinking of the sterling balances, some of which are clearly held by countries which are unlikely to realise them?——We would regard the sterling balances held by other countries as an entirely different system.

2708. Has there not been a great increase since before the war in the amount of the floating debt held by currency boards?——*Mr. Cobbold*: I would have thought that they were in rather a special category. I confess that whether a Commonwealth central bank or monetary authority holds short bonds or Treasury Bills does not interest me very much. I would agree with you on those special holdings.—*Mr. Mynors*: If you got a rapid rundown in the balances held by an authority of that kind, whether it was liquidating short bonds or Treasury bills, it might have some market effect.—*Mr. Cobbold*: There are also some occasions when Treasury Bills would be less firm because the price disadvantage of running down in a hurry might be less.

2709. From your point of view in controlling the system, the fact that there was an increase in liquidity of this type would not be so much of a problem as an increase in the liquidity of the banking system?——I regard overseas central bank and monetary holdings as a slightly different problem, and I am less interested in the composition of their portfolio.

2710. *Chairman*: In paragraph 8 (*c*), you say:

"The virtues of informal and flexible methods of persuasion would be lost, and this would not be without influence on international opinion."

——*Mr. Cobbold*: I regard the last ten words as a very great under-statement.

2711. *Professor Sayers*: Although such methods as we are talking about here are used commonly in other countries, including the United States, you would still regard the introduction of them here as being adverse to this country in international opinion?——To our position as an international banking centre; yes, I should.

2712. *Sir Oliver Franks*: Is there not a distinction to be drawn there between a judgment based on purely theoretical terms and that based in the light of historical situation during the last twelve years? Were you making that distinction in your mind?——I was.

2713. *Chairman*: If you want to promote healthy competition among the banks and the most efficient use of their resources, is it not much better to give them a rule to which they all must comply and leave them to make the best of their situation within the terms of that rule?——I would see a strong argument for that as a long-term proposition if any further rule than the 30 per cent. is required.

2714. There would be nothing contrary to our traditions that would shock international opinion if we said: "Here are rules for the conduct of banking operations. Within those rules you may make the best use of opportunities you can."?——We must have regard to the practical point Sir Oliver has just raised. In present conditions any statutory requirement imposed on the banks might, in relation to recent history, have some disturbing influence on the international view about British banking.

2715. *Professor Sayers*: Might not the effect of such an announcement be to make people outside this country say: "The British are at last getting their banking system really under control. Now we shall see an end of inflation"?——I think the first sentence would alarm them very much.

2716. *Chairman*: But is not much of the argument about the effectiveness of package deals based on the fact that confidence outside this country tends to be restored by seeing that we are imposing new legal rules?——I would not say new legal rules; I would say taking new action. 7 per cent. as against 5 per cent. is not a new legal rule.

2717. *Professor Sayers*: If one of these rules were introduced as part of a package deal, would you still consider this international point important?——I should.

2718. In paragraph 8 (d) you allude to the difficulty of making general rules for such a variable subject matter as the kind of business that different banks and banking institutions concerned would be carrying out. Is not that true of all general rules?——It is. It would be much more true of the British banking system and the London banking system than of any other banking centre that I am aware of.

2719. *Professor Sayers*: Surely our clearing banks are more like each other than those of almost any other centre?——Certainly the clearing banks are; but there is an enormous number of branches of overseas banks and British banks operating overseas and every type of banking institution in London; far more than anywhere else.

2720. *Mr. Woodcock*: May I just go back to the distinction between cooperation and compulsion in 8(c)? Is this simply an argument on method? If the banks themselves were voluntarily to make changes, to impose arbitrary standards upon themselves, would that have the same effect?——I was making the point that there was distinction between a method adopted by themselves and a method imposed upon them.

2721. *Chairman*: Then in paragraph 9(a) you are stressing the importance of trying to find a measure that will look most like a general credit measure and not like a measure aimed principally at finding more money for the Government?——And he most like; I emphasise both "look" and "be".

2722. *Professor Sayers*: Would it be implicit in paragraph 9(c) that any measure ought to be very fully explained and the public kept informed about the reasons why any adjustment was made?——It would.

2723. *Chairman*: Then we reach the actual possible alternative techniques. Are they in any order of preference?——No, Sir; only as described in the text.

2724. On the compulsory liquidity ratio. You point out that such a thing does not prevent liquidity arising; it merely tries to stifle what would otherwise be the natural consequences. You give us a number of arguments against it: that it would have "all the disadvantages of a standard based on outside considerations" alien to the normal conduct of banking, and "risk encouraging changes in the form of bank accommodation which were based not on the requirements of customers but in order to raise additional liquid assets. For example, bank advances could, within limits, be replaced by commercial bills."—*Professor Sayers*: Could not that be kept in check to some extent in that the commercial bills to command a good market would need to be accepted either by a London accepting house or by one of the clearing banks?——*Mr. O'Brien*: Yes.

2725. The clearing banks could evade this type of control by accepting bills for each other?——Yes.

2726. *Professor Cairncross*: Is there any reason why the percentage should not exclude commercial bills?——We say in paragraph 14 that it would have to.

2727. *Professor Sayers*: The last point mentioned in paragraph 14 could be dealt with by dividing the call money for the purposes of liquid assets ratio. It would be unhandy, perhaps, but it could be done, could it not? I am not suggesting that the discount houses would rejoice at having to do such a sum, but their call money could in fact be split up into three parts, one secured by short bonds, one secured by Treasury Bills, one secured by commercial bills?——It would not be impossible.

2728. But you think it would be singularly troublesome?——*Mr. O'Brien*: It would be troublesome; I would not like to be sure about singularly.—*Mr. Cobbold*: Call loans from outside sources would complicate that frightfully. It is a technical point.

2729. *Sir Oliver Franks*: You get beyond a technical point when the degree of detail of control begins to become a point of policy?——I think you would in that case.

2730. In general one wants, if one is forced to control, either to have a broad measure which leaves a lot of freedom of individual decision or, alternatively, a measure which impinges on a limited category of objects sufficiently clearly and definitely to be effective and to leave everything else free. The ideal of the second case would be, if it worked, a physical control; the ideal of the first case would be Bank Rate; but when you get beyond that sort of thing you are moving into a world in which the patient is restricted from breathing let alone living?——Getting in that direction.

2731. *Professor Sayers*: So the comment on that passage is that it would be possible to deal with it, but it would add to the complication of control?——I would say possible but impracticable.

2732. *Chairman*: May one go a little further, and say that, if you are considering a compulsory liquidity ratio, owing to the uncertain boundaries of the word "liquidity", you have a subject in which ingenuity is particularly liable to defeat your purposes? The more ingenuity is brought to bear, the more complicated the laws have got to be?——I would back myself at defeating it much more easily than imposing it.

2733. *Professor Cairncross*: Could you not define the assets qualifying for inclusion as those eligible for rediscount or advances from the Bank of England? You do not, it is true, bold out the possibility that commercial bills might be included, though I do not see much argument in these paragraphs against their inclusion, and you do not discuss whether short bonds might not equally be thrown in. But you would then end up with a total made up of perfectly well defined assets which you would regard as convertible into cash?——You would be getting very near an investment ratio.

2734. I was looking for a definition already practised, and I would suggest there is this one which I should have expected to see argued here?——*Mr. O'Brien*: Short bonds are not included in the banks' definition of liquid assets.

2735. *Professor Sayers*: Is it desirable that they should be? Have we not again and again in these discussions come back to the point that one of the weaknesses in the Bank of England's control of the clearing banks is that these are reckoned outside the liquidity ratio?——But the liquidity ratio is a definition of the banks themselves; they publish their ratio every month and include certain assets in it.

2736. Surely we are still at a stage when a convention can be changed?——*Mr. Cobbold*: I think what you are suggesting is that there might be another ratio half way between a liquidity ratio and an investment ratio.—*Professor Cairncross*: So defined that it would be made up of quite definable assets.——*Mr. Cobbold*: It would be three quarters of the way to an investment ratio.—*Mr. Mynors*: There is one more technical point. You could make a recognisable definition to include certain short bonds, Treasury Bills and certain classes of commercial bills. You would then get into what would have the force of a statute a class of commercial bills which the Bank of England would define from time to time. That would give those hills as defined at any moment a status deriving from what I might call an artificial cachet given to them. We have rules as to bills which we regard as eligible for re-discount, but those rules are drawn up on different criteria which we are free to adjust from time to time; if there was too much paper of an approved character circulating we could impose particular limits. I do not think you can take over for the purposes of statutory definition of a liquidity ratio the kind of informal though well-understood definition of eligible bank hills that has been operating traditionally for a different purpose.

2737. *Professor Sayers*: Is the present practice of the Bank of England that the answer to an inquiry about the eligibility of any class of paper is to refrain from any commitment and say: "Try it"?——That is right.

2738. *Chairman*: I wanted to call attention to one point in paragraph 13. Is the implication of the last two sentences that you would be giving a special reason to the banking system to try to attract Treasury Bills to itself?——*Mr. Cobbold*: I think the last sentence is a considerable under-statement. As I understand this the banks would probably he on occasion pretty heavy sellers of investments.

2739. *Professor Sayers*: The process of attraction of Treasury Bills and the running off of investments at maturity would have marked effects, would it not? It would change relative rates, which might be the kind of change that the Bank was desiring to bring about, or

might be desirable to bring about for purposes of the control of the situation?——*Mr. Mynors*: One would expect there to be some effect on rates at any rate in the early stages, which might or might not be one of the reasons for which one might intervene.

2740. On the other hand it would tend to coincide with what the authorities thought was desirable?——*Mr. O'Brien*: A tendency for a lowering of rates on Treasury Bills and an increase in rates of short-bonds, yes.

2741. Then on the last sentence: "The partial withdrawal of the banks from the gilt-edged market . . . would have consequent damage upon the success of funding". If one is thinking of funding as the replacement, of short-term debt held by unstable holders, by long-term debt held by the general public, surely this real funding would not be damaged?——The withdrawal of the banks from the gilt-edged market would mean that what might otherwise be a powerful influence on market prices to go upwards (when funding is facilitated) would be removed; and the contrary indeed might take place: prices might sag.

2742. But if you are aiming at controlling the credit system in the interest of tightness, surely this movement would be in accordance with the aims?——*Mr. Mynors*: As I understand funding we would sooner sell a long-dated security than a short-dated, but we would rather sell a short-dated than no security at all. If you get the banks out of the short-dated market you will not encourage the long and medium market.—*Mr. O'Brien*: If the banks are not there the general tendency to go forward will not be so strong, and we rely on that general tendency to sell, when we can. But neither short nor long can be sold if the market is not tending to move forward.—*Mr. Cobbold*: If the point is whether the fact that the banks were inclined to be sellers would have an adverse effect on the general receptiveness of the longer-term securities, I think it would—*Mr. O'Brien*: The simple one of more sellers than buyers instead of more buyers than sellers.

2743. *Professor Cairncross*: Is the argument that the banks would simply move away from medium and long-term bonds into bills, and that would be a weakening element on the market?——*Mr. Mynors*: Certainly it would be.

2744. Whether it is the kind of weakening element you might want to see if you were going to fund is another matter?——I would think not.

2745. *Professor Sayers*: If there were this development it would be open to the authorities to say: "The market needs for short-term bonds are not what they were. We can make the banks hold more Treasury Bills. To the extent that they decide they would rather hold Treasury Bills than short bonds we can make them hold those Bills firmly by raising the liquid assets ratio". You would then have a position in which the banks were holding just as much of Government debt as before. There would be no excess of short-term bonds on the market except what the authorities were perfectly able to take up as the result of this issue of more Treasury Bills, but the final result would be a tighter holding of the banking system than before. Why should there be "damage to the success of funding"?——*Mr. Cobbold*: I think the insurance companies and all the others would be less likely to buy longer stuff if they felt the clearing banks were either out of the market or selling.—*Mr. O'Brien*: I think you tend to ignore the effect on general market sentiment of the conduct of the banks.—*Mr. Cobbold*: As a matter of experience, I am frequently told by my expert advisers that it makes an enormous difference to the general state of the gilt-edged market whether the banks are known or thought likely to be in that market in either direction. That has been so over a period of years. If that has been said in my room once over the last ten years it has been said many hundreds of times.

2746. But that is in a system in which the banks are big holders of bonds and are liable to vary those holdings; so of course it matters. If you had the short holdings of the banks either stabilised by their inclusion in their liquidity ratio or replaced by Treasury Bills which were so stabilised——?——You would have a 60 per cent. liquidity ratio.

2747. And the banks would not be in the market on either side?——*Mr. O'Brien*: I do not think that follows. It is for the banks to say what they hold, but I should doubt whether only short bonds.

2748. Yes, the banks do hold over-five-year bonds, of course; my point is that we are not thinking here of any system whereby they would be forced by the introduction of this measure of liquidity control to be sellers in the market in a way in which they are not now?——*Mr. O'Brien*: No, but the general atmosphere in which they would then live would encourage them to keep very close to the shore for the fear that requirements of liquidity would be raised at any moment and they would have to comply.—*Mr. Cobbold*: This system would surely make them more likely to be sellers.

2749. *Chairman*: Are there any questions on the advances ratio?—*Professor Sayers*: The point made at the beginning of paragraph 19 must be, I suppose, a great embarrassment in the present set-up?——Certainly.

2750. *Chairman*: In effect what you are saying is that banks would have thoroughly to re-arrange their business if the thing was to be possible at all?——Yes.

2751. *Professor Cairncross*: Does the Bank of England know how much of overdraft facilities are undrawn?——We have no formal information. From time to time we make some inquiries, and we have a good deal of informal information on the subject.

2752. *Sir Oliver Franks*: I think our impression is that the amount taken within the limits is usually about 60 per cent., although obviously it will vary a bit; but it is of that order?——50 to 70 per cent., I would say from my purely personal and informal experience.

2753. *Chairman*: Then in paragraph 20 you make the point:

"... advances are a banking asset whose nature would not for long permit uniform direct control to be applied. There would be concern that, if only through accidents of timing, the less essential needs of industry and other borrowers might be met while the more essential were excluded."

You would be up against the ceiling without knowing what was coming along:

"The authorities would most probably be presented with many instances in which temporary and special relaxation of control was sought to meet hard cases."

Do you not get more or less that difficulty under the present system?——Yes, we do, though it is a little less precise and definite; there is a bit more play in the present system.

2754. *Professor Sayers*: It must be cumulatively increasing as time goes on?——Once you have pressed out the inessential advances, yes. That is one of the points we have stressed in an earlier paper.

2755. *Chairman*: Then we come to the advances limits. I do not know whether we need to discuss that in great detail, because that is in effect what we have been going into. Then there is the investment ratio?——This is just the other side of the advances ratio which we have already been talking about.

2756. You say in the footnote that specific investments, such as securities issued by the F.C.I., the I.C.F.C. and the Agricultural Mortgage Corporation should be included within the definition of permissible investments. It would become, through them, an indirect way of financing the activities, industrial or agricultural, which they support?——Yes; it would be regarding those as, so to speak, semi-public, and excluding them from the banks' direct personal customers; in effect putting them and their loans in the public sector.

2757. *Professor Sayers*: Accepting the last sentence of this paragraph 23, would you agree that this is the kind of instrument that might very well be most appropriate for a once and for all change following some easing of the situation that had led to excess liquidity in the banking system? Supposing at the end of the war instead of fearing, as I think we nearly all did, that sooner or later there would be a post-war slump, we bad envisaged continuing boom, there would have been very strong argument for saying that such and such a part of the banks' holdings of Government securities should be frozen as a once

and for all post-war measure. That is the kind of occasion for this kind of measure?——Yes. I think it would have been a possible alternative treatment of the excess liquidity at the end of the war; it would have done something more dramatic about it than was done.

2758. *Chairman*: Would you accept that this method would present itself as perhaps the most naked form of compulsory lending to the Government?——Treasury Deposit Receipts are top of my batting list for that purpose.

2759. This next to T.D.R.s?——Yes.

2760. Do you envisage this as a variable ratio?——Yes; all of them would have to be I think, if they were to be effective methods of control at all.

2761. *Professor Cairncross*: I notice you speak of debentures as a possibility in paragraph 22. We have come a long way if you can visualise the commercial banks of this country putting large sums into debentures?——I can visualise them doing a lot of these things under these controls.

2762. *Professor Sayers*: Or even if you gave them a chance to compete?——To a lesser extent.

2763. *Lord Harcourt*: Are debentures so very far off? When we were talking about advances you said they were not readily callable?——*Mr. Cobbold*: I believe that nominally all advances are callable at sight.—*Sir Oliver Franks*: With the exception of a small and defined class of medium credit and term loans; but it does not follow, as has just been said, that they could all be called with success.

2764. *Professor Cairncross*: It is not part of your theory that the British banks should remain liquid on the assets side?——I am not thinking of any changes in that respect.

2765. *Chairman*: Then we come to the cash ratio. I am not sure that I follow. So far as you have a minimum cash ratio, the cash below the minimum is represented by a frozen balance with the Bank of England?——In effect, yes.

2766. What happens to it? Is it just a dead balance?——*Mr. O'Brien*: It would not be dead; it would operate. After all, the banking system would collapse if it did not. The bankers would have to maintain it by one means or another.—*Mr. Cobbold*: They could draw on it at any time, but would have to replace it.

2767. They must never get below that amount of the balance?——If they showed signs of it Mr. O'Brien or Mr. Hollom would ring them up to see that it was replaced.

2768. *Professor Sayers*: They must get below their 8 per cent. in the course of the business?——*Mr. O'Brien*: We do not look at it until the end of the day's business.

2769. If they need not always have 8 per cent. for their business, might it not just as well be 0 per cent?——*Mr. Cobbold*: That would be very awkward for their day's business.

2770. For their day's business 2 per cent. would be adequate?——*Mr. O'Brien*: Not always.

2771. *Mr. Jones*: The 8 per cent. cash reserve is held partly at the Bank of England and partly within the tills of the banks themselves. Have you any means of determining whether 8 per cent. is being maintained throughout, in view of the fact that you only control part of the 8 per cent?——We know the amount in their tills weekly, so that we have not a complete daily picture.

2772. What is the proportion roughly in tills?——*Mr. Cobbold*: Tills tend to be slightly higher than deposits at the Bank, depending on the season. At this time of the year they are going up in preparation for Christmas.

2773. *Chairman*: In fact they have the day's business to play with? As long as they finish with the right percentage at the end of the day, that is what is required of them?——Yes. I do not believe it could be otherwise.

2774. *Mr. Woodcock*: Is it not really the end of the week?——*Mr. O'Brien*: We are in daily contact with the banks; we know what cash they have with us, but not what is in their tills. They know what they have in their tills, and knowing that they tell us what they should have with us in order to keep the 8 per cent.—*Mr. Cobbold*: At the close of each day they have 8 per cent. in tills and deposits at the Bank.—*Mr. O'Brien*: Professor Sayers expressed some doubt about that at an earlier session [Q. 10-13]; it is no doubt a question that he will want to ask the banks in due course. But our understanding is that it is a daily arrangement and not a weekly arrangement.

2775. The contact between the Bank and the banks depends whether or not the percentage with you had been overdrawn. So that there is a good deal of flexibility with regard to the other part of the cash ratio as far as the banks themselves are concerned?——It is not true to say our contact with the banks on this subject only takes place when they are keeping less with us than they should. It is much more regular than that. We are in contact with them every day in order to make sure that we know what the figure should be.

2776. *Chairman*: In paragraph 25 you are laying down the necessary conditions for a compulsory cash ratio to operate?——*Mr. Cobbold*: We are really there back to the question Professor Cairncross was asking me earlier on, when I said any interruption of this arrangement would mean very radical changes in the whole system, as we say in paragraph 26.

2777. *Professor Sayers*: In the middle of paragraph 27 it is stated that "outside" holders of Treasury Bills do not necessarily hold bills to maturity. Has experience shown that they do actually sell bills before maturity in any quantity?——*Mr. O'Brien*: One particularly big class of holders of Treasury Bills, overseas official holdings, sell a great many.—*Mr. Cobbold*: And one or two of the large industrial companies.—*Mr. O'Brien*: One reason why such people hold them is because they can be sold so readily.

2778. Is there any forward market in Treasury Bills?——No.

2779. *Chairman*: The sum of all these arguments in these paragraphs is really that you hardly think a compulsory cash ratio is feasible?——*Mr. Cobbold*: It is a non-starter.—*Mr. O'Brien*: Subject to the need to finance the Exchequer's requirements.

2780. *Chairman*: We know your attitude about Ways and Means Advances; then we come to Treasury Deposit Receipts, to which I think we would like to give fairly close attention, and to the special deposit scheme. Has anybody got substantial questions on these last two portions?

2781. *Mr. Jones*: Would the financial and economic effect of the reintroduction of Treasury Deposit Receipts be the same as funding a substantial amount of floating debt?——*Mr. Cobbold*: I think the general effects would be very different.

2782. The introduction of Treasury Deposit Receipts would put upon the banks a responsibility for taking Treasury Deposit Receipts at fixed rates of interest and holding them. In that way would you not have a less liquid situation in respect to the monetary position in the country?——That depends on the definition of liquid and liquidity. If Treasury Deposit Receipts were excluded from a formal definition of liquidity, it would be less liquid. I think my bother about Treasury Deposit Receipts is that they were intended to be and would still be primarily a means of pulling money out of the banking system in order to push it back to work again. I regard them as an extremely inflationary instrument.

2783. *Mr. Woodcock*: If it was not pushed back, what would be the difference between the Treasury Deposit Receipts and the special deposit?——Treasury Deposit Receipts would appear to be and be a borrowing operation and not a credit operation. That is what they were in the war and would be again.

2784. Is that because of the name?——No, because of the fact.

2785. I am not clear if there is any necessary difference between an instrument which you would call a Treasury Deposit Receipt and a special deposit with the Bank of England. Could not either be used as a credit instrument?——I am not saying that both could not be used

as such; I am saying that a Treasury Deposit Receipt is primarily a borrowing instrument, and I believe we ought to go for something that is primarily a credit instrument.

2786. *Professor Sayers*: Surely if the Treasury were provided with money by Treasury Deposit Receipts the money it received on Treasury Bills would be so much the less?——Unless they used more money totally, that is so.

2787. But that qualification would apply to any of them?——Yes.

2788. Is it not the name?——No, I do not accept at all that it is the name. It is a direct borrowing instrument by the Treasury from the clearing banks.

2789. So is a Treasury Bill?——No, a Treasury Bill is bought in the market.

2790. In the market, which has taken them up on the understanding that those it cannot sell to the clearing banks and cannot hold with other money it can sell to the Bank of England?——*Mr. Mynors*: They can sell them to lots of other people.

2791. *Professor Cairncross*: There are two points of difference which you have not elaborated; one is, is it not, that the special deposit would not automatically be invested in Government bonds?——*Mr. Cobbold*: Not automatically, but probably to a large extent. There would be hopes of investing it in Treasury Bills or Government short-term stock.—*Professor Cairncross*: That is my second point.—*Mr. Cobbold*: There would be a degree of flexibility.

2792. Do you conceive of the Treasury Deposit Receipt as a single type of obligation for a stated period of time?——It is direct Government borrowing from the clearing bank system.

2793. Which is the point you are labouring strongly? Is it the invariability of the form of investment, the automatic obligation to turn over the money, or something else?——The point on which I am laying most stress is the fact that the T.D.R. is in the nature of a blank cheque on the clearing banks. It is an instrument by which the Treasury decides itself how much it is going to extract from the banks.

2794. *Mr. Woodcock*: What if it were a once for all operation?——That would be a forced funding; that is an entirely different proposition.

2795. *Mr. Jones*: Is there anything against that?——It is, as it were, insisting on the banks buying Government securities in replacement of Treasury Bills, in contrast to selling long-dated securities to the banks' customers. The ideal form of funding has the effect of taking bank deposits down to match; this would leave the debt entirely within the banking system.

2796. *Professor Cairncross*: Is there a third point of difference, that you are looking upon the T.D.R. as a recurring weekly deposit, whereas you are looking on special deposits as highly intermittent?——Certainly; we have said that it would be for consideration on the same sort of basis as Bank Rate.

2797. But these three points of difference are differences more of form than of substance; the two things are not so very much apart in actual operation?——They are very different because of their intermittency; but the major point in my mind is that T.D.R.s are a blank cheque by the Government direct on the banking system.

2798. *Chairman*: There is no other instrument you have outlined that appears to you quite in that way?——There are varying forms with a rather similar effect, but I regard this as the most blatant example of that.

Chairman: I think it would probably be most satisfactory if we broke off now. We might come back to this at a later stage.

(Adjourned until Tuesday, 3rd December, 1957, at 10.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTEENTH DAY

Tuesday, 3rd December, 1957

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	W. E. JONES, Esq., O.B.E.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.B.	PROFESSOR R. S. SAYERS, F.B.A.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E. (Questions 2799 to 2903 only).	SIR REGINALD VERDON SMITH
	MR. R. T. ARMSTRONG, *Secretary*
	MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary, of H.M. Treasury, and SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section, H.M. Treasury, called and examined.

M. J. THORNTON, Esq., Deputy Principal of the Statistics Office of the Bank of England, called and examined.

2799. *Chairman*: May we take up your paper on debt management*?——*Sir Roger Makins*: Before you begin your questioning I should like, if I may, to say a few words relating to the scope of the evidence which the Treasury witnesses will be able to give you. When I made my opening statement to you on 10th September I described the relationship between the Treasury and the Bank of England as follows: "In broad terms the Treasury looks after the public debt and the Bank looks after the money market." But loan operations affect both the debt and the money market, and to a large extent, therefore, are the joint responsibility of the Treasury and the Bank.

Now the scope and the objectives of the loan operations are dealt with in Parts III and IV of this paper, and we will do all we can to help you insofar as your questions are directed to matters for which the Treasury is responsible. But where the questions relate to actual market operations and market practice, we shall suggest, if we may, that the competent witnesses are the Bank and not the Treasury. We will go as far as we can but there may be one or two points on which we shall ask that the Bank shall be questioned.

With regard to the statistics given in this paper the Bank of England have provided the particulars about the distribution of the debt between holders in Appendix C and Mr. Thornton from the Bank of England is in attendance today to answer any questions on these figures.

On another point this paper deals with debt management under existing conditions and using the monetary system as we have it in operation today. It does not consider the different conditions which would exist if the system were modified, for example, if alternative monetary tactics were adopted for the regulation of bank credit. The Treasury is concerned with this problem, both because of the Government's responsibility for maintaining the balance of the system and therefore for controlling the supply of money, and also because the adoption of such techniques would result either directly or indirectly in compulsory lending to the Exchequer.

I hope you will find it convenient if the Treasury witnesses confine their evidence on the paper before you to the management of the debt under the existing system, and allow us to give separate evidence on debt management and credit control in a modified system. We are considering whether to submit a separate paper to you on this; but the subject has been well covered by the paper on "Some Possible Modifications in Technique" already submitted by the Bank of England, and we would hope to take this paper as the basis of our own evidence.

2800. Do you want to put in any suggestions of your own about particular alternative techniques that differ from those in that paper?——Not necessarily, but to make some comments on that paper at this stage. It will probably be sufficient if you permit us to make a statement giving such comments as we wish to make, and then we could answer any questions on that statement.†

2801. I think it would be best if you put in a statement about it when you have had time to think it over.——*Sir Oliver Franks*: If the Treasury are going to prepare a statement for us I wonder whether they would be willing to comment on one very general point which arises in this connection. The various possibilities explored in the Bank of England paper are all differing possibilities of the control of bank credit mostly by means other than price; that is to say they are differing forms of direct control. In the present system there is some degree of control by price (i.e. Bank Rate) and there is a degree of direct control, that is to say, the restriction of advances in the various forms it has taken over the last few months. Quite apart from the views you may have on the relative desirability or undesirability of the different possibilities, it seems to me there are two general issues: one is whether as a matter of policy measures like this are desirable at all; and the second is whether as a matter of expediency and practice in the foreseeable future you expect to be able to dispense with them. If the answer on the second question were "no", then the consideration of the various possibilities becomes practical and urgent; if the answer to the first question were "yes", then it becomes perhaps rather more general and theoretical?——May we think that over?

2802. *Chairman*: On the debt management paper I understand it would be convenient for yourselves and the representative of the Bank of England if we started with questions on the three appendices A, B and C.——*Professor Cairncross*: May we begin by asking what statistics in this paper (not just in the appendices) have not previously been published?——*Sir Edmund Compton*: The whole of Appendix A is already published. The matter in Appendix B is mostly published, although not I think in this arrangement, save for the distribution of non-market and market Bills, which is new, though not new to this Committee because you have already had that in other evidence. The information in Appendix C is largely new. The sources are described in detail in the notes; I will ask the Bank of England representative to answer detailed questions on that. In the body of the paper the information in paragraph 5 on the holdings of the Bank of England Issue Department analysed by maturity is new. Similar information for the National Debt Commissioners is derivable from their published annual reports, though not for that particular date, 31st March. Finally the tables in paragraphs 29 and 30 are not published. That in paragraph 29 about Exchequer financing in the market is again a reproduction of new material that we gave to this Committee in the Exchequer financing tables, while the figures of the Issue Department's

* Memoranda of Evidence Part II No. 10. As a result of this discussion certain revised and additional material was supplied, which has been included in the published version of the paper and in the Appendix to Part II of the Memoranda of Evidence.

† See Memoranda of Evidence Part II No. 13 and Qns. 3226 to 3308.

3 *December*, 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., SIR ROBERT HALL, K.C.M.G., C.B., and MR. M. J. THORNTON. [*Continued*

net purchases and sales in paragraph 30 are published for the first time.

2803. One of the difficulties with which anyone studying the figures of National Debt is concerned with is that different series seem to be used in different contexts. I think that generalisation would apply to this paper, especially taken in conjunction with the Bank of England submission on "Principal Changes in the British Monetary System since 1931." Your figures as given, for instance, at paragraph 3 are very difficult to reconcile with the figures given in Appendix B. This is particularly true if we take the total for market securities and small savings; as far as I can judge "small savings" means something different to different writers. Is it possible for you to indicate to us, either now or later, just what is the significance of including this breakdown in paragraph 3, when an alternative analysis is given first, in the Bank of England's paper we have, and secondly, in Appendix B?——I would rather not reconcile these figures with those in the Bank of England paper, which I am afraid I have not before me, without notice. I would like to begin by reconciling the table in paragraph 3 here with the table in Appendix B of which it purports to be a summary. The only difference is that in the summary in paragraph 3 we have adjusted the figures for small savings. In Appendix B small savings are the small savings securities, that is to say, National Savings Certificates, Defence Bonds and Premium Bonds. That excludes the savings banks deposits because in Appendix B we have shown the securities held by the Savings Banks Funds against savings bank deposits under the heading "Market Securities" in so far as they are market securities. But we thought that, for the purpose of showing the distribution of the debt in broad terms today as it is compared with 1935, it would be right to attribute to the small savings holder the whole of the debt that is owed to the small saver by the Government. For that purpose it would be misleading to count against market securities repayable, say, thirty years hence a sum which is largely, so far as the Government is concerned, repayable on demand because the savings bank depositor has a right to repayment. So in paragraph 3 "small savings" includes the savings banks deposits, and "market securities" excludes the Savings Banks Funds.

2804. *Professor Sayers*: So when we are thinking of the holdings of the public as distinct from the internal holdings of Government Departments, it is paragraph 3 that gives the right figure, not Appendix B?——Appendix B is the crude figures analysing the recorded and published totals of different classifications of the debt; in terms of what the Government owes the public, the correct picture is the picture in paragraph 3. On the other hand, for certain other purposes I believe that the other classification may be more useful, for example when considering the constitution of the official funds.

2805. *Chairman*: To which arrangement does paragraph 10 of the Bank's paper correspond?——It corresponds to our Appendix B.

2806. *Professor Cairncross*: The market securities differ by about £80 million?——*Mr. Thornton*: There is a stock of a marketable character, not on the market, at £78 million which is not in the Treasury paper but is in that of the Bank of England.

2807. I should welcome some note on the Bank of England's figures and the Treasury figures. It is extremely difficult to see how they tie up.—*Professor Sayers*: It is of very questionable value that we should publish these figures without explanation of how they are to be reconciled with other figures to be published. I should much prefer a paper on national debt statistics that cleared the whole matter up and gave a starting point for a future series. Is it possible to have that?——The figures that are before you now have been primarily provided for the purpose of illustrating the paper; on that basis there are bound to be some discrepancies. It is perhaps another question what basis of figures might be adopted for a continuing series after the publication of these figures in your proceedings. If I may take one particular point, it will be noticed that in the Bank of England paper the starting point is 1931, whereas the starting point in the Treasury paper is 1935. The starting point of 1935 in the Treasury paper was chosen of set purpose because this paper is linked with our Paper 6 on Monetary Policy where, in dealing with the debt, we used 1935 as the starting point. It is for consideration which would be the better starting point, but we were concerned as part of the exposition here to have statistics which were in line with what we had given you already.

2808. *Professor Cairncross*: In Appendix C you use 1939 and 1956, so that we neither have 1931 nor 1935?——That is partly a question of availability; the figures in Appendix C are those that the Bank of England have been able to provide in the time and from the material available.

2809. Is there any possibility of extending the 1939 figure backwards to 1935, for instance, to give us some figure in common with pre-war data?——*Mr. Thornton*: I shall have to refer that question.

2810. If monetary policy and debt policy are as interwoven as they appear to be, it is important that the information available should be as complete as possible. The general impression appears to be that the data on the debt are extremely difficult to interpret and relatively inadequate in comparison, say, with data on monetary policy. Therefore we should welcome a paper on the statistics of the national debt that would try to present us with a consistent series of what you would regard as the figures of most interest and importance in relation to monetary policy?——*Sir Edmund Compton*: We will certainly look at that. It will require some pretty detailed study; we have produced here a good deal that will now be published for the first time, and for that reason special care will be necessary to provide the basis for a continuing series, if it is decided to make a continuing series of any of these new material.

2811. *Chairman*: I think it is only fair to be as concrete as we can in asking you: could Professor Cairncross give some indication as to what the paper is to show?

Professor Cairncross: This is a matter on which we may have recommendations to make in due course; I think in the meantime we should like you to make sure there is a consistent series before us which would be of a character which could be continued in the Monthly Digest of Statistics or the Statistical Abstract and be available continuously before the public. The data would be along the lines you have been supplying to us, but as we have them now they are unsatisfactory; this will develop, I think, more clearly as we go on.

Professor Sayers: There are two points: internal consistency, and the relation to the linkage between monetary operations and debt policy.

Sir Oliver Franks: I think we should try to be a little more explicit. This is not a field in which I am in any degree expert, but is what falls under Professor Sayers's second heading in part the distribution of the different kinds of debt among the different sorts of holder? I am not clear whether that is the type of information he is suggesting is required under his second heading, so that one may bring the facts about the management of the debt into relationship with the problems of monetary policy, or whether he has other considerations in mind.

Professor Sayers: That, and the broad maturity breakdown of official holdings, and the reconciliation of the debt statistics with those that are included in current series to be used by people in commenting on monetary action.

Sir Edmund Compton: If I may take the two points: first, internal consistency. This may be rash of me, but I do not think that there is a great deal to clear up here either as regards what we have given you or as between the Treasury and the Bank of England. There is the point about the base date; on that, frankly, we have adopted the one on which we could report to you in time. We have had to use the material that we had; we expected a certain amount of inconsistency there but felt that, so long as we provided you with a pre-war base date we had taken you some way. For a continuing series that is something that would have to be cleared up. The only other point on internal consistency is about the treatment of "small savings" and the securities in the Savings Banks Funds; that is a statistical conundrum on the national debt which we have to face in Parliament every year. We can offer you the figures in either form, as we have shown you.

The second point, about what can be done to provide first the Committee and then the public with a rational basis for continuing statistics using the new information which we have here, needs a good deal further consideration before we could put proposals to you. We have produced some of the new information here for the first time and rather hurriedly, and we are conscious that some of it is only before you for what it is worth; for example, we are under no illusions about the gaps in Appendix C in its present form. I doubt whether Appendix C provides the basis for a continuing series, quite apart from what may be said to this Committee by some of the contributors to Appendix C.

2812. *Professor Cairncross*: The information on Appendix C is on your own showing as much as you have, though probably not as much as you would like, on certain important problems arising out of the distribution of the national debt. It is a little alarming, if the information shown here really does represent the most up-to-date and complete information that you have, that, for example, the holdings of the banks and the discount market should be provisional for 1956. Is it impossible to present in respect of the banks of the country, which you regard as extremely important in monetary policy, their current liquid position?——*Mr. Thornton*: For this Committee we asked those particular bodies to provide us with better figures than we are accustomed to have. These are the ones we already had available, and are marked "provisional" to put you on notice that we shall send the Committee a series of corrections. That applies to 1939 as well as to 1956.

2813. Then there are no published figures for the Scottish banks as a whole. Is that not the position?——*Sir Edmund Compton*: You are speaking about the full figures; that may be right. I should perhaps add that there are returns to the authorities.

2814. I accept that; but from the point of view of public comment this gives a picture of holdings of market securities by the banks at this moment, which may not be the general impression, and could not be arrived at without some research. The Scottish banks have doubled their market securities since before the war; that would seem a material difference which is generally not brought out in the published presentation. There are, moreover, banks for which figures are not given here, and one would like figures to show what part they play. Do you have data for all the banks?——*Mr. Thornton*: Not in the form which we could use in this table.

2815. *Professor Sayers*: Are the people responsible for determining policy in possession of those figures?——I should have to ask you to direct the question to the people concerned.

2816. *Professor Cairncross*: In item 10 insurance companies, other public companies and provident societies are all grouped together, although they appear to have been estimated separately. There is no estimate for superannuation funds, but I take it there are some figures for their holdings of national debt?——The three components, as you say, have been estimated separately, but we do not regard the estimates as sufficiently reliable to show separately on a table.

2817. This is a serious matter. If we are investigating liquidity, it is very important to know what changes are occurring in the liquidity of public companies. Is it impossible for us to have even a rough analysis, based on balance sheets, of their holdings of Government market securities?——*Sir Edmund Compton*: The figures here overlap to some extent with the work that is in preparation for this Committee on the financial assets of companies and other holders of securities.* Those are the financial assets of every kind, not only Government debt, but I am wondering whether in that connection we cannot try to see whether there can be provided some more detail about the holdings of debt in the different categories which are lumped together here.

2818. *Chairman*: Appendix C is made up, as I understand it, of all the information with respect to these matters that is available to the Bank of England?——*Mr. Thornton*: We have used everything we have.

2819. There is no pocket of the Bank which has not been drawn upon for this purpose?——No.

* See Memoranda of Evidence Part III No. 1.

2820. *Professor Cairncross*: Have you used the registers of the national debt, which should show who are the proprietors of the national debt?——The registers do not generally show the beneficial ownership of the debt, and have not been used in the compilation of this.

2821. *Professor Sayers*: Has any attempt been made to analyse the registrations on a sample basis in order to see to what extent the beneficial ownership seems likely to be obscure? In the knowledge of the Bank are nominee holdings, for instance, only a very small or a large part of the registered holdings?——*Mr. Thornton*: Investigations have been undertaken, but I am afraid I am not able to answer questions about them under my instructions today. —*Sir Edmund Compton*: I would like to add, from the standpoint of the Treasury, that we have considered with the Bank of England what is the possibility of providing information, whether for publication or indeed in confidence, about the distribution of the debt, which might be based on the register. The considered opinion of the Bank, expressed to the Treasury after looking into the nature of the register, was that the register should not be used for that purpose. I understand the reason to be that the register is compiled for the purpose of debt management, and for that purpose it is not necessary for the names of the holders to show what sort of holders they are.

2822. *Chairman*: It is *prima facie* impossible to know whether you are looking at a nominee or not when you look at the register?——Even if it is not a nominee you cannot tell by the name whether it is an industrial company, a finance house or even a private person.

2823. On the other hand do not the banks themselves identify nominee holdings by the actual names of their respective holding companies?——Yes; if one went over the register from A to Z like a telephone directory, one could pick out certain holders whose names identify them as being in certain classes of holder, but my understanding is that that only happens by luck, and that you could not get from that results which would be of any statistical validity.

2824. *Professor Cairncross*: Is the difficulty of the character you are now describing, or is it that you are not empowered to use the register to make a simple analysis?——The difficulty I am now trying to describe is the difficulty inherent in the nature of the register. A separate question would arise about the publication of results from the register if the results were obtainable; but that second question does not arise.

2825. Let me take one very specific question: what other forms of overseas holdings of the debt are there other than appear under item 11? Are you in a position to make any estimate of that?——*Mr. Thornton*: The foreign holdings are particularly susceptible to this difficulty, because a great many of them are held in the name of the London bank of the foreign holder, and show up merely as an address of a London bank.

2826. But you know the exact holdings of London banks; if you had the entire holdings of the London banks, there would be no difficulty in deciding what they held for themselves, and so you could judge how much they hold on behalf of their clients?——*Sir Edmund Compton*: We have said in paragraph 5 of the paper that the statistics in Appendix C in that regard go as far as we can go, and we have suggested, that it is for the identifiable holders to say whether they can give more. That applies in particular to the London banks.

2827. In other countries the banks are compelled to provide much more information than is provided to you in this country. Do you contemplate that they might make some return which would make available to you the maturity distribution of their holdings?——There is a distinction here between returns the banks make for publication and information they provide to the authorities for management purposes. I think the Bank of England have given evidence to this Committee about the extent to which in confidence the bankers tell them, when the authorities need to know, what their portfolio consists of. Our position in this country is that under the Companies Act there is special dispensation to the banks and the shipping companies about the information they provide and publish.

3 December, 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., SIR ROBERT HALL, K.C.M.G., C.B., and MR. M. J. THORNTON. [Continued

2828. *Chairman*: That does not actually relate to their holdings; it relates more to their reserves?——There is a link between what they bold in investments and what they hold in reserves.

2829. The exemption that the Companies Act gave was based on the statement that it would shake the foundations of the banking system if they were compelled to disclose inner reserves. The question of what they hold does not directly relate to that?——This is a point on which I would rather let the bankers speak. One can see that the argument might run the other way: the bankers might feel that people would have more confidence in them rather than less if they gave more particulars about their investments; but it is not a question that I feel I have any right to answer.

2830. *Professor Sayers*: The Treasury is responsible through the Chancellor for debt management and through that for monetary policy; it surely is in the Treasury's interest in the broadest sense that there should be well-informed public discussion of these problems. If it is necessary for well-informed discussion that facts should be made available to the public which are now known only to the bankers and to certain people in the Bank of England, does it not follow that dislike of the bankers for publicity on these points must be overruled?——I agree that well-informed discussion is of assistance to the authorities in debt management and monetary policy, but I do not follow you in thinking that this particular information is essential to that well-informed discussion. There have been points in public information about banking statistics where we have felt that further information was required, and have seen that it was published. The instance I have in mind is that of bank advances, where we felt that the progress of credit policy could not be properly understood unless one separated out the figures of advances to the nationalised industries from the advances to other customers. When the bankers themselves did not publish that figure separately the Treasury published it on their behalf, and that is the regime that we now have.

2831. You now say that it is not necessary; you began by saying you thought the bankers would not like publishing it. Which is the reason?——I would prefer to know first what the bankers would be prepared to do and what their reasoning was. This particular piece of information is not one whose publication we have thought of as essential for the purposes of either debt management or monetary policy.

2832. Does that mean that, in considering the problems of debt management yourselves, you do not worry about it?——I made a distinction earlier on between what we ourselves either know or can find out by inquiry and what is known to the public.

2833. This distinction is at the root of the matter. If you are to form policy, you judge that you need certain information. If there is to be sensible public discussion of that policy, must not the public have the same information, unless there is quite overwhelming reason to the contrary in a particular matter?——I meant to relate it to the particular problem of debt management. For example, it is certainly useful for us to know what the bankers' holdings of securities are for the purpose of dealing with a piece of maturing debt, because that is material to its replacement. We have not felt it necessary for framing the terms of an offer of a conversion security or for successfully selling it, either on the occasion or afterwards, to ensure that the public knew in detail who were the holders of the maturing security, whether in the banking system or outside it.

2834. *Professor Cairncross*: We are discussing liquidity, and liquidity is a function of the maturity distribution of the national debt. If the maturity distribution of the national debt is not known how can one talk of it?——I was relating it to a particular problem of debt management.

2835. *Professor Sayers*: Let us relate it to that particular problem: do you feel that the issue of a new security or handling of a maturity never calls for any defence from the Government? Perhaps there have not been many cases of its being attacked, but surely these things should be defensible?——They should; in fact the Chancellor defends his debt policy in his Budget statement each year, and on occasion a defence, in the sense of an explanation of a particular debt operation, is made on the occasion of that operation.

2836. *Chairman*: Does not that lead one to wonder whether he should not qualify his critics before he makes his defence?——I am not conscious of the need for defence of it on these occasions. It is not as though the Treasury were operating the debt in the face of hostile criticism.—*Professor Sayers*: The hostility need not be there.

2837. *Sir Oliver Franks*: Is Sir Edmund perhaps distinguishing his persons a little too neatly? We have been told in evidence that in the very responsible position in the Treasury which he occupies he in fact is dealing with at least two things in relation to the Bank of England: one of them is the management of the debt and the successive operations which that entails, but the other, of course, is monetary policies as they may be formed in the Treasury as a whole. He has been giving these answers strictly as to debt management; he has been referring us to the way in which a particular operation of debt management would be carried out as the test as to whether certain information is or is not desirable from the point of view of the Treasury or from the point of view of the public. If he would consider his whole ambit then I think quite different questions arise. The sort of point which Professor Cairncross was putting about liquidity is at the basis of all considerations of monetary policy. In so far as the successive operations in the management of the national debt are clearly of the greatest possible importance in regulating monetary policies, it would appear that a detailed knowledge of the liquidity of the various institutions and persons concerned would matter very much if the management of the debt were more than a series of technical operations. I am sure Sir Edmund is in fact profoundly concerned with the policy aspects of these two things, and if he is I do not think it is so easy to get away from the questions being asked. So would you, Sir Edmund, abandon this distinctive aspect and talk more generally?——Certainly, Sir Oliver. From the standpoint of monetary policy clearly there is much that we would like to know and do not know about the distribution of the debt. I do not say that we do not find out the distribution of the debt in certain of these holders, and important holders at that; we have said we do. That is true as regards the bankers. But a big gap appears in Appendix C, mainly through our lack of knowledge of how the debt is held by a big class of holders. That is an ignorance that we share, if I may put it so, with the public, and if our information on that could be improved it would certainly help us in our job.

That is as regards what we know or would like to know; the question of what should be published as opposed to what we should get to know is a matter where other considerations arise. That is a point on which I am rather diffident about going forward until I know more about what the "victims" themselves have to say. There are certainly two considerations on which I am not ready to give an answer: the first is the readiness or otherwise of these people to go in for the returns and publication of these returns which would be involved. The second is one of policy (here I have reservations about speaking, because I am not sure that it is not for the Bank rather than for the Treasury), whether market management might not be impeded rather than forwarded by publication.

2838. Take Appendix C: has information of this character been given regularly, say, twice or four times a year, by the Bank to the Treasury in the past? Is this kind of breakdown part of the information which Treasury regularly has before it, or is it new to the Treasury as well as to us?——I need to distinguish between the different classes of holdings before answering that question. The National Debt Commissioners we know, of course, and the Bank of England Issue Department we know; the Exchange Equalisation Account we know; and as regards the nationalised industries and local authorities, I am not sure that not only do we know but that we provide the figures. As regards the London clearing banks, the figure is the published figure. The figures for the discount market are not regularly provided by the Bank to the Treasury. The Scottish banks we know; the figures

are embodied in a return that the Scottish banks make to the Treasury, so that we are the source of that. The other figures have been derived by the Bank of England Statistical Department from the sources that are described in the notes here: and as far as the Treasury is concerned, that has been an *ad hoc* exercise; it has been done for the purpose of this paper.

2839. And therefore it is done for the first time?——This analysis has been done *ad hoc* on one or two occasions in the past, but it is not a regular service. Perhaps I should just add that we have and can use the same sources as the Bank have described for obtaining that information.

2840. I believe the clearing banks return regularly to the Bank of England their holdings of different Government securities in different maturity groups?——*Mr. Thornton*: Not to my knowledge.

2841. Then is it the case that the holdings of the clearing banks, in the categories, say, nought to five year bonds, five to ten, ten to fifteen, or whatever the broad categories may be, are not known in aggregate either to the Bank of England or to the Treasury?——*Mr. Thornton*: There is no regular return, to my knowledge; but it is not true that we do not know.

2842. When one is trying to think about policy in regard to the management of the debt, as opposed to the successive operations which the movement of the calendar makes necessary, there is certain information which I should have supposed was necessary, to the Treasury as the source of policy as well as to anybody else, if there was to be a policy and a strategy in the matter. Now the holdings of Government securities by the clearing banks change from quarter to quarter; I would have thought that was as material to the formation of policy in this matter as the holdings in different age distributions by other very large groups of holders would be. I was interested in whether, these factual pre-conditions of policy were present to the Treasury, because it seems to me there is a very important distinction between the practical management of the debt, as it is required from month to month, and any attempt there might be to have a policy of dealing with it as a whole, over a period of years. What breakdown does the Treasury have of the holdings of the clearing banks?——*Sir Edmund Compton*: We do not get a regular return from the Bank of England of the breakdown of the investments of the clearing banks.

2843. Am I mistaken in thinking that that kind of information is relevant to the formation of policy, both in the management of the debt and in relation to monetary matters?——It is certainly relevant, and on occasion, when we have felt we needed it, we have obtained that kind of information from the Bank of England; but it has not been the subject of a regular return.

2844. *Chairman*: Has the Treasury, as distinct from the Bank of England, the power to require from these various sections of holders information of this kind, or is it obtained, as it were, by their courtesy?——There are the special provisions of the Bank of England Act, by which we can put a statutory force behind a Bank of England request; apart from that, I am not aware of any legal powers of requiring information of this kind.

2845. *Professor Sayers*: That power is, of course, limited to any holder who can, for the purposes of the Bank of England Act, be described as a bank?——Yes. It has to be somebody carrying on a banking undertaking, who is named by the Treasury as the subject of a statutory request.

2846. *Lord Harcourt*: And that would still only affect the holdings of the bank for its own account?——That particular exclusion is written into the Bank of England Act; a banker cannot be required to give information about an individual customer's affairs.

2847. *Chairman*: If you, as the Treasury, concerned with policy, were avowedly given powers to acquire information, and, if you like, to make it public, some of your misgivings about the reactions of the people on whom it would operate would disappear? If you obtain things by goodwill and co-operation your attitude towards making that public becomes different?——Yes. I would have to go through this list in some detail before giving a really clear answer about the extent to which we have the powers of obtaining information, because some of the information here is derived from the statutory returns that companies make; then there are the provisions of the Friendly Societies Act; and both the building societies and the insurance companies provide statistics under statute which we have used for this purpose. But if the question is whether we have power to require them to produce particulars about so detailed a provision in their balance sheets as the maturities of their Government debt, we have not.

2848. *Professor Cairncross*: Item 3 of Appendix C refers to the Exchange Equalisation Account and other public departments. The figures given there, I believe, are new and unpublished heretofore. Are you in a position to tell us what the other departments are which are included there; and is there any specific reason why we should not have for 1939 the holdings of the Exchange Equalisation Account without the other public departments?——*Mr. Thornton*: The principal other departments in item 3 are the Paymaster General, the Postmaster General, H.M. Treasury, and the National Coal Board, which is a public corporation, not defined as in footnote A, and therefore falls into the category of "other public departments". There is a number of smaller bodies: the Ministry of Transport, the Charity Commission, the Metropolitan Police, the Ministry of Agriculture, Fisheries and Food, the Public Trustee, the Church Commissioners, the Supreme Court, the Ministry of Health, the Admiralty, the Board of Trade, and Foreign Compensation Funds.

2849. *Professor Sayers*: Why should there be such a large block of market securities? Are these largely to be ascribed to the Exchange Equalisation Account, or are they largely for the other public departments?——*Sir Edmund Compton*: We cannot, I am afraid, distinguish between the Exchange Equalisation Account and the other public departments. The "other public departments" include such bodies as the Public Trustee, the Church Commissioners, and I think that those two together account for a good deal of the item.—*Chairman*: The Ministry of Agriculture comes in, I think, as quite a large holder.—*Professor Sayers*: It is like adding cows to cucumbers.

2850. *Professor Cairncross*: Can you give us information about the basis on which the Exchange Equalisation Account is grouped in this category?——*Professor Sayers*: 1939 is now eighteen years away; are no figures to be given in respect of 1939 for the Exchange Equalisation Account?—*Sir Oliver Franks*: 1939 is, in most respects, more decades away than the mere number of years; it is another world. It seems to me that to be unwilling to publish the figures of the Exchange Equalisation Account for the years before the war, unless there are any factors of which I am ignorant, gets far too near mystery for mystery's sake. These arguments do not apply at all to this year, or 1956 or 1955; but when you are dealing with something which is as near pure history as the pre-war period, it seems to me that the information there is something which it is very unlikely could really harm the existing policies and operations of the Treasury. Would it not be very greatly to the benefit of all concerned if this element of sheer mystery was got rid of?——*Sir Roger Makins*: We have naturally looked very carefully into this, to see how far we could go to meet what we expected to be asked on this. The conclusion we came to was that we could not give the figures; but naturally in view of what you say we will give it some further thought.

2851. *Chairman*: Appendix C is confined to the two years 1939 and 1956. What are the real reasons for its being impolitic to give the Exchange Equalisation Account's holdings for 1939 and 1956? What would be the public mischief that would arise from publishing these figures in isolation?——I think it would disclose to a number of people, not necessarily here but abroad, how the Exchange Equalisation Account was made up and possibly how it operated.

2852. *Professor Sayers*: How does the maturity distribution of the Exchange Equalisation Account's assets give information to people about how the Account works, given

the fact that there is monthly publication of the gold and dollar position of the Account?——*Sir Edmund Compton*: This is a question which, relating as it does to our external policy in the operation of the Account, I am not sure that I ought to answer. The fact is that this figure of the effective sterling capital of the Account has been, of set purpose, kept a secret. It is revealed, under secrecy, to the Public Accounts Committee when they examine the Account each year, and, as we are at present advised, it is necessary to retain the secrecy.

2853. *Chairman*: I do not yet know enough about it to say that I appreciate the reason. What would it mean to the reader, except that, at the date you are taking, the assets which the Exchange Equalisation Account was capable of realising, if it wanted to use sterling to purchase foreign exchange or gold, were distributed in this way?——I think it is probably not so much the securities in the Account as the movement in these figures which we should be reluctant to disclose.

2854. *Professor Sayers*: Surely what the market is interested in is how much there is of gold and dollars in the Account, and that figure is published promptly after the end of each month. I am sorry, but I do not understand how the disclosure of the distribution between Treasury Bills and securities, of what sterling remains in the fund, gives the market any clue that would embarrass the authorities at all in the Account's operations?——I do not know that I personally can take it further than this: that when we were compiling this we felt that separate figures for the Exchange Equalisation Account and the other public departments would reveal a figure which has hitherto been kept secret. These figures have been compiled so as to keep it secret; but, in view of the fact that the Committee has today expressed the view that they would like to have it separated or, if that cannot be done, they would like to know why, we will look at it again. There is one further thing we would need to do before making any further disclosure, and that is to decide what is to be given to this Committee, in relation to what is to be given to Parliament for the purposes of Parliamentary control of the Exchange Equalisation Account.

2855. Parliamentary control in this context is for rather a different purpose; the Public Accounts Committee is not thinking of the relationship of these figures to monetary policy. We are. Is that not so?——*Sir Edmund Compton*: I do not put it higher than this at the moment: that, if a decision is taken to give this Committee a figure, which means that it is going to be published, it would mean a change of the basis on which the Public Accounts Committee examines the Account. Because of the official view that it should be kept secret, they examine it under quite exceptional considerations of secrecy at the moment. ——*Sir Roger Makins*: We will consider further what you say. I think the position is this: the Bank of England manage this fund on our behalf, and they operate from day to day. They have advised us that the disclosure of these figures would assist foreign and overseas persons who might be interested to gauge the way in which the operations of the authorities were conducted. I cannot explain to you the rationale of that view, but it is one which we have accepted and which Parliament has accepted; and for that reason we have after discussion and thought maintained this view in our paper which is now before you. If you wish to press us on the point, we will look into it again, and will endeavour to work out whether it is possible either to bow to your wishes, or to try to give you some rather more explicit reasons for the view which we have.

Chairman: We will have a word among ourselves here as to what we ought to press for, and then I will let you know.*

2856. *Professor Cairncross*: Now may I return to item 11 of Appendix C? The footnote tells us that it refers to overseas central banks, currency boards and "certain other official bodies." What other official bodies are meant?——*Mr. Thornton*: There are certain other bodies which are similar in character to central banks, in countries where there are not central banks; and there are also the I.M.F., the I.B.R.D., and the B.I.S., the international institutions.

* See Qn. 3223 and footnote.

2857. Would you like to hazard any guess as to what the non-official overseas holdings of British debt come to in addition to this £5,000-odd million?——*Sir Roger Makins*: No.

2858. A sixth of the British national debt is held abroad, in effect; is that not so?——*Sir Edmund Compton*: That appears to be the deduction which can be made from these figures.

2859. *Professor Sayers*: Can you not confirm it?——I could not confirm it, no.

2860. *Sir Oliver Franks*: Has the Treasury over the last two years inquired of itself whether it has all the statistical information that it thinks it should have if the problems of debt management in their relation to monetary policy are to be adequately settled? If I may, I will take you back to the war-time relationship between the Ministry of Supply and the Ministry of Production; it was important if you were in the policy department that you had all the facts and figures that the operating department had; otherwise it was difficult to lay down the policy for the operating department. Now in these matters, the Treasury is responsible for broad policy, and therefore I suppose it is extremely relevant to consider whether you have all the information you need in order to relate these two difficult aspects of your responsibilities together. Have you so inquired and, if you have, are you satisfied that you have all that you need, whether from the Bank or from any other source?——We are by no means satisfied that we have all that we need. We have been very conscious of the need for improvement of the financial statistics; if I remember rightly, two years ago there were remarks in Parliament about "last year's Bradshaw," and of the need to improve all official statistics. One should not press the simile too far, because we have felt, as a matter of debt management, and indeed of monetary policy also, that much of the information that one requires for current policy is available, to a larger extent than in other fields. The movement of bank credit, for example, is available month by month, whereas information about investment, and particularly investment intentions, was very defective indeed. It was for that reason that the first stage in the improvement of statistics related to investment, as the Committee will know. We had marked down for the next stage the improvement in statistics on financial assets before this Committee was set up, and the paper, which I hope will shortly be given to the Committee, on the financial assets of institutions represents work in progress that had been laid down, largely, I think, at the instance of the Treasury.

2861. *Professor Cairncross*: In paragraph 27 you explain that the Exchequer has advances outstanding to the tune of £4,719 million to nationalised industries, local authorities and both bodies. It is not clear whether the £4,719 million is in addition to the £3,292 million outstanding for guaranteed loans to the public corporations, or whether that sum is part of the £4,719 million?——No, they are separate. This paragraph relates to the Exchequer's actual assets, not to its contingent liabilities which are represented by those guaranteed loans. These are the actual sums which the Exchequer has on loan to the local authorities, the Post Office and, then, from the first, to the National Coal Board, and since last year, to the other nationalised industries also.

2862. If we amalgamate all the operations of the central Government, there are advances to various bodies, which could be taken as backed by assets of a roughly equivalent amount; there are in addition the nationalised industries' stocks outstanding, which are guaranteed by the Government, and are therefore, to all intents and purposes, a part of the national debt backed equally by assets of a roughly equivalent amount. If you add these together, you get a total of about £8,000 million, which represents real assets of some kind, and perhaps even understates the value of those assets?—Yes. There is what used to be called the dead weight debt; that is to say, the debt which has been used to finance deficits and nothing else. Then one can try out an alternative calculation of the debt and see to what extent there are revenue-producing assets behind it. If that is done, however, it is very hard to see how to deal with one block of debt which is included here, namely the local authority debt. If a local authority

has spent the money on building houses, is that to be treated as revenue-producing assets? From the point of view of the Exchequer accounts, the local authorities have to service the loans that we have made to them; and therefore for the purpose of debt management it is revenue-producing. On the other hand, I think for the purpose of Professor Cairncross's question it is more doubtful, particularly remembering that proportion of the service which in fact the Exchequer pays out of another pocket by way of housing subsidy.

2863. May we approach the matter from a rather different angle? At the end of your paper you suggest that the interest paid on your advances of £4,719 million is £147 million; that represents an average rate of 3 per cent. Are you getting only 3 per cent. on nearly £5,000 million worth of advances?——In 1956-57 it was of that order. One has to remember that the peak loading of this is represented by the Exchequer financing of the local authorities' capital during the first decade after the war. One big block of that debt was at 2½ per cent., and then there is another big block which is at 3½ per cent., or only a little over that.

2864. *Professor Cairncross*: We do not know on what terms any of this £4,719 million will be repaid to you.—*Chairman*: Is not that very important for our purposes? If this £5,000 million is going to come in on a large scale in the near future, it would revolutionise the liquidity position?——It is not going to come in in the near future. This is a calculation which, with the aid of a computer, we can let you have. These outstanding figures are all represented by individual mortgage deeds between the Treasury, as lender, and the local authority or public board, as borrower, under which the borrower has engaged to repay by equal instalments the principal and interest. Most of it is fifty year loans; all the housing ones are fifty years, and the ones for the public boards are for the most part thirty years. We could produce a table projected right into the distant future, showing how the principal element gets bigger and bigger and the interest element gets smaller.

2865. *Professor Cairncross*: Your debtors are funded even if you are not?——One is not to know what the shape of the Budget is going to be thirty years hence, in which this big receipt will presumably figure as a receipt, and one does not know what judgment will be taken by the Chancellor of that day about his Budget surplus, if any.

2866. *Professor Sayers*: Do you not have as a matter of information a running calculation which keeps you up to date all the time on what the maturity distribution of these assets is? Surely it is just a matter of day-to-day operation to do the sum as you go along. You must have this kind of thing for debt management, surely?——We can calculate in advance as regards what over the years ahead is going to be our receipt on outstanding loans; we do not know what the fresh element is going to be in respect of new loans made year by year, which has to be added to the calculation.

2867. The fact that you may be operating afresh in 1967 surely does not make it of no interest to know now what is your present liability to repay bonds in 1967, nor what you may expect to receive on the asset side?——It is always interesting to see what a figure like this would be a number of years ahead, but for practical purposes I have never called for a figure covering more than say, five years ahead, to see on a five-year forecast of revenue and expenditure what, over that period, this particular receipt would amount to, so as to try to make sense (so far as sense can be made of these forecasts) of what the net debt management charge should be.

2868. I agree that the interest is much greater as you are getting nearer home, but surely the easiest way of having the information is to do the sums as you go along. You can always do that. You need not look at the position of the seventies very often, but there it is; and when you get to the end of the sixties you will have the figure already calculated, so far as the position has been determined by the facts of your loans in the past?——The principal element in the earlier years has been so small that for practical purposes we have concentrated on the interest; but it may well be that we are now at the stage when it becomes of practical importance to see how the principal element is going.

2869. *Professor Cairncross*: Do you recoup yourselves for these advances to the Public Works Loan Board by loans in the market of roughly equivalent duration?——The terms of these advances are not related to Exchequer financing. Ever since the Local Authorities Loans Act, 1945, we have refrained from borrowing in the market on terms corresponding to our lending, and have financed our lending out of our general fund. It may be done without borrowing at all, so far as we have an above-the-line surplus; but if the lending means a *pro tanto* increase in the deficit to be covered by borrowing, then it has been covered by general borrowing.

2870. *Chairman*: So excess liquidity in the system, which largely arises from Treasury short-term borrowing to make these loans to nationalised industries, public corporations and housing authorities, is not likely to be sensibly related to or affected by these loans coming in on repayment in the near future?——Not in the near future. But I am attracted by the idea that we should produce a statement or table showing how the position stands, projecting forward what the repayments may be.

2871. *Professor Cairncross*: As regards item 1 in Appendix C, we are not told on whose behalf the National Debt Commissioners operate in holding all these securities. Would it be a long list?——It is a long list, but practically the whole of it is covered in terms of amount under the two heads of the Savings Banks Funds and the National Insurance Funds.

2872. Might we have a list, since I do not believe there is a complete list available anywhere of the National Debt Commissioners' funds?——We should be able to do that.

2873. *Mr. Jones*: Would the amount in item 1 be the full amount of the investments of the National Debt Commissioners, as they are obliged to invest in gilt-edged?——The National Debt Commissioners are, as Mr. Jones says, obliged to invest all their funds. Item 1 shows the distribution of their investments over the whole range of gilt-edged securities; but they must hold a liquid balance, which is held in Treasury bills, and I think there is a small holding of Ways and Means Advances; that is their 24-hour money. For the rest, they invest in quoted Government stocks. There is also a debt from war-time of just over £1,000 millions in terminable annuities, not in market securities at all. They invested the money accruing to the Savings Banks Funds direct with the Exchequer by means of these annuities.

2874. Let us assume that the National Debt Commissioners have available for investment in gilt-edged a substantial amount on the National Insurance Funds. As I understand it, they must invest those funds to secure the best possible return?——I have to distinguish between the obligations of the National Debt Commissioners as regards the National Insurance Funds and their obligations as regards the Savings Banks Funds. I would prefer to say that the National Debt Commissioners invest their insurance funds in accordance with the terms of their trust deed; that the requirements are different in the case of one fund as compared with another. In the case of the Savings Banks Funds, the savings bank depositor is not interested in the amount that the National Debt Commissioners earn on their investment because, wet or fine, he gets 2½ per cent. On the other hand, the national insurance contributor has an interest, though I think perhaps not more than a contingent one, in the amount of the National Insurance Fund, and so from that point of view the National Debt Commissioners, subject always to the overriding need for liquidity, invest to earn income in dealing with that Fund.

2875. To the extent that they have money available for short term investment in Treasury bills and the like, I take it they take those Treasury bills on tap, and that they do not tender for them?——That is so.

2876. How do you determine the basis of discount in circumstances like that?——There is a regular weekly system of determining what we call the tap Bill rate. Every Friday, when the result of the weekly tender is

known, we declare the corresponding tap rate, which is to within one-sixteenth of the average rate which has been revealed by the result of the weekly tender. So the tap Bill rate is kept in line week by week with the market rate.

2877. On Appendix A, how can you have outstanding in the Floating Debt a sum of £277 millions in Ways and Means Advances when, as I understand it, Ways and Means Advances made available to the Exchequer are on 24 hours' notice? In paragraph 22 you talk about Ways and Means Advances not being outstanding for more than a single day?——From the Banking Department of the Bank of England. What looks like a big amount outstanding at the end of the year there in Ways and Means Advances is not Ways and Means Advances from the Bank of England, but day-to-day balances of the departments who are lending to us, such as the Issue Department of the Bank of England, the Exchange Equalisation Account and, it may be, the Paymaster General. For the purpose of the National Debt Return on which this is based we do not distinguish Ways and Means Advances from the Banking Department and Ways and Means Advances from other sources; but I should be very surprised to find, on 31st March, that we had any Ways and Means Advances outstanding with the Banking Department at all; if there were, they would not amount to more than £5 or £10 millions.

2878. *Lord Harcourt*: I have one question on the item in Appendix A: "Other Debt, Internal". Is the £65 million held by the International Bank for Reconstruction and Development the unexpended portion of our 18 per cent.? Equally, on the interest free notes held by the International Monetary Fund; is that our quota?——In the case of the I.B.R.D. the figure represents the 99 per cent. of our original subscription payable in sterling, which was borrowed back again on the security of interest free notes (that is £82·6 million), less the notes we have repaid over the years since 1947 to provide sterling loans to the various member countries, amounting to £17 million. The difference between £82·6 million and £17 million gives the outstanding figure of the notes at 31st March, 1957, as shown, at £65·6 million. Then on the I.M.F. the figure of £577 million represents two elements: 99 per cent. of our original sterling subscription, plus the £201·8 million of additional notes that we created as a result of the drawing of $560 million on the Fund in December, 1956. We described the technique of that transaction when we were examined on the Exchequer financing tables [Q. 1072].

2879. *Professor Sayers*: In the analysis in market securities in Appendix B, do all those figures include official holdings?——They do.

2880. Could we have the figures for 1935 excluding official holdings? I think we can do the sum for 1957 from the figures given to us earlier in the document?——*Sir Edmund Compton*: The figures for 1956 and 1957 can be re-worked to exclude the holdings of the Issue Department and National Debt Commissioners by deducting the figures of their holdings in paragraph 5, provided that you are content to lump together the figures of holdings of dated stocks over 15 years and of undated stocks. —*Professor Sayers*: Yes; I was thinking primarily of under five years and over five years.—*Sir Edmund Compton*: I could give the 1935 figures across the table, if that would help: the deduction for the Issue Department and National Debt Commissioners for up to 5 years is £38 million; for 5 to 15 years it is £43 million; and for over 15 years, that is, the total of the last three items, it is £208 million. If it would help the Committee, I could put in a sheet of paper which gave these calculations for 1935, 1956 and 1957.—*Chairman*: Thank you.

2881. *Professor Sayers*: At first sight it seems curious that in 1956-57 the Issue Department sold £439 million of stocks of over five years' life (as we see from paragraph 30), and yet had £153 million more of such stocks on its books at 31st March, 1957, than at 31st March, 1956 (as we can calculate from paragraph 5). What is the explanation of that?——There are three points which bear on that. The first is that paragraph 30 gives the figures of the transactions in the market of the Issue Department alone; they do not include the transactions between the Issue Department and the National Debt Commission. The second point is that the figures in paragraph 5 show the nominal value of Issue Department holdings, whereas the figures in paragraph 30 are of cash transactions and therefore reflect market value. In so far as they have sold stock in the market above or below nominal value, that causes a discrepancy between the two sets of figures. But the main reason for that is the acquisition by the Issue Department of new long term securities in the process of underwriting, which we describe in paragraph 16 of the paper. There were in this year ending 31st March, 1957, two issues of long-term Government stock; in February, 1957, there were the £300 million of 3½ per cent. "Eternity" Funding Stock, 1999-2004, and earlier in the year, in April 1956, there were the £250 million of 3½ per cent. Treasury Stock, 1979-1981. The increase in these holdings reflects the underwriting function of the Issue Department in relation to those issues.

2882. It seems to suggest that during that year the authorities were not able to catch up with themselves in funding?——No. They indicate that in fact the Issue Department took on board further supplies of long dated stock.

2883. The position is that the Issue Department unloaded quite a lot, but not as much as they took on?——One of the reasons why new issues took place was to replenish the portfolios of the Issue Department for further operations.

2884. I am only suggesting that this difficulty underlines the impossibility with which we are faced of finding whether the authorities have really succeeded in lengthening the average life of the debt during this period. If these figures all coincided, one could come to a conclusion on that?——That question is perhaps better studied by looking not at the figures of the official holdings but at the debt held by the public; in other words the analysis of market securities by maturities in Appendix B, but excluding the holdings of the Issue Department and National Debt Commissioners.

2885. Have we got that for 1956 and 1957?——That is the sum you were good enough to excuse me from doing because you said you could do it yourself.

2886. *Professor Cairncross*: May we ask you to do the figures for 1952 as well, so as to present us with the picture over the five year period of the change?——I need notice of that; but I think that can be added to the table I have promised to put in.

2887. At some points in the document it is made clear whether Government guaranteed stock is included; at other points it is not altogether clear. I take it that public corporations' stock will be included, for instance, in the figures in paragraph 30?——Paragraph 30 is transactions in securities of the Issue Department, which consist substantially of Government and Government guaranteed stocks.

Chairman: If there are no more questions on the appendices, we can release Mr. Thornton.

(*Mr.* Thornton *withdrew.*)

2888. *Professor Sayers*: On paragraph 6 am I right in saying that the Treasury is emphasising here that it cannot borrow except under fairly direct authority from Parliament, that all expenditure is authorised by Parliament and the Treasury only borrows to spend, or to pay off debt, and therefore when people are saying that the monetary arrangements make it too easy for the Government to spend too much, they mean that because borrowing is so easy, Parliament goes on authorising too much expenditure; is that right?——I am not quite sure what people mean when they say it is too easy for us to borrow, but I think they mean two things: the first is that, though Parliament has authorised the amounts of the borrowing, the ceilings attached to the amounts are high

ceilings. In effect the Treasury is authorised to borrow to finance issues below the line; it is the definition of a below-the-line issue that it is for a purpose for which Parliament has authorised us to borrow. We have therefore authority to borrow up to the total set by the various statutes; in so far as we have a surplus above the line, that provides us with a margin. The second, and perhaps more cogent, criticism is that we can borrow in any form that we like. Whereas Parliament has controlled the amount, the statutes leave the method entirely to the discretion of the Treasury.

2889. *Chairman*: May they not mean that the system enables you to borrow easily on short term but not so easily on long term?——*Sir Edmund Compton*: In so far as we have complete discretion as to the method of borrowing, the critic might say we have a temptation to borrow by the easiest way.—*Sir Robert Hall*: But I suppose the general sense of the criticism would be the formal one that Parliament authorised these big borrowing programmes. Every now and then each nationalised industry gets a new authority for a programme.

2890. *Professor Sayers*: Partly because it all looks so easy?——*Sir Edmund Compton*: I think perhaps authority for the nationalised industry to borrow is more venial, if I may put it that way; it is borrowing for a revenue-producing asset, so that on the face of it Parliament might reasonably ask to give that authority leave to borrow either from the Exchequer or from the market the capital it required to create those assets.—*Sir Robert Hall*: I think Professor Sayers meant that it was easier to authorise borrowing than taxes, did he not?—*Professor Sayers*: Yes.

2891. *Sir Oliver Franks*: Has consideration ever been given, and if so what are the main pros and cons, to segregating that part of Government borrowing which is for the creation of capital assets, whether by the central Government or by the nationalised industries or through the local authorities for the building of houses and so forth, and requiring that where borrowing for these purposes is undertaken the loan or security should match in time the period over which the money could be expected to come back? When the State becomes a major capitalist and is constructing all sorts of long term projects, it is legitimate at least to query a system which leaves the financing of these projects wholly at the discretion of the Treasury, and therefore may mean, according to the convenience of the times, that fifty year projects are financed by three month Treasury Bills (to put it at the extreme). It is not clear to me that absolute discretion in regard to this category of borrowing is in the national interest. What are the pros and cons there? Is there not a question of policy there?——*Sir Edmund Compton*: There is indeed. In the past, a long way back, Government borrowing was earmarked for the particular project. That system was retained for local authority lending up to the war, when we issued Local Loans Stock in so far as we were needing to raise fresh capital in order to lend to the local authorities. (As a matter of detail there was no issue of Local Loans Stock after 1925 or thereabouts, because the repayments from old loans were enough to finance the new loans). Apart from that it has been fixed Government policy since the 1914-18 war that all Government lending should be financed out of general Government borrowing and that the system of earmarked loans should be given up.

2892. The events of the last ten years, with the immense extension of the State's activities in capital expenditure, have not led to any revision of that view?——On the contrary, that view was affirmed by the decision to put the nationalised industries on the Exchequer in 1956. Before that the nationalised industries raised their capital on Government credit on terms which did not indeed correspond with the life of their assets but did broadly correspond to their readiness to face the market in terms of interest and eventual repayment of the principal. You could say that their guaranteed stocks were matched in amount roughly with capital expenditure. The transfer of the nationalised industries to the Exchequer was largely justified on the basis that in that way the Exchequer would then be free to finance that capital expenditure by whatever form of borrowing suited the convenience of the Exchequer and also assisted monetary policy.

2893. *Chairman*: So the argument in favour is that you can take advantage of the market by putting it on to the general fund of Government borrowing in a way you could not if you were tied to a particular kind of borrowing with a particular kind of purpose?——Yes, and not only that; if it is so decided on policy grounds, we can finance a portion of our capital outlay by revenue, not by borrowing.

2894. *Professor Sayers*: In fact you can make debt management in the widest sense, including all these operations, serve the purpose of monetary policy and indeed of general Government economic policy?——Yes. There are in other spheres arguments against earmarking or borrowing for a purpose. We are continually being pressed to glamorize National Savings, to encourage somebody to lend to the Government on a Savings Certificate because it will be spent on an atomic power station or something thought to have glamour. In fact if that is done, you really jam the works in the management of the Exchequer.

2895. *Chairman*: What would happen to your above-the-line surplus?——We should have to make some detailed provisions about the classes of debt; there would be certain earmarked ones to which we could not apply our above-the-line surplus; and when we repaid debt we should have to remember that the money borrowed from a particular investor could not be used to repay another man's Saving Certificate. That sort of complication immediately arises.

2896. *Lord Harcourt*: The real difficulty in the system adopted in the nationalisation Acts, as I see it, was the fact that we had H.M. Government and the nationalised industries coming to the market at different times both pledging the same credit, though they were coming to the market for different purposes?——Whenever a nationalised industry came to the market, the investor was really lending to the Government, in the sense that he was lending on terms governed by Government credit, but it did make for inefficiency both in the issue of our loans and in market management, because these issues took place at times which might not suit the authorities for purposes of market management, and the terms were not necessarily those which suited the market at the time. That could to some extent be mitigated by the two safety valves, of bank overdrafts for the industries pending an issue, and underwriting of these issues by the departments. But there are limits to both those safety valves, and it was because of those limitations that the nationalised industries were moved on to the Exchequer.

2897. *Professor Cairncross*: Would a nationalised industry in making a loan limit it to the expected life of the assets?——A stock issue by a nationalised industry was for a period which was a compromise between what the market advisers said the market would take and what suited the finances of the industry. They would consider their earning capacity, and broadly want to borrow as long as they could, consistent with not paying an excessive rate of interest for something the market did not want.

2898. That was in the past; I was thinking about the current position. Is the rate of interest charged on their borrowing from the Exchequer that which would be appropriate for a loan issued for a period for which the assets of the nationalised industry were expected to last?——Broadly, yes. The rate charged on an Exchequer advance to a nationalised industry is the rate at which the Government would borrow for a loan of that period. The period for which currently we are making advances to the nationalised industries is 30 years.

2899. That is not related to the life of the assets?——It has regard to the life of the assets. Their borrowing is for a wide variety of assets, some of a comparatively short life, some for a much longer life. The period was arrived at by negotiation with the borrowers; it does not purport to be a set calculation of the expected life of the particular asset, though it broadly reflects the life of the assets they borrow for. One particular class of nationalised industry is treated as an exception; that is the air corporations. Aircraft account for nineteen-twentieths of the capital expenditure for which they borrow, and because of that the period of their advances is not 30 but $7\frac{1}{2}$ years.

2900. The rate you charge them is the rate you would have to pay in the market for that?——It is the rate of Government credit for stocks of the comparable period.

2901. *Sir Oliver Franks*: The determining element is the period?——Yes.

2902. *Professor Cairncross*: The period is in fact rather longer than the corporations would be able to borrow for in the market against similar assets?——Yes, but they are repaying us by instalments of principal and interest.

2903. *Mr. Jones*: What would be the position in relation to a nationalised industry itself, supposing the asset was a wasting asset on the basis of a period of fifty years; if they were borrowing on the basis of thirty years would that be a hardship to the borrowing corporation?——No, because it would be permissible for them in the event to re-borrow over the unexpired period; that is always supposing they did not take a decision, which as business concerns they might well do, to repay out of money retained over and above the Inland Revenue allowances.

(*Adjourned until* 2.15 *p.m.*)

SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B., further examined.

2904. *Chairman*: On paragraph 7 (c), you say: "The different statutes which authorise these issues also empower the Treasury to borrow the money required for this purpose, in any manner in which they are authorised to raise money under the National Loans Act, 1939". Does that not mean in any manner altogether? Need you really have the words "... under the National Loans Act, 1939"?——No; but the wording of the statute has been repeated because the 1939 Act applies the more detailed provisions for charging such loans on the Consolidated Fund and the whole machinery of the debt raising and repayment.

2905. *Professor Cairncross*: If the Chancellor of the Exchequer wished so to operate the Budget that he balanced the above-the-line items over a period of years but was in deficit the first year, would he require to seek special authority from Parliament?——Yes. The process under which Parliament has secured that is described in paragraph 10. Essentially it is the provision that was enacted in Mr. Snowden's time, in section 48 of the Finance Act, 1930.

2906. It is not open to the Chancellor to budget specifically for a deficit in one year without seeking the appropriate power to borrow?——That is so; and in fact, on each occasion on which a deficit has been budgeted for, provision has been made accordingly in the Finance Bill of that year.

2907. *Sir Oliver Franks*: These provisions are all about a surplus or deficit above the line. What is important nowadays clearly is the overall Budget, above and below the line. It is all one operation, and this, I suppose, purely historical distinction between above and below the line is not very useful. As I read it, these provisions do not apply at all to the overall Budget. Is my understanding right and, if it is, what happens to the Budget as a whole? Is this another one of the areas of great discretion for the Treasury?——No, I do not think so. I do not entirely agree with the suggestion that the distinction between above and below the line has lost its utility. We feel that it has still a considerable degree of usefulness; by now most of the issues below the line are issues of capital on which interest is paid and principal is repaid.

2908. Is that true of none of the above-the-line?——Of very little above the line. There are some so-called capital items above the line, but the number of issues of capital above the line to bodies who pay interest on them is very small indeed and practically can be disregarded. The only important recipient of capital above the line, apart from the so-called capital items in the economic sense, like a Government motor car, is the Atomic Energy Authority; that has been charged above the line because there is in effect no commercial basis upon which their capital can be supplied.

2909. *Professor Cairncross*: Is not expenditure on the roads also above the line?——Yes; but again there is the difficulty of saying that a road loan is serviced from the earnings of the roads. So we think the distinction still retains its utility. On the question whether Parliament has lost control over the below-the-line issues, the formal answer is no, because Parliament has determined the amount that may be borrowed.

2910. *Sir Oliver Franks*: Certainly it has authorised that in authorising the policy in the programmes. But it has authorised a specific amount of borrowing and in that formal sense Parliament has control?——*Sir Edmund Compton*: Perhaps the practical control is that the amount of financing that has to be done below the line is a material factor in the judgment as to the Budget balance. One of the things that has to be decided when the Chancellor prepares his Budget is the extent to which below-the-line issues are going to be financed out of revenue, that is out of the Budget surplus. In so far as the Budget above the line provides a surplus towards the Budget balance, the Government is presenting to Parliament for approval a scheme for financing expenditure both above and below the line.—*Sir Robert Hall*: The Budgets since 1947 have been broadly constructed from the point of view of their influence on the total level of activity. As carried over into the national income accounts the below-the-line expenditure is taken into the capital investment programme of the whole country, and the above-the-line surplus is taken in as one of the sources of finance. So the Budget as a whole has to be looked at from the point of view of its impact on the economy, though I agree entirely with Sir Edmund that the distinction in the accounts is a useful one, and indeed I have sometimes thought it would be even more useful if we had a precise distinction between current and capital expenditure. To think of looking at the below-the-line expenditure as something which can be financed by Government borrowing would, I think, give a misleading effect; the way in which it is provided for expresses the Government's judgment as to how much of the total investment programme requires to be financed by Government saving rather than by Government borrowing.

2911. *Professor Cairncross*: There is a distinction between the division in the Budget and the division between capital and current in the national income figures?——Yes. There are several items, as Sir Edmund has mentioned, above the line, which from the national income point of view are regarded as investment, and then there is the question of the treatment of death duties from the point of view of the income side.

2912. Do you not feel that in treating an item like roads, where a capital item is created, and where the cost falls above the line, a different attitude should be adopted towards the capital expenditure because no monetary income is derived from that expenditure?——*Sir Robert Hall*: It would be a consideration from the point of view of the debt management, but not from the point of view of the broad construction of the Budget, at any rate in respect of that particular year. In that particular year the objective would be to finance the total investment from *ex ante* saving.—*Sir Edmund Compton*: In terms of the investment programme we do not distinguish whether a particular item of public investment is financed from above the line or below the line.

2913. *Sir Oliver Franks*: In paragraph 11, you say that "the Treasury has complete discretion as between Floating Debt and other debt, and as between the amounts raised from the Departments and the public." Sometimes freedom is most satisfactorily exercised when it is in certain respects limited by rules; there is a certain balance between free discretion and regular behaviour. Is it clear that the Treasury gains by the completeness of its discretion, and that the self-discipline of rules, for example, perhaps, about the amount of floating debt that there may be, would not help in some of these difficult problems

of restraining and decreasing the amount of floating debt and the liquidity of the system? There is nothing here which makes you go back to Parliament and say: "There is a real difficulty; we must have a sanction"; there is nothing here which gives cause for public debate; the discretion is absolute. How far do you judge, based on postwar experience, that this complete discretion has really proved advantageous; because it could be a weakness?——*Sir Roger Makins*: It is true that the position is as stated: we have the discretion. I do not know that we have ever examined the question whether we should do better, if there were a code of behaviour, than we do without one.—*Sir Robert Hall*: It is similar to the point you made this morning, about whether it would not have been desirable to link the term of borrowing of the nationalised industries to the life of the assets. I think that all we could usefully say on this is that the problem of the increasing liquidity of the debt has increasingly exercised our minds.—*Sir Edmund Compton*: As regards a code of behaviour, we say in paragraph 21 that it is the aim of the authorities at the present time "to reduce so far as possible their dependence on finance raised on the Floating Debt", and we describe how that is an object of debt management operations. That code of behaviour has also been published to Parliament on more than one occasion by Chancellors in Budget speeches, as a principle on which he is proposing to Parliament that the debt should be managed; but that is not a code which Parliament has to endorse.

2914. There is a difference between a principle which declares an intention, and a rule which you have to apply. What I have in mind is not in any way critical of the Treasury. It is simply that in this difficult relationship between Parliament, that authorises expenditures, and the Treasury, with its responsibility for policy and for finding the means of financing, it seems to me at present so easy for Parliament to go on authorising and approving policies and programmes of expenditure without counting the cost, not thinking at all about the means by which it will all be financed. The means make a difference to the whole state of the economy, but with the separation which at present exists between the part that Parliament plays and the part that the Treasury, with its discretion, plays the people who declare the policy are never faced with these possible consequences of their decisions. It was from that point of view that I was wondering whether the system was satisfactory?——*Sir Roger Makins*: I appreciate that you were not implying any criticism in what you said, and I did not take it in that sense. All I was saying, really, was that I was wondering (it is obviously something which requires more thought) whether the fact that we had an absolute discretion would have greatly affected the judgment that we made, or the policy which we recommended. As Sir Edmund Compton said, there is a self-imposed regime which applies to these matters. I have some difficulty in seeing the kind of rules which you would impose and what difference they would make to the Treasury's judgment if it had to conform to them in particular circumstances.—*Sir Robert Hall*: I think there are two quite separate points: (1) whether the investment programmes to which the country is being committed are within the capacity of the country, with which the Treasury has endeavoured to deal in the course of its formulation of budgetary policies, and to the extent that it looks forward as to how things might be in a few years' time; (2) the degree of uncontrollability or explosiveness, so to speak, which might be coming into the system because of the methods of finance which follow from the lack of rules. I think your point was whether, if there had been more rules about the terms of borrowing, it would not have been easier to deal with the second point. That is, of course, a fundamental question raised by the whole of these papers.

2915. I do not want to anticipate a later stage of the discussion, but one of the things that I had in mind in asking the question was that it would appear that over the period since the war, while the Treasury has consistently had the aim which Sir Edmund has described, its absolute victories have been few. What has been done is to hold the enemy at bay day by day, year by year, but not really to reconquer ground for good. I had wondered whether, if there had been certain rules which entailed taking problems back to Parliament at a certain stage, more heroic measures, measures which went beyond simply dealing with the problems that evolved from year to year, might have become necessary; some measure which only Parliament, perhaps, could authorise for dealing with the amount of floating debt might have been put into force in a way which is not possible if, as at present, you simply go on doing battle year by year. The rules and the extent of your ability to comply might have kept your issues down to a size which would have demanded absolutely major policies to be determined?——*Sir Edmund Compton*: On the success of the battle, you will see from paragraph 29 a significant change in the trend in market Bills. They have swung from net increases of £306 million in 1952-53 and £284 million in 1953-54 to net repayments of £31 million in 1955-56 and £348 million in 1956-57. But the point that you were making is really, I think, one aspect of the question of alternative techniques, on which we may, as Sir Roger Makins has said, have something more to say to you.*—*Sir Oliver Franks*: I shall abide in happy anticipation of redemption of that promise.

2916. *Professor Sayers*: In the last part of paragraph 14 there is the statement:

"The transactions in Bills are for purposes of money market management and so outside the scope of this paper."

That must not, I suppose, be taken to imply that what happens about the shortest rates of interest is irrelevant for debt management generally?——No, indeed. That is dealing with the rather more limited question of market operations in Bills, by which we mean primarily the buying and selling of Bills by the Bank of England in the market, and it was one of those questions on which we thought that you should ask your questions of the Bank rather than of us.

2917. The fact that the transactions in Bills are conducted in a particular way, and the money market is managed in a particular way, does lead to certain consequences about the structure of the debt, does it not?——This type of money market operation in Bills by the Bank has not got any very significant effect, I think, upon the proportion of short-term debt to the other; I would have thought that was primarily determined by what happened at the Bill tender.

2918. Does not the fact that the Bank is always prepared to act in one way or another as the lender of the last resort influence the choice that the authorities make from time to time as between the issue of a longer term bond and an increase in the floating debt?——We have dealt, I hope, with that area of choice later on, where we describe our objectives in regard to the floating debt. We have in effect said that we would not prefer to borrow by the issue of floating debt rather than by selling a long-term security just because it would cost us less.

2919. Because the money market is managed in this way, there is a certain stability about the shortest rates of interest that there would not be otherwise. If the arrangements were quite different in this fundamental respect of money market management, the choice between issuing a long term bond and adding to the floating debt would sometimes look quite different?——Yes, I imagine it could do. That is a question of market operations in a hypothetical situation that does not exist.

2920. I am only asking you to qualify this statement to the extent of admitting that money market management is an integral part of management of the debt, that has a bearing on the whole monetary situation, and not just the situation in the little circle?——One would readily admit that it is fundamental to the management of the debt, in that whatever else we may do we know that the market will cover the amount of the floating debt borrowing that we ask it to cover week by week, and that if that assurance were not there, it would be quite different.

2921. *Chairman*: How far does your statement of general policy in the later paragraphs go? Does it mean to say that in these years you would always rather have sold a bond than added to the floating debt, if you could?——Yes, given our objectives that has consistently been the way in which we have tried to distribute the debt.

2922. *Sir Oliver Franks*: Would you say that, given that that view was held all the time, the fervour with

* See Memoranda of Evidence Part II No. 13 and Qns. 3226 to 3308.

which it was held had increased over the years? Did you think it so strongly in 1951 and 1952?——I feel that there is a difference in fervour after the period 1955.

2923. When conviction began to steal in?——We speak in this paper, as we did in Paper 6, of 1955 as a year in which monetary policy was made more active.

2924. *Professor Cairncross*: May we just try and get clear why you attach so much importance to pushing back the maturity of your obligations, and reducing the degree of liquidity in the system? I would suggest that we ought to distinguish between two things. Sometimes what is submitted is that the floating debt is too large—for monetary policy to take effect, presumably; sometimes what we have put to us is that a different distribution of maturities is desirable, and that you like to see a high proportion of the debt funded. The second point would be well taken in relation to earlier periods in the history of the national debt; the proportion of funded debt was always very much higher. But can you explain to us why it is so undesirable to have a substantial proportion of the debt short-dated? Is it merely a matter of the impact on the banking system, and the difficulty of making control over the monetary supply effective? Is it for securing your control of the movement of rates of interest, or what is it that is primarily in your mind?——We summarise it in paragraph 18 (*c*) of the paper, where we say:

"These operations strengthen the future position of the authorities and also reduce the immediate liquidity of the public."

The first part of that sentence refers to two things. In the first place, to the extent that maturities are pushed forward, we have more opportunities to work on the liquid reserves of the bankers. Secondly, there is the position of the authorities as managers of the debt. As we are at present, with this mass of short-dated securities to deal with, we have loan operations to face and repayments to make year by year in large quantities; to the extent that we are able to lengthen the debt and relieve ourselves of a year, or two or more years, we shall not find that our efforts to reduce the money supply by funding may be frustrated by the fact that we are obliged under loan contract to repay large sums. The point about the immediate liquidity of the public is the obverse, I think, of my second point: that apart from the banks themselves these short-dated securities are held by the public, in the widest sense of investors of every kind, and in so far as they have these short-term securities they have something that is very close to ready money; not quite as ready money as the small saver has, but getting close to that. Finally there is the consideration, in dealing with interest rates, that in so far as one of the objects of interest rate policy is to make holders of securities less willing to monetise their securities by selling because of the loss that they will incur in selling, and the proportion of short-dated securities that they hold is high, the increase in interest rates that is going to make them incur a capital loss is so much greater.

2925. *Chairman*: If you could prevent the public having so much near-money in their hands, the money which is now put into that kind of investment would have to go, as you say, into some other, and presumably longer term, bonds. The deterrent from realising money on those is the current level of interest which might inflict a loss upon them in certain circumstances. That makes the attempt to control the longer term rate of interest a vital consideration in trying to reduce the liquidity in the hands of the public?——Yes. The last point that I made, about the rate of interest, is, in this context of debt management, the one furthest away from my mind. In terms of debt management, the nearer consideration is the attempt to get some release from the annual liability to repay, and the desire to get a closer hold upon the liquidity or near liquidity of the bankers and the public.

2926. *Professor Cairncross*: Your anxiety on that is due to your fear that rates of interest may become progressively higher; if you thought rates of interest were coming down you would be quite anxious to get a position with early maturities where you could review them and obtain the advantage of the lower rates of interest?——*Sir Robert Hall*: If one thought it likely that the longer term rate of interest was going to fall, there would be some advantage in having short-term securities to convert, as was done in 1932. But with the Government committed to a policy of maintaining a high rate of activity the recurrence of conditions like 1931 seemed improbable; the presumption was moving against the idea that there might be a time when we could make a big conversion at very favourable terms.

2927. This would certainly be true if the rate of interest was universally thought to be on the low side. If there began to develop a school of opinion which thought that rates of interest were rather high, and might subsequently fall, there would be merit in maintaining a structure of debt in which the number of near-maturities was high. I wanted to couple this with a question to you about the reason why you feel that the holding of near-money or near-maturities is potentially explosive and dangerous. Are there not conditions where it may suit the holders of the debt to hold short maturities rather than long, and when they are as firm holders of these as they would be of long term obligations? Take, for example, National Savings Certificates and Defence Bonds: these are in one sense highly realisable, but they are usually held pretty firmly and are not exchanged for money except when people have to realise capital. There is not, is there, an overwhelming case for assuming that a large proportion of short-dated debt must in all circumstances be a tremendous handicap? It may, in fact, be of advantage to you if the demand equation takes that bias?——*Sir Edmund Compton*: That is so, because there are continuing firm holders of short dated stocks; that justifies the funding that has been done at the short end of the market. For example, the discount market is a firm holder of short-dated stocks, in the sense that they do not deal in anything but short-dated; I would think also that the bankers were in that same position. But, apart from such holders, the disadvantage of a high proportion of short debt is surely that the initiative as to whether to go on holding or to monetise rests with the holder; that the authorities have that much less control, because they have to respond to whatever decision, one way or the other, a holder takes, and it is very difficult if not impossible to know in advance how holders are going to behave.

2928. The essence of the matter is that you are afraid of excessive liquidity because it means that an excessive number of people will be under temptation to cash their holdings, and then to employ the cash. If they merely cashed the holdings and held cash the system would be, from your point of view, cheaper to run even if more explosive; it is the danger, presumably, that someone is going to cash what they hold and then use that cash that is your chief perplexity. From that point of view it is surely important to spotlight the potential sellers, to know what they are likely to sell and for what reasons. If you find, for instance, that some of the larger companies are large holders of short-dated securities you are likely to have much more trouble than if you find that these holdings are in the hands of private persons, who may have special reasons for wanting to be short-dated in their distribution. We have no information about the distribution there.—*Professor Sayers*: There are large groups of people and institutions that individually find it necessary to hold short-dated securities, but in total they are firm holders of these securities. The fact that some are nearly always having to cash some to meet temporary needs does not mean that the existence of these short securities is a threat to the stability of the economy. On the other hand, there are people who are holding short securities as they would hold cash and they are ready to run them down when they see a profitable opportunity to spend the money. There is all the difference in the world, from the point of view of whether the situation is explosive or not, whether the short-dated debt is held by the one set or the other set of people. What facts have you that bear on this? What can you tell us about the market for short-term debt?——I must stop short of what you should get from the Bank rather than the Treasury, but I would distinguish perhaps one more class than Professor Sayers. First of all, there are what one might call the professional firm holders of short-dated securities, the people whose job it is to hold short-dated securities, such as the banks and the discount

market. Secondly, there is the business community, who in recent years have learned to put their semi-liquid balances into short-dated securities; whether they are firm holders or not really depends upon the course of the business. They are not operators in the securities market, I would say, but are holding that money in the expectation that it may sooner or later be needed for the business. The third class I distinguish might be called the investment operators, who have as a matter of choice bought shorts and are ready to move from shorts into other areas in the gilt-edged market, according to their judgment of market trends and yields.

2929. I was thinking of another genus of people, of which Lloyds' underwriters are the leading species, where the individual firm knows that it will have its ups and downs that it has to meet occasionally, and the obvious way of holding its reserves is to hold a block of short securities to meet the contingency of rather heavy losses in one year. That seems to me, as a group, a firm holder of short securities, although each one will be in and out of the market from year to year. It is rather different from the investment trust, which is just speculating on the different yields between short and long securities?——I agree with you; I would class it with the banks and the discount market.

2930. The banks and the discount houses are not firm holders in quite the same way, are they? You are going to look on them rather differently in that the more they hold in short securities the less you will feel in control of the general credit situation of the country. That is rather different, from your point of view, from the in and out man who has occasional losses to finance?——Yes. The banks' investments naturally fluctuate; in so far as they want to adjust their balance-sheet they may just decide to do that by increasing or decreasing their investments. Our main concern with the banks in this context is their ability to add to their liquidity by in effect running off or selling at the very end of its life a short-dated security.

2931. *Professor Cairncross*: May we look at the problem from the point of view of the Treasury Bills which you have issued, which have the shortest maturity in the market, as shown in Appendix C. Some are held partly by the Government itself, for good and sufficient reasons. You are concerned, presumably, about the tender issues. A very large part of those is with the banks, the discount market and the other financial institutions. The amount held there is clearly excessive in relation to the conventional liquidity ratios but the absolute amount of the excess is not so very high: it is presumably of the order of £200 million. The overseas official holders are in a quite different category. They have a genuine demand for securities of this kind. It may be embarrassing if they fluctuate, but you cannot really do anything about it by funding. Then there is a final item which includes holdings of joint stock companies and others and all the residual errors. We have no details as to the way in which this is held, but if we were to assume that a substantial proportion of that met a real requirement, and was not in any sense more inflationary than any other method of finance, we are left with a comparatively small proportion of the total Treasury Bill issue which would be affected by any funding. I assume, therefore, that funding in your mind is linked much more with the conversion of short-dated bonds to long-dated bonds than with an actual reduction in the Treasury Bill issue, although Treasury Bills loom larger in relation to monetary policy. This is relevant to the question how far you feel that it would be necessary to go in funding for the purposes you have in mind. I have the impression that in the last few years there have been two important influences tending to make you think that funding was extremely important, which might be losing some of their force. One influence relates to the doubts that have been felt as to the future of the rate of interest, and, indeed, the future value of money. If people were reassured that the value of money could be maintained you might have much firmer holders both of short-term and long-dated bonds, and the worries that you now feel about your power to meet forthcoming maturities would tend to disappear. The second influence that has been in operation, and about which something might conceivably be done, is related to the very large issues of fresh debt by the Government. In prewar periods my recollection is that the national debt was generally either stationary or falling; that was certainly true whenever any conversion operations or funding were in prospect. Now you are thinking of funding against a background of a rising national debt, and you have seen £3,000 millions of nationalised industry stocks put on the market in the last seven years. That is a very substantial addition to the outstanding national debt. If you are operating in conditions in which you have to push out the debt all the time, and in which people are doubtful about the future value of the bonds they are buying, it is natural that you should have not only rising rates of interest but doubts about having anything long-dated, and that you should also be thinking that it would be useful to fund. Are not all these problems linked to one another?——They are indeed. On the first proposition, that funding both in terms of firm holders and in terms of volumes of sales would be improved if there were confidence in the value of money, undoubtedly that is so; that has always been the prerequisite to the sort of consistently firm gilt-market that one would like to have for that purpose.

2932. And funding would be less necessary?——Yes, because the debt would fund itself, in the sense that holders would be firm. On the question of the change in climate because of the higher debt, undoubtedly that is so; there has been an Exchequer deficit, that has required an increase in the debt to cover not only our own requirements but those of the nationalised industries in that period. That, again, is not necessarily a situation that will continue; the figures in Appendix B show that between 1956 and 1957 the total of the national debt was stationary.

2933. So is the total for Government guaranteed securities?——The reason for that was that the nationalised industries were taken on to the Exchequer; there has been a corresponding increase of Exchequer financing. These figures are made comparable by adding back the issues of Government guaranteed securities to the Exchequer totals for the previous year. The extent to which one has or has not to face a rising debt for management purposes in coming years is partly a function of the Budget.

2934. You told us this morning that the rates of interest charged to the nationalised industries were geared to the cost to the Government of borrowing for a similar term of years. By that you meant the rate at which the Government could borrow if the market were such that it could absorb large quantities of Government stock at the existing rate, not the rate that would be necessary if you had to add to the total issues on the market and in doing so depressed the price of all your other outstanding obligations. From that point of view it could be said that the nationalised industries are being rather favourably treated?——Yes. As against that the rate at which we lend to the nationalised industries is one which is fixed on pretty broad terms, and which we vary. The long term rate is not varied unless the level of credit has changed by at least one quarter per cent. That provides a certain amount of evening out of ups and downs, which on occasions works to the advantage of the Exchequer and on other occasions to that of the borrowing authority. We also make some small allowance in the calculation for what we call unmarketability, to allow for the fact that the borrowing authority does not have to face the expenses of putting an issue on the market, but I agree that this does not meet the point that the rate at which they could raise money on the market might be higher than the rate at which existing securities are quoted.

2935. Have you considered what proportion of the fall of gilt-edged in the last five or six years can be attributed to an increase in the supply of debt, and what proportion can be attributed to a change in the attitude of the public towards holding the debt? Do you regard the attitude of the public as the sole factor in this?——I would find it very difficult to distinguish between those two items, but I would have thought that the attitude of the public was the dominant one.

2936. If you had the experience over a period of years of actually reducing the size of the national debt, would you not expect that to promote some recovery and allow you to proceed with funding? On the figures given to us 1954-55 was a remarkably successful year in bringing

3 *December*, 1957] SIR ROGER MAKINS, G.C.M.G., K.C.B., SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B. [*Continued*

about a fall in the maturity of outstanding debt; in that year there was a sudden reduction in the Exchequer deficit, and in the recourse to the market for Bill finance. Does not that look as if the reduced recourse to the market during that year enabled you to put through far more funding than in any of the years on either side?——*Sir Edmund Compton*: Net sales of securities in the market were only £18 million.—*Professor Cairncross*: I was taking the increase in sales of stocks with final maturity dates over ten years.—*Sir Edmund Compton*: Yes, it was unusually successful in that. An abnormal amount of maturing debt was successfully dealt with, but I recollect that the further funding which had been expected that year did not take place owing to the setback in confidence that was experienced in the closing months. For chapter and verse on that there is a passage in the Bank of England's paper no. 9 on monetary history in the last five years.

2937. *Professor Sayers*: In paragraph 16 this doctrine comes out that the Issue Department only operates "in response to public demand and at the prevailing market price". Does that mean that the Government broker would never operate at anything different from the market price which he had heard mentioned five minutes ago?——For chapter and verse on what the Government broker does I think the Bank of England should give the answer.*

2938. When you say that it is the policy that the Issue Department shall operate only at the prevailing market price, are you taking into account that the prevailing market price may be affected by the expectation of large Government issues later in the year?——The prevailing market price is undoubtedly affected by the knowledge that the authorities are standing sellers, in accordance with an avowed funding policy. It is known that "the departments" have their underwriting functions, and that either out of the proceeds of new issues or by other means "the departments" acquire and hold supplies of stocks for official sales ranging from the long to the short end of the portfolio.

2939. *Chairman*: Accepting that, what is left of the view that there is a market price independent of the actions of the authorities, or of any other big suppliers to the market? Is not your decision not to sell at a particular price, if that decision was ever made, or to offer at a particular price, a large element in making the market?——I do not think so, because the market is making a price for securities all the time, in the knowledge that the departments are there, and may or may not be selling. It is not known whether "the departments" are selling or not.

2940. *Professor Sayers*: Would you accept that the market must take a view, when it forms its price, of the extent to which stocks of a given class of maturity are going to be put on the market by the Government during the ensuing months?——No.

2941. Do you mean to say that, if the Government announced tomorrow that it was not going to sell any more long-term stock during the next twelve months, and that it was going to finance itself entirely by the issue of Treasury Bills and very short term stock, that that would have no effect on the gilt-edged market?——No, I have not said that; that would be a completely new departure from the present understanding of the market, which is that "the departments" are going to take opportunities for selling any stock that they have got in the portfolio, from the long to the short end.

2942. Such an announcement would represent a change in the supply conditions in the market, and would, therefore, cause a change in price at once?——I would have thought that an announcement of that sort would.

2943. Similarly, if it was announced that the Government would be making a big issue of long-term bonds early in the New Year, that would affect the market today?——That is the point at which I do not follow the argument at all. The fact that the Government is making a new issue of long-term bonds does not mean that from then on the Government is embarking upon a sale to the market of long-term bonds which was not occurring before.

2944. You mean that the market is now so used to the fact that a prospectus does not mean what it says that it would not take any notice, it would realise that this was a convenient way for the Issue Department to supply itself with ammunition. But suppose that there was an announcement that did cause the market to believe that the authorities had changed their view about the extent to which they should press bonds on the market; that would alter the price level?——Yes, I think it would. I think the understanding of the market about the position of the Department as standing sellers affects prices. If, for example, the Government said they were no longer interested in bond sales I have no doubt it would affect the market.

2945. *Professor Sayers*: That is to say that you as the seller of this commodity, which plays a very large part in the total market for paper securities in London, do affect the market price by your decisions as to the rate at which you are willing to supply the market?—*Chairman*: Every time you contribute by making a sale your decision to sell at that level affects current prices, let alone expectations?——I think that is a point that we have conceded, but I think the question which Professor Sayers was asking was what effect it would have on the market if the Department announced that they were sellers of a particular commodity or at a particular rate. Naturally that would have a big effect on rates.

2946. *Professor Sayers*: This was purely to illustrate the point that you as suppliers help to determine the prevailing market price; that there is not a market price fixed that you have to accept, but the rate at which you sell is one of the factors contributing to the fixing of the market price?——It must contribute to it, but the extent to which it contributes is another matter. For example, if we said we were going to sell £20 million a month that would contribute very materially indeed. The extent of the contribution must vary considerably in so far as our policy is to sell when the demand appears, but, if there is no demand, not to sell.

2947. *Professor Cairncross*: Over a period of years you have certain borrowing obligations that you must meet; there is not a great deal of surplus on current account. Presumably there is a certain amount of room for manoeuvre, in that the Issue Department can get loaded up with long term stock or can go over to Treasury Bills; but by and large, over a period of, say, three years, you have just got to unload surplus stock on the market, have you got?——In theory we can finance the whole of the deficit, including the deficit on the Exchequer caused by a maturing debt, by floating debt borrowing; but given the policy objective which we have it is our aim to do as little of that as possible, and in fact to reduce that amount. The corollary of that is that we try to take full use of these assets as we can. Our success in dealing with that is to be seen in the results.

2948. I am speaking of the minimum results you have to carry through, not the maximum. The maximum is fixed by the securities you would like and are able to switch around. But, given that your policy in relation to the floating debt is what it is, and given that there is a limit to the extent to which you would wish to change the portfolio of the Issue Department over a period of several years, you have not got a free hand in just playing the market; you have a minimum supply of bonds which you must somehow feed out?——As a matter of debt management we have never seen it as an irreducible minimum which has to be accomplished. The factors vary so extraordinarily year by year. In the first place, there is the question of what is required to finance the Exchequer. We have the above-the-line surplus; then those other extra-budgetary factors which go to make up the total of Exchequer requirements that must be financed by borrowing from the public, as you will have seen from the five years' figures, have varied enormously; that includes, of course, the external position. We have to take account of financing outside the market and what can be done by borrowing on small savings and tax reserve certificates. Having done that, there is the residual operation, on which one might say that the minimum objective would be to avoid an increase in Treasury Bills.

2949. *Professor Sayers*: Suppose you found by experience that you were falling a long way short of that minimum objective; suppose you found that this refusal to do anything deliberately or openly about the market price was leaving you to meet a public demand that was a long

* See Appendix to Minutes of Evidence and Qns. 11919 to 12065.

way below that minimum for which you look; what would you do about it?——I hesitate to say before the event. One would begin by looking to the reason that bad caused it, which would presumably be some very strong reason behind the demand of the public for liquidity. Then it would be a matter for policy decision whether action should be taken to counteract that, and if so what action. One would immediately have to consider whether monetary measures were in fact enough or whether they needed either to be supported or even supplanted by non-monetary measures. That situation is getting well outside the realm of what one might call mere debt management.

2950. You are not regarding debt management as a weapon of monetary policy at all? You are saying that, if the atmosphere is not right for your debt management to go forward, you would change the monetary situation? This is rather odd, considering that this morning you said that the case for bringing all the nationalised industries under the one hat for the purposes of borrowing was partly so that you should have the freest possible band in debt management, which you wanted to have so as to make it fit in with monetary policy. Now you seem to be saying that debt management has got to conform to monetary management?——I do not take back anything that was said this morning. I am now trying to say that one would not expect to deal with any monetary situation by debt management alone.

2951. You would never take a view on what the long term rate ought to be for the sake of the general situation of the country, but you would accept what happened in the long term market; is that right?——I prefer to put it this way: that it has certainly hitherto been argued that, while debt management comes into monetary policy because its operations impinge on the money supply and therefore on bank liquidity, and while those operations have an important part to play in monetary policy, they are not by any means operating alone; that there may be, as we have found by experience, limits to what can be done by that means in the controlling of credit; and that it has been necessary to take supporting action with requests and other non-monetary measures.

2952. *Chairman*: You say: "the Issue Department take up the remainder of the loan and sell it over a period"; is there any standing understanding between you and the Bank of England as to what the period should be?——No, there is not. If there were, then the Issue Department would be set a kind of minimum funding programme, and that is not the position.

2953. *Professor Sayers*: In the last sentence of paragraph 20 you refer to the effect that deliberate market operations to affect the rate of interest would have. I accept that; but is it not also true that debt policy combined with monetary policy over the last few years has had precisely these effects? This policy of moving the short rates about, not only up but also down, but not in such a way as to bring about a decisive change in the long rates such as would act quickly on the general economic situation, has tended to "create market uncertainty and so impair the prospect of continuing official sales", and has involved the risk of "damage to confidence and to the Government's credit". Is there any reason to believe that such operations as are referred to at the beginning of this sentence would have these effects to a greater degree? Please understand that I am not here criticising what has been done in the past; my own opinion is that it has been defensible. But I would say that it has had these effects, and I am not sure that the alternative policy would have these effects in greater degree?——The present long term price of gilt-edged reflects some loss in public confidence in the value of money. No doubt there is a lowering in the price to compensate for the fact that it is fixed interest stock. In that sense it can be said that Government credit has been impaired. Then a Bank Rate change can reduce the price; by working through the structure of the gilt-edged market it can have an effect upon the longer end as well as the shorter. That is an instance when official action taken reduces the price of gilt-edged. The distinction is really between that kind of indirect action affecting the Government's credit as measured by the long term rate, and the direct action, as it would be if the Government deliberately sold its securities at a price below the market price.

2954. *Chairman*: Does not everybody know now that this method of holding them for a time in the Issue Department and then selling them as demand arises is what the Government is doing?——That is generally known, yes.

2955. Therefore they know that the Government in fact is in that sense selling down its securities at something below the issue price?——Not necessarily below; over the years we have as often sold at a profit as at a loss.

2956. *Professor Sayers*: But over the years the price has actually dropped; thirty points have come off the price of Consols in perhaps six years? Is that not something which tends to impair Government credit? But this is the price at which the Issue Department is selling. I am suggesting that market uncertainty, impaired prospects of continuing sales, damaged confidence and damage to the Government credit, are equally the result of what has been done about rates of interest and sales by the Issue Department. I say that without any idea at all of "bostile criticism"; it is a very difficult problem?——There are degrees of uncertainty. This is a particular form of uncertainty which I think would be regarded as particularly damaging to the Government's credit, just as would be the uncertainty that would result from a policy of not selling but buying securities in the market, as a device for jacking up the market price, which might introduce an acute element of uncertainty. A lot of what we have done in the past, which I emphasise has been experimental, has been based on the fact that we felt it right to act on the supposition that a fall in the value of money should not be treated as inevitable; we did not take such action as would have been regarded by the market and indeed by the public as an indication that we had given up hope of controlling prices.

2957. But this action might well be taken because it was seen and published to the world that you believed that this was the only effective way of holding the pressure of capital expenditure, not only by private industry but also, of course, by the nationalised industries and everybody else, in check?——Yes, if the view had been taken that this was the only way, that might have justified the shock to the market and to credit which would have followed from such action.

2958. Let us suppose it was judged to be not the only but the best way; why suppose that Government credit should be damaged to a greater extent than it has been damaged by the fall of War Loan that we have seen, from 75 to 55?——The rise of gilt-edged interest rates is, I suppose, primarily due to two things: uncertainty and loss of confidence about the price level, and the fact that the authorities have been willing to make full use of the interest rate weapon as applied by the Bank Rate.

2959. I would not agree at all. I would say that the fall in the price of the War Loan has been due to the underlying situation of the scarcity of capital; the way in which the fall of the War Loan has come about has been regulated in part by the action which the authorities have chosen to take, among them the raising of the Bank Rate sometimes and the depressing of the Bank Rate at other times, and by the instructions which the Issue Department has had to dispose of securities on the market.

2960. *Sir Oliver Franks*: I am still puzzled about the place of the rate of interest on long term bonds in our problems. May I make two assumptions: (1) that while price and the market mechanism may often not be the only important element, it usually helps in the total situation if price is going the way you want; (2) that the situation that we are faced with is the sort of situation we have been living through, that is a high level of consumption and superimposed on that a capital investment boom both on public and on private account with the result that the pressure of resources becomes too great. It seems to me that the rate of interest on long term borrowing must be very important from the point of view of the capital investment boom; that if you want to moderate the boom, raising the rate of interest on long term borrowing must be one of the things that conduces to that. On your view how far has what happens to the rate of interest on long term borrowing to be left

as it were to the course of nature, or how far do you regard it as being within the ambit of policy and Government action? In so far as the basic scarcity of capital has pushed the rate up, that is due to economic pressures rather than Government action. If the alteration of the Bank Rate and the change of rates of interest on short term bonds work through to the long term rate, that would be a degree of control; but I suspect that the extent to which that doctrine is true in practice turns very much on how far one is willing to sacrifice the alternative doctrine of flexibility. If whenever you put the Bank Rate up you bring it down again to keep the muscles continually flexible, that must minimise the effect on the long term rate. Both you and still more the Bank of England have told us how important you think it is to keep the Bank Rate flexible; so I rather discount the effect of that operation on the long term rate of interest. I find it difficult to reconcile the key importance of the rate of long term interest, if we are faced with a capital investment boom, with the rather negative case which you seem to be making about the way in which the Government can tackle the problem of the long term rate of interest. How do you think we ought to come out on it? Has that been the source of all our trouble over the last five years?——We feel this is a field in which we badly need to know more, perhaps to have our minds clearer than they are. Certainly the big ingredient in the situation is the question of the security of capital. The second ingredient, looking at this from the point of view of Government borrowing, is the declared funding policy, the fact that we are therefore in the position of standing sellers of securities in the market. The third ingredient is market uncertainty about the future of the value of money and a certain loss of confidence. That loss of confidence in the ability of the authorities to hold prices and all the rest adds up to a high long term rate of interest. The particular point here is whether to that a further uncertainty should be added, namely that the Government should sell its securities below the sort of market level that has resulted from those other ingredients. That is the point at which we have felt that that would involve us in risks not only to confidence but also to Government credit that would not be worthwhile.

2961. You are answering me, if I may say so, by history. Suppose for the sake of argument that it would have been a good thing if you had tried to contain the boom a little faster and a little earlier; if you had wanted to get the long term rate of interest up and the price of bonds down earlier than you did so in order to diminish the zest for capital investment both on public and private account; how would you have set about it? You say that big open market operations in the long term market for this purpose are undesirable: granted, but the effects of simply moving the Bank Rate about must be limited in the long term field, and it may be that fairly quick effects with the rate of interest on long term bonds are crucial if you wish to bring a capital investment boom under control and to prevent a bad state of affairs from coming about by history, when it might have been cured earlier if you had been able to apply policy to the situation. If you say you ought not to intervene with open market operations, how do you intervene to deal with the rate of interest on long term bonds? Or do you say we cannot intervene, that this is one of the things that has to take its course until the inevitable end is reached and there is a crisis?——It is at that point that one brings in the fact that, at any rate so far, we have thought that there were limits to what should be attempted through the monetary mechanism. This is not the only way in which one attempts to control the situation; we have had, as a matter of history, recourse to the support of requests to the banks and other supporting measures of a non-monetary character. So the position, at this moment when we come before you, is really that we have not made up our minds how far we ought to go in relying upon the monetary measures pure and simple.

2962. This still is not answering the question. It is not a question of the extent to which, for example, you will move the Bank Rate; it is a question of the extent to which, by any form of Government action that may be appropriate, you will directly influence the rate of interest on long term bonds as a means of dealing with a capital investment boom in its relative early stages.——*Chairman*: Why would it not be possible to implement this particular policy through your first major conversion offer after you had made up your minds? Would not that get you out of the difficulty of deliberately knocking down the Government's existing securities?—*Professor Sayers*: You would not be dribbling stocks out; you would offer a large block of long term bonds on terms that looked more attractive than the current market terms?—The first difficulty is what this would do to our continuing market operations. As we say in this paper, that sort of thing would be "possible for a time"; that particular operation might well come off, but the doubt is what would happen on the next operation.

2963. Has not that sort of doubt arisen from the policy that has been followed, which has been accompanied by big drops in the prices of Government securities?——But not as a result of a trick offer by the Government of a stock well below the current market level, which would have the immediate and direct effect upon all comparable securities of reducing them to that level. Such an offer could not be in any way isolated from the market. That is the moment at which one turns to the effect that that will have upon the confidence of the investor. The market knows and takes account of the fact that the Government are standing sellers but for an unknown amount; what would happen in the minds of the investors if they had a concrete instance of the Government deliberately knocking the prices of all Government securities down three or four points, one does not know. Our belief is that that might well induce investors generally to avoid a security when it was liable to that kind of shock. It is perhaps a question of degree of uncertainty and degree of damage to Government credit; but it would be an additional degree of uncertainty and damage which we have certainly not felt hitherto would be worth while.

2964. The damage would manifest itself in the market tending to sag further down; if your desire was to get the rate of interest up by, say, 1 per cent. pricing the bond at a figure that would mean ½ per cent. higher yield then the existing market might well, in the matter of a month or two, on your argument, bring about the desired end. That would be fine, would it not?——In one sense fine; as we said in our paper on monetary policy, the Government, if it so desires, can always influence the rate of interest by the terms on which it sells its securities. What would happen to our funding is another matter and it is on that that we feel uncertainty.

2965. You are saying that this policy of funding at the prevailing market price is thought of greater importance than raising the long term rate to check the boom; is that right?——It does look as though there are influences, other than selling below the market price available, to raise the long term rate of interest to a higher level.

2966. But they do it so slowly and they take it too far. It has been raised too far now, and this situation has come about because the long term rate of interest, instead of being pushed up sharply, was left to be dragged up gradually over years, during which time the price rise gathered force and people were left to come to the conclusion that gilt-edged prices were always sagging and the value of money always going down. So we finished up with a yield on long term bonds of 5½ per cent. or so, which may be too high for 1958. The trouble is not that the long term rate has gone up but that it has gone up so slowly that it has not been much help in checking the boom, and has left prices to rise for so long that now there is in the long term rate quite a big element of discounting the future value of money. Is that not so?——There are two factors which have certainly been perhaps gradual in their accumulation: (1) the scarcity of capital, the continual mounting of demand for investment without a corresponding increase in the supply of savings, and (2) the growing uncertainty about the price level. It is a tenable view that all this might have been stopped years back if the decision had been taken not to operate by the measures that have been used, but instead of all that, by a sharp increase in the price of money. One is not to know; as a matter of history that was not done.

2967. *Chairman*: I do not know the answer, but it is the argument that I cannot quite get hold of. Surely we can all see before our eyes that the recent rise in the Bank Rate has, for the time being at any rate, depressed

the price of Government securities. There is no real doubt about it, although nobody quite knows to what extent it goes. But by putting up the Bank Rate with, I should have thought, its inevitable effect on the gilt-edged market, you make just this blow to confidence and the reduction of prices of Government securities which you say you must not do by a conversion operation at a different level of yield?——It may not be wholly rational, but I believe it is a fact that the investor on the market would distinguish between those two influences upon his securities. The effect of a Bank Rate change upon long term gilt-edged is an indirect and for that matter an uncertain one. For example, when the Bank Rate was reduced in February, 1957, the long term rate did not go down, but up; and after the change of Bank Rate to 7 per cent., although the effect was there, it was comparatively small; a matter of three or four points on War Loan.

2968. *Professor Sayers*: If you just look at the position over days you are ignoring the fact that there are expectations that may change quite sharply after a few days?——But all those come into the picture. That is how, I think, one justifies what is perhaps not wholly rational. If the market takes the view that, because of a decisive Bank Rate change and other measures, the value of money is going to be held, that might have an effect upon the supply of capital and upon the readiness to hold which could lead not to an increase but a marked reduction in yields. That sort of thing can follow. It is not the same effect on the market as when the Government makes a deliberate decision to sell a security at a given price.

2969. If that decision to sell a given security at a given price is put out as an important part of policy and is explained, is it not possible that an investor would take the view that perhaps something successful was being done this time and that the value of money might now stop falling? Would not that be just as rational as the change in confidence that came about when the Bank Rate was raised to 7 per cent.?——It is possible to conceive such an operation; none of the operations that has so far been done has been of that character because they have consisted of a composite set of measures operating on the economy at several points.

2970. This would be a thing to include in a package deal, in fact?——*Sir Edmund Compton*: It could be seen as something that could be done either separately or in a package deal.—*Sir Robert Hall*: I do not think the Committee ought to have the impression that we agree with the implication in some of Professor Sayers' questions that all our troubles have been due to the investment boom. While I think that the point of view that has been put forward is an arguable one, I think it would be to over-simplify the policy of recent years to think that the Government was thinking only in terms of the investment boom. As I tried to explain earlier on, the view was taken that there was an element of cost inflation as well as of demand inflation at work on the price level, and the decision to recognise that in the rate of interest would have been a major decision. I am not denying that it is a tenable view that a more rapid use of the rate of interest might have had a more marked effect on inflation, but the issue at a time when we were worried about rising prices, and regarded rising prices as containing a cost inflation element, is somewhat more complicated than the issue here.

2971. All I had hoped to imply was that, as it had turned out, this essentially passive policy on the long term rate of interest may well have been the most expensive possible policy for management of the national debt, and the worst policy from the point of view of influencing the course of the boom and subsequent recession, if any, by means of changes in the long term rate of interest.——I do not think one ought to regard the measures of September 19th as just a change in the long term rate of interest; it was a package deal. If that sort of package deal had been adopted in the past, then I think it is at least arguable that the consequences that you are suggesting would have happened; but again I think it would certainly be over-simplifying it to say that the Treasury view was that we could have done it by the rate of interest alone without raising rather complicated issues.

2972. But the Treasury policy of debt management was essentially a passive one, was it not?——*Sir Robert Hall*: I think the implication of buying and selling at prices corresponding to market levels is a passive policy.—*Sir Edmund Compton*: I agree; I think there were really two active ingredients: (1) the Bank Rate and its effect upon the price of money, and (2) the existence of the authorities as standing sellers of securities, which is really implied in the objective of reducing the debt. Apart from those two active elements I would agree that our policy was passive.

2973. *Professor Cairncross*: I should like to return to the wider issue and ask a question about the influence of long term rates on the economy and the ways in which the Government can influence long term rates in its operations in the gilt-edged market. About half the capital investment in the country is ultimately in the public sector; that part of fixed capital investment is therefore influenced by rates of interest that are within the powers of the Government as lender to fix. While at the moment the Government appear to rely fairly heavily on the use of interest rates for controlling the private sector, it does not appear to place any reliance on the use of interest rates as a means of controlling the public sector, although the bulk perhaps of the fixed capital investment, in large amounts at least, is in that sector?——We have said in earlier evidence that the amount of investment in the public sector has been primarily controlled by means of the investment programme; it is subject to Government authority.

2974. Since you gave that evidence the Bank of England have put to us that they regard a package deal as important largely because they think that the private sector responds to movement in the rate of interest, but that other measures are necessary in the public sector. I would like you to consider again whether, if you charged a rate of interest higher than the rate which you pay, in order to control the public sector, you would not expect to see some results. If the answer is that you would not expect any results, then I am very puzzled as to why you should expect results in the private sector?——If we wanted to stop the Coal Board from investing, we might charge them 20 per cent., and see what would happen.

2975. I am not suggesting anything more stringent than happens in the private sector to business units at least within measurable distance of the size of nationalised industries?——What sort of control? I am not really aware that investment in the private sector is controlled by the interest rate in the sense that you can regulate the amount of that investment by an adjustment in interest rates.

2976. You are telling us that you do not think movements in the long-term rate an important matter?——No; I am saying it is important but that you cannot say that a particular adjustment of the rate will make a difference of so many millions in the amount of investment that occurs in the private sector.

2977. You do not think that there is a functional relationship of that kind?——I think that particular relationship is one that all of us feel is highly uncertain.

2978. This would be particularly true in the private sector?——I would think so.

2979. The long-term rate might be less important in the private sector than in the public; the horizon of business men may be more limited than the horizon of a nationalised organisation. Their current profits would be more important to them than long-term rates. Would not this be the normal expectation?——I have always thought that the psychology was the other way round; that the private business man had it within his choice to decide either to go forward or not to go forward. He could postpone development if he wanted to, because he thought it would not be worth while to pay that rate in order to do it. A nationalised industry is usually working on the production of some basic national necessity, and is working on a capital programme which, to a large extent, is planned forward, which must be done, and whose product must be sold. Certainly that would be true, I would think, of the Central Electricity Authority.

2980. *Sir Oliver Franks*: Most of the nationalised industries are dealing with something which is basic; but

equally they are not dealing with exports, which are in a sense basic in earning our living in the world. Both are essential in different ways. They are engaged on long-term programmes of development; hut so are a large number of major units in private industry which operate in terms of three, five, seven and eight-year programmes which they have got all worked out. Surely the reasons which you were producing are not special reasons for the public sector; they are reasons which attach on both sides. Your argument must proceed on something which is more particular to the public sector?——The distinction may he one of degree, but I believe once you get to the extremes it is of very real importance. The Central Electricity Authority is one where the forward planning period is particularly long; they are working on a curve of demand for the prime mover of industry and they know what demand they must face three, four or five years to come. The second point is that they know that whatever the price they can sell their product, hecause they are a monopoly. It may well be true of private enterprise that they have a planned programme which they would very much like to go forward with; but whether they have to go forward with it in the same sense is, I should have thought, more doubtful. Equally they are not invariably in the position of being ahle to say that the public must huy the product. I would have thought that, as a matter of degree, a given rate of interest would therefore have more effect on an investor in the private sector than in the public sector.

2981. *Professor Cairncross*: The Central Electricity Authority have been estimating for nuclear power stations; they appear to have taken a rate of interest of 7½ per cent., including depreciation. A public utility of comparable size in the United States would take at least 12½ per cent., if not 15 per cent. The calculation that you make of the operating cost of a nuclear power station as compared with a thermal or hydro-electric station, or of different types of prime mover, is enormously affected by the rate of interest you take. I put it to you that they have been encouraged to think in terms of 7½ per cent., which is an outrageous rate, because they are charged the gilt-edged rate at the time they make the calculation plus depreciation based on general experience of the life of the assets. If they were charged a higher rate of interest their calculation would come out quite differently. Of all the units in this country, this is the unit whose capital needs are far and away the largest. Their capital demands at the moment are ahout £250 million a year, and they are bound to increase. If they do not respond to the rate of interest who is going to respond?——Their response to the rate of interest in that instance is the response of choice as hetween different methods of producing the energy. I have not first-hand knowledge of this, but I am sure that their fixed point on all this is that they have to increase their investment by so much in so many years to meet a demand, and then the rate of interest has come in. It is rather a good example; they may choose between one way of doing it and another way of doing it according to how they estimate the cost of the capital element and the recurrent cost element in production, but either way the rate of interest does not seem to have influenced their decision about the total of their investment over a period.

2982. I will not dispute the facts with you; that would he idle. But is it your view that a change in the rate of interest from, say, 4 to 6 per cent. would have no effect in changing the programme and the phasing of the programme of the Central Electricity Authority?——I should hate to say that it would have no effect. It is a big and very diverse undertaking, and they do things that they might think twice about if the rate of interest was exceptionally high. They might, for example, take a different view on the extent to which they would finance hire purchase according to whether they could get money cheap or dear. I think it would be quite wrong to suggest that it had no influence upon them, but I do not think it would be an efficient regulator of their investment programme.

2983. This seems to me to go to the root of our discussion. At the moment we are left with the impression that control over the public sector, where a large part of the capital investment of the country is centred, must be hy means other than monetary, by periodic interruptions of their capital programmes, scrutiny in detail from the administrative angle; but that at the same time in the private sector control should he exercised in part hy the co-operation of bank managers and in part through high rates of interest. There appears to be a dichotomy here which is puzzling to an outsider who has always heen brought up to think of the public utilities of this country, the industries which are now nationalised, as an area in which higher rates of interest become effective?——Direct control over public investment is certainly part of the constitution of the nationalised industries, as indeed, I would say, of the local authorities, as laid down by Parliament. The whole structure of Government approval for development programmes and borrowing by the nationalised industries is laid down in the Acts constituting them as nationalised industries, and the whole loan sanction procedure is laid down for the direct control of investment by the local authorities. So in terms of their constitution as laid down by Parliament that dichotomy is there.

2984. But as Parliament originally constituted the nationalised industries, I do not think it was intended that there should be interference day by day with the various nationalised industries, or that there should be any more intervention with the detail of their investment programme than was necessary. If you were to charge them a higher rate of interest would that he contrary to the regulations under the nationalisation Acts? You have to approve their programmes; have you not also to approve the interest rate that they pay; are you not, in fact, the persons lending them the money?——We are the persons lending them the money; but I do not think that regulation of their investment programme by adjustments in the rate of interest forms any part of their constitution as laid down hy Parliament. What is there provided is that they can raise money by horrowing by the issue of stock, and there is permission to the Treasury to guarantee that stock, which has always been exercised. In addition to that there is now the additional power of the Exchequer to be a lender. But whether Government intervention has heen by Treasury guarantee or hy direct Exchequer lending, it has always been the hasis of providing the nationalised industries with Government credit.

2985. At no stated rate?——Government credit cannot be granted to somebody at a rate that is ahove Government credit, hecause then it ceases to he Government credit.

2986. *Mr. Jones*: Is not that the difference hetween this sector and the private sector? The nationalised industries in the main are something slightly to the right of the public service; they are not commercial undertakings, in that they are not run for a profit. Does not that create a wide difference between the rate of interest in this context and the rate of interest argued for by Professor Cairncross?——*Sir Edmund Compton*: I confess I am not clear what scheme Professor Cairncross would wish us to consider for this purpose. Is it that instead of regulating the volume of their investment, as is now done, by direct Government approval for their investment programme and for their borrowing, we should tell them that they could raise what they like from the Exchequer provided they paid the rate demanded, and then we should name the rate according to whether we wanted them to expand or modify?—*Professor Cairncross*: Yes, in effect; and any profit on the transaction would remain with the Exchequer and accrue to the public purse.—*Sir Robert Hall*: It never is done in that way, because the investment programmes are discussed with the central authorities largely from the point of view of the estimated rate of growth of the economy as a whole. Although I do not think we say so explicitly, we have assumed that the rate of interest would not be a very important factor compared to the estimated changes in total demand.

2987. *Professor Sayers*: Then do you not arrive back at Professor Cairncross' question whether you cannot do anything hy increasing the rate of interest in the public sector?——We do not say we could not; we say we do not. We control them directly.

2988. Then why do you use the rate of interest weapon at all?——Our relation with the public authorities allows us to control their investment programme directly, whereas we have given up direct controls of the private sector. I

do not think you can deduce from that that the rate of interest would be effective or not effective. We have another method of doing that which we found ourselves bound to use because of the importance of keeping the growth in step in this sector.

2989. *Professor Cairncross*: Do you regard the road programme as being in step?——No, I think we lagged behind there; but that does not alter the case.

2990. *Sir Oliver Franks*: Clearly, with the amount of debt that actually matures from year to year, a great part of the management of the debt must be to deal with problems of maturity and conversion as they come. There must be the perpetual danger that that becomes the predominant occupation, that people live from hand to mouth trying to push the debt forward, but perhaps not doing much more than keep up with the calendar, which brings the debt one year nearer every twelve months. Has there been time or desire at any time since the war to try to formulate a policy which would rise clear of these regular preoccupations and try to devise a means, which might have to be heroic in character, of dealing with over-liquidity and the short term debt? There have been times in the past, before the war, for example, where operations of that sort have been conceived and carried out, no doubt when conditions made it possible to do so; but the impression that I have had from this paper, with its clear-cut view, on how debt management is practised from year to year, is that neither the Treasury nor the Bank (and I think it would be primarily for the Treasury) have been thinking in those terms at all. I have had the impression that they have been so preoccupied, even bedevilled, with preventing things going wrong from month to month and year to year that this larger scale of operation, which perhaps alone in the end is going to be able to deal with the situation, has had to be left out of the thinking and therefore out of the possibility of realisation. How far has this entered into the practical thinking and been something which with a little turn of circumstances might have been put into action already; or something which has just had to be left aside because of the press of the daily exigencies?——*Sir Edmund Compton*: It would be claiming too much to say that we have been able in this period to have a consistent major objective of that kind constantly in mind while we practised our art of debt management. You are quite right in saying that a major preoccupation has consistently been dealing with the debt as we found it and as it changes from year to year. The material here is after all the debt (*a*) as it was left us at the end of the war, (*b*) as it subsequently became after the whole process of nationalisation had been completed, and (*c*) as it then became after that, with the new capital financing of the nationalised industries. In fact the major part of the history of debt management from that time to this has really consisted of dealing with the maturities as they arise, and dealing with the fact that the debt is growing younger every day, that what were medium stocks in last year's list become short stocks in this year's list. You will have noticed, for example, the sudden increase in the under five year element last year. I interested myself by looking out the origin of the two stocks maturing in 1961 and 1962. The 2½ per cent. Funding Stock, 1956/61, started its life in 1935 and was added to in 1950. The 4½ per cent. Conversion Stock, 1962, is mainly a continuation of one of the war-time National War Bond issues, which matured in 1956 and was then converted at the current rate for a further period of six years.

We are necessarily working with the debt as we find it. Subject to that, I think we can legitimately claim that we have had consistently in front of us, certainly in full measure since 1955 and in some sense since 1951, the objectives, as they are described in the paper here, of reducing the floating debt by means of sales of securities, lengthening the debt by pushing forward the maturities. The preoccupation with the floating debt can be dated to the Serial Funding Stock operation of November, 1951, when we accepted the fact that there was this big excess of liquidity and took special measures to deal with it. That in its turn has added to our problems now, because of the way it was dealt with, by issuing Serial Stocks; so that we have had the management of those to cope with as well as the management of the war debt.

2991. That means, I suppose, that the chance of finding in the history of debt management the key to the problem of the future, the key to a policy which will not merely not make worse but which will really decisively influence the whole situation, is small?——I do not know. One can at least say that we have been doing better these last years, as the figures show. In 1951 we took an *ad hoc* measure to deal in a once-for-all way with the excess floating debt at the time. But the figures that we have for the last five years show that, after a period in which market Treasury Bills were going up, we got them level in 1955-56, and in 1956-57, we had them quite noticeably reduced. Our aim is the same this year; and reductions of that order year by year could have a material effect upon the liquidity of the whole system.

But, in case I seem to end on too optimistic a note about the prospects of control, I must revert to the obvious risk in looking forward to funding operations of this sort, that after all we shall not be able to deal with our maturities. We can so plan our Exchequer surplus, our National Savings, our departmental arrangements, and indeed our determination to fund, so as to get a reduction in market debt. But that would go for nothing if we were not able to succeed in dealing with these big maturities of debt over these next few years, which may, according to the decision of an individual large investor one way or the other, result in a change of £100 million either way in the market position.

2992. *Professor Sayers*: How substantial that risk is depends in part on how firm the holders of this short-term debt are. What is the nature of the demand for short-term bonds on which you are in the dark?——To a large extent, I believe, it depends upon what one or two big classes of holders of short-term debt may decide to do, on which we have some knowledge.

2993. *Chairman*: If we look at the table in paragraph 29, there is a marked difference between the general effect of the first two years and the later years; I would like to feel assured that a major contributor to that difference does not lie in the Exchange Equalisation Account operations; I know it has been a contributor?——It has been a contributor. If we had had no loss from the gold and dollar reserves in 1956-57 we should have still made some reduction of floating debt, though nothing like this amount. We would attribute that reduction, apart from the loss of reserves, to the special recognition of the need for funding that was embodied in the measures of the 1956 Budget.

2994. *Mr. Jones*: Am I right in concluding that the summarising of that table in paragraph 29 indicates that in that period the floating debt has been increased by a round £260 millions?——I confess I have not done the sum, but the figures are cumulative; the sum of the figures plus and minus across the table will show the extent to which the market floating debt has been built up over the period.

2995. *Chairman*: On paragraph 30, is it right that the Issue Department confines itself in general to acquiring the next maturity?——It does not only acquire the next maturity. It can also go in for switching operations; somebody may be holding short stock and decide to go longer, and if the market is in that sort of situation the Issue Department may go into the market to finance a transaction of that kind. But (though I could not say they are confined to that) in principle what they buy to hold is mostly the next maturing stock.

Chairman: Are there any more questions? Thank you very much, Sir Edmund; it has been a hard day.——*Sir Roger Makins*: Thank you, Mr. Chairman.

(*Adjourned until Tuesday, 7th January, 1958, at 11 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FOURTEENTH DAY

Tuesday, 7th January, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, Esq., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH (Questions 2996 to 3097 only)
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR FRANK LEE, K.C.B., C.M.G., i.d.c., Permanent Secretary, and J. STAFFORD, Esq., C.B., Director of Statistics, to the Board of Trade, called and examined.

2996. *Chairman*: We are very grateful to you, Sir Frank, for the useful paper* you have put in. Questions will come along from various quarters as we go through it; I will just mention the main themes of each paragraph as we go through and see what questions arise on them. In paragraph 2 you make the point that credit squeeze measures overlap each other, and that it is therefore very difficult, if not impossible, to ascertain individually their separate economic effects.—*Sir John Woods*: In paragraph 2 you talk about capital investment, and the effect on that of these various measures, but you do not specifically say what you think has happened to capital investment by reason of the credit squeeze. You go on in paragraph 3 to talk about the effect on production and demand, and then in paragraph 7 you have the negative phrase: "the Board . . . have no reason to think that productive investment specifically designed to increase exports has been held back" etc. I did not get a clear impression of what effect you thought these various measures had had on capital investment, whether investment in stocks, or fixed investment. Do you think that they have had a material effect?—*Sir Frank Lee*: The words in paragraph 7 to which you have drawn attention reflect a question on which I was asked by the committee to comment, and they are therefore used deliberately in a very narrow context. Paragraph 2 of this memorandum deals only with the question of the difficulties of measuring the effect, whether on investment or on production, of these measures. If you ask me whether it is the view of the Board of Trade that these measures, in their totality, combined no doubt with other factors to restrict demand, have had an effect on capital investment, whether in fixed plant or in stocks, I would say this: in stocks yes, although less than I had thought would be the case from the level of the Bank Rate; and in fixed investment yes, although the effect, I think, was more delayed than many of us had thought would be the case. It is only now that the future order books of, for instance, the building industry and the manufacturers of capital plant, are really showing a decline when projected ahead.

2997. Was there any more noticeable effect from the Board of Trade point of view with last September's measures and the 7 per cent. Bank Rate than with the earlier measures, particularly the Bank Rate, which went from 3 to $3\frac{1}{2}$ per cent. in January, 1955, and was raised to $4\frac{1}{2}$ per cent. in February, 1955, with, of course, all the other measures: hire purchase and restriction on bank advances, and so on? Do you think there was any material effect on investment from the earlier measures before the 7 per cent. Bank Rate?——I think that the effect of the Bank Rate operating at the levels before September was less on the holding of stocks; I was referring only to the holding of stocks when I said that it was less than I had thought would be the case.

2998. And presumably not noticeable on fixed investment?——If you can isolate that factor alone, which we are at some pains in paragraph 2 to show is difficult, not on fixed investment; the interest rate is what matters on fixed investment.

2999. *Chairman*: Unless you tell us otherwise I shall assume that when you talk about the credit squeeze you mean measures taken up to September, 1957, your point being that it is too recent to be able to observe effects since then; is that right?——Certainly. Our written memorandum, as we emphasise at one point in it, is largely based on our experience of the measures up to September 19th.

3000. *Professor Sayers*: I suppose that these impressions you have of the effects of the various steps are based on the statistics you collect, interpreted in the light of what you learn by your direct contacts with industry?——Certainly. They are an amalgam of our interpretation of the statistical position, the monthly reports we get from our regional controllers, contacts with business groups through advisory committees, such as the Machine Tool Advisory Committee and the Motor Industry Advisory Council, and a whole range of contacts with individual business men.

3001. You have mentioned just now the delayed effects of the measures taken; I wonder if you could say something more about the kind of time lag that is involved? Are we, for example, in this winter of 1957-1958 seeing in the field of fixed investment the effects of the changes in the rate of interest and the other measures taken in 1955, 1956 or 1957?——It would be difficult, if not impossible, for me to be precise as between 1955 and 1956. But I think that this winter we are feeling the effects of the measures taken twelve months ago, particularly in relation to the field of fixed investment, but that that has been perhaps intensified by the element of uncertainty about demand which has probably increased through 1957 as world economic conditions have become less favourable, and in the light also of the events of the autumn.

3002. In asking this I have very much in mind the question for what kind of situation a change in the interest rate structure is an appropriate measure. If the situation to be dealt with is likely to be short-lived, then something that is only very delayed action is obviously not particularly appropriate?——*Sir Frank Lee*: I have never sought in my mind to isolate the effect of a change in interest rates from the effect of the totality of measures taken. I was brought up to believe that the rate of interest would particularly, and relatively quickly, show itself as effective in the level of stock holding, but our experience since interest rates were raised has demonstrated that that is less marked than such economics as I have learnt had led me to believe would be the case.—*Mr. Stafford*: The statistics of stocks show that stocks have been mounting, right up to the most recent figures, those for the third quarter of 1957. What connection that has with the various factors which are operating, prices, cost increases, as well as increases in interest rates,

* Memoranda of Evidence Part IV No. 10.

it would be hard to know; but the fact is that stocks have been mounting.

3003. *Professor Cairncross*: Is it fair to say that the proportion of stocks left with the manufacturers has increased slightly; that retailers and wholesalers have been pushing back responsibility for stockholding on to manufacturers?——*Sir Frank Lee*: A constant internecine struggle goes on when there are high interest rates and falling demand in the business world, and it depends where the relative strength is, but by and large I think it is true that there is a tendency for retailers to be able to make manufacturers hold unwanted stocks, or stocks in excess of what they would normally hope to have.

3004. *Professor Sayers*: I presume that by "relative strength" you mean liquidity; that the people who hold cash, or are in the best position to borrow, tend to get left with the stocks?——No; I beg your pardon. I meant that there tends to become a struggle between, say, the multiple firm and its suppliers as to which of them is going to hold the unwanted stocks. It is normally the weakest person in bargaining strength, which may be affected by a number of factors, that gets left to hold the baby.

3005. There is no general lesson to be learnt about the effects of liquidity being distributed in a certain way?——I would doubt it.

3006. *Professor Cairncross*: Have you any data on this, or is it an impression?——I have no statistical data; but it is a clear impression from a large number of contacts, particularly in industries like the textile and furniture industries.

3007. If more of the resources of manufacturing companies are tied up in stocks, do you think that reacts on their fixed capital investment?——I would doubt it. I think that if the tendency went on, if the holding of their excess stocks were continued over a very long period, and they sustained heavy financial losses by forced selling of those stocks, it would have an effect; but I would have doubted whether this has had any effect. That happened in the 1952 recession, in particular in the textile field, and I doubt if it has had any effect on capital investment in fixed plant since then.

3008. Have you any knowledge about the recourse that firms denied bank credit have had to alternative sources of credit, such as credit from other firms, or from financial institutions?——I have not very much statistical information on that, but in analyses that we have done of small firms who have applied for assistance from the Revolving Fund for Industry there is an impressive amount of evidence showing the extent to which they have obtained loans from what we have called "private sources". In the samples we took 54 per cent. of the firms who applied in 1955 had had such assistance, and 50 per cent. of the firms applying in 1956. It is also clear that there has been a substantial increase in the recourse had to hire purchase finance for capital plant.

3009. What is in my mind is whether the credit squeeze obliged firms to have recourse to credit that would not normally be extended to them, from institutions other than banks. What do firms do when they do not get the bank advance they were counting on? Do they simply fold up?——No.

3010. Where then do they go? Do you feel that they have been able to get all the credit they would have had from the banks?——I hesitate to say "all", because my information is obviously inadequate to enable me to do so. By and large I would have said that, so far as our information goes, firms have shown great ingenuity, as one would expect, in seeking financial assistance if they have been denied it from the banks, and that, as we have said in the memorandum of evidence, we have had extremely few, if any, cases brought to our notice in which firms have said that they are near the point of having to fold up because they cannot get money from the banks or from other sources. In a way the extent to which we have not had such complaints, despite the credit squeeze and despite the high interest rates, has been remarkable.

3011. Would you think there has been a permanent shift in the source of credit, and that the banks have lost business that will not come back to them?——I should have thought not. I think that many of the smaller firms to which I referred have always looked for part of their credit to private sources; only between 65 per cent. and 70 per cent. of them had overdrafts already when they applied to the Revolving Fund (in other words some 30 per cent. or so probably got their finance elsewhere). But I would have assumed that if the credit squeeze were relaxed the bank overdraft would again be regarded as the normal source of financial assistance.

3012. *Chairman*: What are the distinguishing features of these alternative sources? Is it very expensive for them to finance themselves in this way? Are they very short term or fixed term loans?——What form of security, interest, and so on, the lender may require may obviously vary. What I do feel is likely to be a continuing permanent feature, which may indeed have been accentuated by the credit squeeze, is that firms will try to keep themselves more liquid than they used to be. The increased liquidity of firms has certainly been a feature of the post-war period as compared with the pre-war period.

3013. Have the alternative sources of finance been primarily friends?——A mixture, I think; friends, relatives, associated businesses, businesses who supply them with goods extending credit, and, as I say, hire purchase on capital plant.

3014. *Professor Cairncross*: You are not basing this on your sample of small firms?——No. I am basing it on the reports we have received, primarily from our regional controllers whom we have asked to tell us about cases of potential difficulty, and how they are to be dealt with, and on a number of personal discussions that I have had over the last two years with businesses both large and small.

3015. *Lord Harcourt*: Would it be your impression that these alternative sources of credit are both more expensive and also much less flexible than bank credit? Would that be the reason why they would probably revert to bank credit when it becomes available?——I have no data that enable me to answer whether they really are more expensive, though I would agree with you that they probably are. They are undoubtedly less certain and less flexible than bank overdrafts. In fact, except in the very small firms, these are rather in the nature of desperate expedients.

3016. *Mr. Jones*: Am I right in concluding that in certain circumstances there has been a substantial expansion of credit within industry and within commercial firms themselves? Is there a situation where in spite of the credit squeeze firms have been using a greater amount of working capital?——The need for working capital really reflects the scale of operation of the businesses. Firms have certainly tended to try to finance more and more of their operations, including some of their investment in fixed plant, out of their own resources rather than depend on bank overdrafts or other sources of credit. That has been a marked tendency of the post-war period, and continues to be so even in those sections of industry, like the textile industry, which have been in difficulties. The recent figures about the liquid reserves of spinning and weaving companies, for instance, show how they have been at great pains to maintain those at on the whole rather surprisingly high levels.

3017. *Professor Sayers*: When industry has the opportunity to replace these "desperate expedients" by bank advances in the ordinary way, would you expect there to be a very large proportionate increase in the total of bank advances? When the control is taken off, would you expect the total of bank advances to rise above its present level by a third, a half, or a tenth?——I would expect it to be more marginal than one might suppose; if I had to quantify it, it would be nearer a tenth than the other fractions that you mentioned, but this is only a very broad judgment.

3018. *Sir Oliver Franks*: We were asking you whether you could give any indication what sort of situation you thought appropriate for action by means of interest rates, and we followed that up by wondering whether you thought that the effects of action by interest rates were primarily short-lived, acting quickly and soon passing off, or of longer effect. I was not clear about the answer to the second question. You might want to say it was a matter of emphasis rather than absolute separation, but I should be very interested to know where you think the emphasis falls?——I have to answer that rather obliquely, though not because I wish to be oblique in my answers: I think that it is clear that with higher liquidity in a great

many companies, and with current taxation levels, an increase in interest rates has lost a great deal of what I might call its classic efficacy. I think of it as a necessary element in measures designed to curb the excess strain on the economy largely because of its perhaps psychological effect. I have a belief that without an increase of interest rates the other measures would look to be less effective, and I believe that in the general effect of these measures on business men's opinions it is what they look like, what the demand feature looks like being, that has a greater psychological and cumulative effect than the actual fact that money has become dearer, or even that they are unable to get an advance from the banks. As to the specific effect of higher interest rates, I have always assumed that that would be relatively quick in its effects, particularly on stock levels; as I said earlier, it has been to me one of the surprising, and indeed disconcerting, things that the advances in the Bank Rate have not had that effect.

3019. Would it follow from what you have been saying that, if the use of interest rates is normally accompanied by other measures, the totality of which are designed to produce certain results in the whole economy, on the whole these measures, and therefore the action by interest rate included, must tend to produce a long range effect? To alter the whole state of the economy is a fairly major undertaking and normally takes time, and I would judge from what you say that you regard a change of Bank Rate as part of a series of measures designed to effect a fairly major, and therefore relatively long term, alteration in the economy?——Certainly, subject only to this: that I would not want you to have the impression that I thought that a change of one per cent. in the Bank Rate, which might, I know, be desirable for almost technical reasons, would necessarily form part of this general range of measures which we have been talking about. I was really addressing myself to the necessity of curbing excess demand in the economy, and I would entirely agree with you that in that situation an increase in interest rates is only one element in the range of measures, though an important psychological one, and those measures will take longer to work through the economy, and to have effect, than some of us thought was the case in, say, the early fifties.

3020. Then it would follow that the immediate effects of a change in the Bank Rate, for example the repercussions in the discount market, are not very important?——I would judge not.

3021. Do you feel that all that you have been saying holds equally whatever the level of Bank Rate? It might be the case that what you have said holds for the levels to which the Bank Rate was raised between 1952 and August, 1957; but, if September 19th turned out to be the beginning of a new concept of new levels of the Bank Rate, it might equally mean the same consequences followed much sooner from a given level of Bank Rate. At that point might it not become a very effective and very blunt instrument?——Certainly. I am grateful that you have given me the opportunity of saying this, because I may have given unwittingly an impression by my earlier replies that I did not think the Bank Rate almost at any level had a deterrent effect by itself. Of course it must at the margin, particularly when it gets to levels of, say, 7 per cent. and above, have an effect on business men's judgment, both as to holding of stocks and as to investment in fixed plant; and not only on business men's judgment, but, as we have been seeing recently, on the judgment of local authorities.

3022. But if in an inflationary situation the Bank Rate is used at these higher levels does it equally have to be part of a package?——I think so. I can visualise a position in which a Bank Rate of between 10 per cent. and 20 per cent. might have of itself a sufficiently deterrent effect but given the other factors that I have mentioned before I should feel doubtful about it, and as a practical administrator I should always be happier if it formed part of a general package.

3023. *Chairman*: Would that be in order to make the effect you wanted arrive quicker, or to make the effect last longer?——Both; I think a high Bank Rate would help to bring about quicker results in, e.g., the holding of stocks, but also I think it would affect business men's judgment about the future, and therefore would have an effect on their longer term plans. That is looking to an effect which will bear upon actual happenings two or three years ahead, because a great many investment plans are in a state in which they manifestly cannot be altered. If people think that the economy is going to be disinflationary at the margin, I think it will influence their judgments in a great many diverse ways, in their investment plans, in their attitude to wage claims, in their attitude to costs, all of which, on the premise that we are talking about, of restraining excess demand, will be valuable; and by and large I would say the more drastic you can make your package, including your interest rate, the better. I think the worst thing of all is to have it inadequate. It is easier and I think healthier to relax restrictions than to have to build them up cumulatively by rather painful additions to them, as we have had to do over the last two years.

3024. *Sir John Woods*: In October, 1954, we had the first public warnings from the Chancellor of the Exchequer and the Governor of the Bank of England in speeches at the Mansion House that the inflationary tendency was showing some signs of getting to uncomfortable levels. Nothing was done until the Bank Rate was raised the following January, and then there was a further effort in February, then accompanied by hire purchase restrictions. Following from what Sir Oliver Franks has said, is it not a possible view that, if in October, 1954, besides making speeches, there had been earlier and more resolute use of the Bank Rate by itself, it might have had the desired effect of checking the tendency at an early stage?——I think that would certainly be a tenable view. If in the autumn of 1954 there had been a relatively sharp increase in Bank Rate, by at least 1 per cent. instead of one half per cent., that would at least have been a clear warning signal which would, I think, have affected business men's judgments. I have some doubt in retrospect whether the seeds of the investment boom which many of us saw apparent in the summer of 1954 were not so strong and so embedded in the system that an increase of 1 per cent. in Bank Rate would not itself have proved sufficient to have checked the boom effectively; but as a general proposition I take your point that the earlier in the onset of an inflation a check can be introduced the better, and the less drastic the check may have to be. It might well be that taken early an increase in Bank Rate alone, provided it was relatively drastic, would have a sufficient disinflationary effect.

3025. *Professor Sayers*: You have been referring almost exclusively to Bank Rate, but very occasionally to interest rates. Suppose that during this inflationary phase it had been considered technically possible to operate more directly and more effectively on long rates; do you think that the effects in moderating the investment boom would have been quicker to appear and more marked?——No, I do not think so.

3026. Why? What effect do you attach to the Bank Rate that you would not attach to other interest rates?——I agree that a higher long term interest rate would be more effective in restraining fixed investment, and therefore in dealing with the main impact of an investment boom, than an increase in short term rates. On the other hand I attach substantial importance to what I have called the psychological element of business judgments about what is likely to happen to the economy, as likely to affect at any rate the totality of demand, and the other factors such as the attitude to wage claims; for that I would have thought an increase in Bank Rate, together with the other factors, is likely to have a more immediate and marked effect.

3027. Why should the Bank Rate have this peculiar influence? Is it its headline power?——I am not saying the Bank Rate alone.

3028. Apart from a package, are you not attaching some peculiar importance to the Bank Rate in its effect on the business man's psychology?——If you press me, I must frankly say that I think that the real effect is more psychological, and more due to what is almost a historical reflex than to actual dispassionate judgments; except, of course, at the margin of decisions.

3029. Is there any sign, in your experience of business men, of the historical reflex wearing out?——I think that it is wearing pretty thin, when the Bank Rate is advanced by slow and cautious stages from, say, 3 to 3½ per cent. or even from 3½ to 4½ per cent., but that it has a very marked effect when you lift it by two points and lift it up to 7 per cent., or even higher.

3030. Supposing that the manipulation of the Bank Rate in the recent past has been such as to lead the business man to believe it likely that a recent rise in Bank Rate will soon be followed by a drop?——That would certainly have a substantial effect the other way from that which I was postulating.

3031. *Sir John Woods*: You mentioned just now two things, which could be separate: a steep rise in Bank Rate, say of 2 per cent. instead of 1, and a level of 7 per cent. Can we have your view as to whether both of those things, or only one of them, will make the business man "linger shivering on the brink, and fear to launch away"? Do you think a rise from 3 to 5 per cent. will do the trick, or is the more effective thing the absolute level?——My answer must be qualified, in that I think it probably depends on the strength of other factors in the economy at the time the decision is taken: how strong in fact is the boom condition, and the expectation that the inflationary elements will continue. That is why I have been urging that Bank Rate can only be an element in the general situation. I could postulate a situation in which the effect of lifting the Bank Rate from 3 to 5 per cent., combined with other measures which showed the Government was determined to remove the excess burden on the economy, would of itself be adequate to deal effectively with the situation, especially if that action were taken early before the boom had become too deeply embedded in the economy.

3032. *Chairman*: When you speak of a business man's psychological reactions to a higher Bank Rate do you mean that he takes that as a sign that trade demand is going to be weaker, or that the Government is going to do all that it can to make trade demand weaker? Might not his deductions about the two things be very different?——I would say that the first is more powerful than the second. I would not think that there was that faith in the Government's determination in these matters that many of us would wish to see.

3033. If the first is the predominating influence, would it not be true that the more generally knowledge is diffused outside what I will call the Bank parlour into businesses and commentators and so on, the less importance the business man attaches to Bank Rate as a signal, because he has that much more information to draw upon?——I think that at that signal, combined with others, there does come into the business man's mind a feeling that trade is not going to be as booming as it was, that he may not be able to sell all his goods, whatever costs he loads on to them, and that therefore he had better take measures, whether it be in relation to stocks or to longer investments in fixed plant and so on; that will mean that he will perhaps restrict his own activities. I think that Bank Rate is, as it were, a signal or a symbol of all that, but is not a potent thing in itself. It is a warning sign, particularly if it is accompanied by other measures.

3034. But a warning sign given by people who are likely to be in a much better position than himself to judge as to what trade demand is going to be in the future?——I think that this is not done so much, in many cases, by a conscious process of reasoning and "nicely-calculated less or more" in business prospects as a general hunch that things are not going to be as lush as they were, and therefore we had better do something about it. That perhaps exaggerates the extent of the irrational in a number of business judgments; it is significant that in Mr. H. F. Lydall's study, published in the September, 1957, issue of the *Economic Journal*, it was the larger firms who were predominantly influenced by judgment about demand, and in many of their cases it must have been the product of conscious reasoning based on a general assessment of the situation as symbolised or lit up by the measures that the Government had decided to introduce, including a raising of the Bank Rate.

3035. *Sir Oliver Franks*: Is this what business men think, or is it what the Board of Trade has been accustomed for some decades to think that business men think? The Treasury told us when they gave their evidence that it had been the policy of Government since the war to make full employment the primary object of domestic policy, and that as the obverse of that they were determined to prevent slump or recession and to keep the level of demand very high, and in addition to secure continual growth in economy. It might be that with twelve or, if you like to take the war into account, eighteen years of that, the business man was accustomed to expect that demand would be kept very high, and that, while he might see occasional attempts, more or less wholehearted, by Governments to prevent the economy completely blowing its top off, he would, nevertheless, always suppose that the first business of Government would be to see that demand was kept really high. If that is so, may it not be that this doctrine of the warning signal especially of the Bank Rate is appropriate to the nineteenth century, perhaps to the first quarter of the twentieth century, but not to this decade that we are looking back at? Is it not possible that a large number of business men have come to assume that they are in a world in which demand will be kept high by Governments, and that therefore these older-fashioned signals would not be likely to have very much effect on their thinking or psychology? Is that different way of looking at the situation one which you would reject out of hand, or do you think that it has some truth in it?——Certainly I would not reject it out of hand. I would say your analysis had very great validity, and that the fact that it has such validity illustrates the great difficulty Government have experienced in bringing about an alteration in the sort of psychological outlook on what is going to happen to the economy. This illustrates my view that, if you have demand running in an abnormally strong way, it is only by a range of measures drastic in themselves and pursued with manifest determination that you can hope to secure a definite change in the business man's outlook.

3036. Suppose that what you say is so, may it not follow that such effect as interest rates, and Bank Rate in particular, may have must be looked for not so much in their symbolic character or psychological effect as in the expensiveness which their absolute level at any time carries with it. It is not that the Rate makes the business man wonder; it is that it actually makes him watch his pocket at five, six or seven per cent.? That is turning the whole doctrine round; do you disagree?——I neither agree or disagree. I think that at the margin the cost factor to which you referred is operative and does have an effect on his judgment. I would not, however, want to dismiss because of that the psychological factor to which I have been referring. I have always felt that if the economy can be made only marginally disinflationary that would have a quite impressive effect on business psychology, not perhaps so much, in many fields at any rate, on long-term investment plans (there I think the raising of long-term interest rates is the more effective weapon), but in such matters as concern for costs, attitude towards wage claims, general willingness to fight wage claims or negotiate at longer periods for wage claims. I think that the experiences of the 1952 depression in the textile and furniture industry showed that, and showed its effect on industries which were not directly affected by the depression.

3037. *Professor Cairncross*: What proportion of stocks in the manufacturing industries would you imagine to be covered by bank credit; 10 per cent.?——*Mr. Stafford*: I cannot answer that question. One can only go by published balanced sheets. Whether it would be fair to say that bank advances were such-and-such a percentage of total stock holdings I do not know, but I think that is the only answer one could make. I have not that figure with me but I could easily get it for the Committee.

3038. You show figures in the National Income Blue Book of £4,000 millions for stocks and work in progress held in manufacturing industry, and I think the usual estimate, presumably on balance sheet data, of advances to manufacturing industry is in the order of about £500 million; so presumably it is roughly of the order of 10 to 15 per cent.?——*Mr. Stafford*: If that is a legitimate calculation. It is very difficult to identify a particular source of credit with a particular use of credit; advances may be used for this purpose or that purpose, and may not necessarily be available simply by reduction of stocks.

3039. That consideration would point to a lower proportion still?——Yes.

3040. You would agree that only a small proportion of the stocks and work in progress in industry is carried on bank credit?——As far as we know.

3041. Would you agree that a higher proportion is carried in distribution, particularly wholesale distribution?——Yes, possibly.

3042. Have you noticed if there has been any divergence in movements of stocks in these two sectors as the Bank Rate has changed?——We have not had good information about stocks in distribution.

3043. *Sir John Woods*: You said that stocks had been mounting up to the third quarter of 1957. Could we be told what the stock position is in volume and value for the third quarter of 1957 as compared with the corresponding quarter of 1956?——I have not that figure by me, but I can very easily let the Committee have it.

3044. *Professor Cairncross*: From the published figures there appears to have been an increase of 10 per cent.—*Sir John Woods*: Is that 10 per cent. in volume or value? ——*Sir Frank Lee*: It is measured in value.

3045. *Lord Harcourt*: Have you any evidence, or is it your experience in the Board of Trade, that the shortage of credit for the carrying of stocks has led to any disposal of capital assets? Has there been a marked tendency for people to sell their buildings and rent them back in order to provide the cash to carry their stocks?——I have heard at most of two or three such cases, but certainly nothing which would suggest that there is a marked tendency.

3046. *Sir Oliver Franks*: You would not think that the experience of insurance companies would show that that tendency existed, because they are the sort of people to whom, say, the owner of a distributive business would go to raise capital, to sell his shop or whatever it may be, for 18 years purchase, and rent it back again?——They would probably have more knowledge if there is a general tendency that way than the Board of Trade. There is no reason why we should know of it unless we happened to hear of it. I have seen press reports, but these cases have not come directly to my notice.

3047. *Professor Cairncross*: Is the proportion of stocks carried on bank credit higher now than in the 19th century?——That would be my impression, but it is an impression that is unsupported by any direct knowledge.

3048. You referred to the change in liquidity, and to the efforts on the part of some industries to get out of debt to the banks. Have you given any thought to the change in the operation of the Bank Rate here since prewar years, and particularly since an earlier period when presumably a large proportion of bank money was being used to finance stocks in industry as well as in trade?——I think that the factor of greater liquidity as well as other factors have combined to make an advance in Bank Rate taken by itself less effective than was almost certainly the case up to probably 1914, and to destroy or impair much of the classical doctrine which I was taught.

3049. *Chairman*: We have covered paragraph 3. In paragraph 4 your point is that in 1956 the boom was certainly checked. In paragraph 6 you say that in 1957, although the general policy of restricting credit has not been relaxed, the effect of the monetary measures appears to have become progressively less marked in the course of the year. In paragraph 7 you come to the Government's policy with regard to increased production for export.—*Mr. Jones*: How can the Board of Trade separate productive investment for export from other investment; for example, in the motor car industry?——This sentence was put in because we were asked about this particular question and I thought we had better try to give an answer. But I hasten to say that this sentence has no real validity in my judgment, because it is almost impossible to identify productive investment specifically designed to increase exports, except conceivably in the case of one or two firms who, like the British American Tobacco Company, for instance, do no trade at all in this country. You could argue that an expansion of their facilities was specifically designed to increase exports; but apart from such cases, I do not see how you could do it.

3050. *Chairman*: In paragraph 8, you say:

"The Board are of the opinion that, when restrictions of any kind have to be applied in order to influence the economy, measures of wide and general application are preferable to selective measures of narrow application; the latter, by their nature, discriminate sharply against particular kinds of production, and may thereby adversely affect the growth and pattern of investment and the channels of trade."

What is the weight of "adversely" there? Would the sentence read the same if you left it out?——Its only weight is in relation to the word "growth": that certain industries, if discriminatory measures had to be applied against them, would grow less fast than they otherwise would, and therefore their growth would be adversely affected.

3051. Obviously if you discriminate sharply against a particular kind of production you will affect the growth and pattern of investment; it does not follow that you will affect it adversely?——I think, now I look at it, that this adverb is perhaps unfortunately placed there, in so far as it might be thought to relate to an overall effect on investment. It was used more in the sense of distortion.

3052. *Sir John Woods*: You mean adverse to particular kinds of production which appear to have a large growth potential?—*Sir Oliver Franks*: Are you not saying more than that? I took this to mean that the Board of Trade were adhering to their traditional attitude of "nature's way" or "laissez-faire," or whatever we call it: that, if there are particular restrictions imposed by Governmental authority, of whatever kind, these obviously point by point cut into the ordinary development of things, and that the ordinary development of things, nature's way, tends to produce the best results. Does it mean that?——I do not dissent from what you have said, but I think you are placing more weight on the adverb "adversely" than I intended it to have.

3053. The view which I took is at least excused by what is said in the next two sentences?——I do not want to dissent from it. It was a question of the use of the word "adversely" in the particular sentence. I readily accept that your broad analysis reflects not only the traditional but the present view of the Board of Trade and my own view.

3054. *Mr. Jones*: Can we afford to have normal development and "nature's way" without any sort of pattern in an economy like ours?——That is a very far-reaching question. In my judgment the nearer you can get to natural development of the economy the better; and, if you have to restrain natural growth, you should endeavour to restrain it by measures of wide and general application, as we say here, rather than by selective measures chosen by gentlemen in Whitehall. I think I would qualify that only to this extent: that I would feel that there were some industries, like the steel or chemical industries, of such basic importance to the economy that, if it could be shown that the measures of wide and general application to which I have referred, and to which I have given clear preference, were having an unduly detrimental effect on such industries, then I would be prepared to introduce some selective measures, e.g., the use of investment allowances or some such technique. Beyond that I would hope not to have to go.

3055. What about roads and road transport, having regard to the proposed development of a Free Trade Area and the necessity for developing a competitive position in those circumstances? Do you not think that involves some pattern, particularly at this stage of our economy?——I am very doubtful whether it would be right to make a selective judgment that you must put an abnormally higher proportion of our resources into, say, roads to the detriment of the growth of productive industry or the railways.

3056. But would it not be a good thing to seek to ascertain what our resources could be and how best their investment and use could serve the economic wellbeing of the country?——If I believed that you could get an overall investment plan operated by people of undoubted vision and wisdom I would agree with that concept; it is because I am sceptical whether such a plan can be achieved that I prefer the approach that is summarised in paragraph 8 of this paper.

3057. I am not thinking so much in terms of infallibility of judgment. I think you would be bound to make some provision for that. But what about planning the economy to a greater degree than you are visualising in the first sentence of paragraph 8?——To some extent of course the economy has to be planned. The measures which the Government and Bank of England take to restrain the economy or alternatively to inflate the economy are themselves examples of a plan. The whole

of our taxation system ought in my judgment to be, to a larger extent than it is, geared to the needs of the economy. And within that system, as I have already implied, you can appropriately have some measures of deliberate selection, as with investment allowances. But within the context that this paper is dealing with, the application of measures of restraint, it is my considered belief that our industrial structure is so complex, and the issues of judgment which would be left ultimately to bureaucrats to decide are so difficult, that more harm than good would be done by attempting such a selective system.

3058. *Chairman*: So the preference for the kind of measure to be taken which you speak of here comes down to your feeling that there is very great difficulty in a complex economy such as ours in making decisions that are right enough for the purpose?——That is the strongest factor in my mind; I will not say it is the only factor, although I think that on analysis the other doubts I have probably all stem back to that.

3059. *Professor Cairncross*: At the same time you do not seem to feel as much confidence in the rate of interest, which is one such measure of wide and general application, as you formerly did?——As I was taught to do.

3060. Would you feel perhaps the same necessity to revise your view as to other measures of wide and general application, and say that some of them are not so powerful and so effective as perhaps we were taught to think?——That may be so, although I believe that, if we had had at an earlier stage in the boom a range of measures of the type I have indicated, and pursued them with resolution, those might have been effective. Certainly it would have been better for the economy to have proceeded in that way than by a process of selective restraint.

3061. *Chairman*: Then we come to the Capital Issues Committee. You say that about 25 per cent. in number of all the applications made to the Capital Issues Committee are referred to the Board of Trade. I suppose that people may also come to you and say: "We are thinking of applying to the C.I.C."?——Certainly.

3062. *Sir Reginald Verdon Smith*: The Capital Issues Committee plainly places very great importance on the advice they receive from the Board of Trade in these cases. Is there an exhaustive examination made on further evidence which may be sought or brought to hear, or is consideration given to the application on the merits of the case as it comes from the C.I.C.?——One of our general divisions receives these applications. Their procedure is to refer them to the appropriate production division in the Board, which has the responsibility for maintaining touch with the industry of which the particular firm is a member, and to ask for their advice on the application. The people in the production division will normally talk to the company itself, in an endeavour to get any further information that it needs to make a judgment on the application, and in particular to consider its relevance to the promotion of the export effort, which, as we say in the paper, is the criterion by which these applications are normally judged. The production division reports back to the general division, which then looks at the case in the light of other judgments we have made and formulates advice to the Capital Issues Committee.

3063. *Sir Oliver Franks*: I suppose that the Board of Trade have responsibilities for the greater part of British manufacturing industry and are therefore very interested in the functioning of the C.I.C., quite apart from the particular advice which the Board gives to the Committee on particular occasions. What is the view of the Board of Trade about the general functioning of the Committee? It is, is it not, a selective instrument, by its particular decisions affecting the prospects of particular companies from time to time. Has it been your view that it has operated powerfully to the good or not so well? Are there any general observations you would like to make?——Frankly, I do not think I am in a position to make a general judgment on the Capital Issues Committee. Of the 4,000 applications a year that it gets we only see less than one quarter, about 750. Many of those are relatively small, and the rest of the field of the Committee's operations is completely hidden from us, except to the extent that they are revealed in the press. I would therefore hesitate to make a judgment on the totality of its work. We find the act of judgment on the applications that come to us a matter of considerable difficulty, for precisely the reasons I gave earlier in expressing my dislike of selective controls: that it is extremely difficult to make a judgment. We have to have a self-given criterion: is this going to help broadly the export effort? Of course, every application we get tells us that it will, and then we have to make a judgment, which is a very difficult thing.

3064. *Chairman*: The whole tenor of what you have been saying is that that kind of judgment is almost impossible?——I am not dissenting from that, nor do I see, with respect, any inconsistency with what I have just said. We are obliged to help to operate the C.I.C. machine.

3065. I did not wish to suggest that you were being inconsistent. You tell us in paragraph 10 that your judgment whether to support an application or not is all brought back to the question of its relation to the balance of payments?——Yes; that is the broad test that we have had to give ourselves in judging the cases referred to us.

3066. *Professor Cairncross*: Would this mean, to take an example, that a furniture factory which wished to reorganise itself in a much more efficient way, but had no interest whatever in the export market and could hardly be said to be reducing imports into this country, would be denied the right to make an issue?——No; of course this test has to be applied in a broad, and I hope a broadminded, way. A manifest economy in production or distribution clearly has a marginal effect on the balance of payments. But the fact that one has to qualify the test by admitting the marginal importance of such cases again illustrates my general point of the difficulty of judgment of these cases.

3067. *Chairman*: Why do you feel under the necessity of trying to relate them to their contribution to the balance of payments? Might it not in many cases be impossible to do so?——As a matter of practical administration we have to give the officers who deal with these 750 cases some guidance as to the judgments they are to make, and this has seemed to us the most sensible guidance to give them.

3068. *Sir John Woods*: Could you not give them as another guide that the capital expenditure should be judged materially to increase their efficiency? What is wrong with that?——Nothing is wrong with it as a proposition. I have an uneasy feeling that, if it were applied as a practical criterion, we should find that every case was being approved.

3069. *Sir Oliver Franks*: But you say that every case now assists the balance of payments, at least in the submission made to you?——I think it is easier to make a judgment on the broad test of the balance of payments than on materially increasing efficiency.

3070. *Chairman*: It is not the limit of the function of the Capital Issues Committee, as I understand it, only to consider whether a loan or raising of capital contributes to the improvement of our balance of payments. It has a variety of tests, negative and positive, which it is supposed to apply. It is not the Board of Trade's function only to consider the balance of payments, is it?——No; but it is perhaps our primary concern. I readily admit it is open to the criticism that this is too narrow a test. I can only say this has been found to be from an administrative standpoint the criterion by which subordinate officers are best able to make this judgment, always understanding, as I said in reply to Professor Cairncross, that it is not exercised in too limited and purblind a way.

3071. *Sir Reginald Verdon Smith*: From paragraph 10 it would then appear that 87 per cent. of the cases in a recent period do help the balance of payments?——Were judged to help the balance of payments.

3072. *Professor Sayers*: And that this is the kind of criterion which allows you to turn down 13 per cent.?——Has had the result of turning down 13 per cent.

3073. It is sometimes said in the criticism of the operation of the control that no reasons are given to people whose applications are refused. Do you give to the applicants with whose applications you are concerned any indication of the reasons why you are not supporting their applications?——No.

3074. Why should they not be given the reasons?——They should not be given the reasons by us because ours is only an advisory function. The ultimate decision, which may be taken on broader grounds than Board of Trade advice, is taken by the Treasury.

3075. Is there anything in the nature of your grounds for advising against a case which would seem to make disclosure inadvisable, so far as your cases are concerned?——No, not inadvisable nor, I think, embarrassing to us.

3076. *Chairman*: Does your experience suggest that it is a source of grievance that people whose applications are rejected by the Treasury on the advice of the Committee do not get reasons given to them?——I would have said from my personal experience there was a good deal of bewilderment and some degree perhaps of resentment, but I think more bewilderment than resentment.

3077. Bewilderment arising out of the fact that no explanation is given?——And the apparent anomalies that A is chosen but B rejected, when A and B seem similar.

3078. *Sir Reginald Verdon Smith*: Would you happen to know whether the same criteria are adopted by other departments to whom the other 75 per cent. of the applications would be referred by the Capital Issues Committee?——I suspect, but I do not know, that not all the 75 per cent. go to other departments. I imagine a number are the sort where the Committee do not need to secure advice. In so far as they concern particular industries with which the Ministry of Supply is intimately connected, the broad criterion adopted by them is the same as ours.

3079. *Mr. Jones*: Would it be possible to transpose the percentages in the first sentence of paragraph 10 into amounts? Have you any idea as to the amounts of capital involved in the applications that were granted and in those that were refused?——I could get it but I have not got it in my mind.

3080. *Lord Harcourt*: How many of these applications are discussed by the company with your production divisions, before they ever get formulated at all? Do companies come and talk to you about their plans, and consult you and take advice from you or seek advice, before ever formulating a request to the Capital Issues Committee?——It is not possible to give you any precise statistical answer to that; the things merge into one another. A great many companies talk to us about their investment plans and we encourage them to do so At points in that discussion the question of how those plans are to be financed comes up, and they will no doubt say: "We shall be having to make an application to the Capital Issues Committee; if it comes your way we hope that you will back it", and we no doubt make some sympathetic and non-committal murmur at that point. Then there are cases in which companies come to us specifically before they make an application and tell us about it, again in the hope of enlisting our understanding sympathy and support.

3081. And frequently in order to give you a more detailed picture than will go in the application?——Certainly; it is often very useful to us and to the Capital Issues Committee that they should do so. But I do not want to imply that that is done in at all a large proportion of the 750 cases.

3082. *Chairman*: You tell us in paragraph 11 that, on the evidence of the applications dealt with by the Board, the company that wants to raise a small amount of capital is less likely to succeed in an application to the Capital Issues Committee than the company that comes forward with a request to raise a large sum. And in paragraph 12 you say that of the cases referred to the Board that involve sums of less than £50,000 about a fifth are rejected and of those involving larger sums about a tenth are rejected. That sounds an important point; but there may be a perfectly innocuous explanation. Are the applications for larger sums likely to be better weeded out?——The second sentence of paragraph 11 (a somewhat cynical sentence) is of substantial importance here. Our experience is that bigger firms are more able to put cases to the Committee which they know are going to succeed, or are more likely to succeed, and to refrain from putting in hopeless starters.

3083. It may also be put rather less conveniently, that they can get, because they can pay for, more persuasive advocates who are able to present their case in a more persuasive way?——That could be so; but without greater knowledge of the Committee's proceedings, I could not make a judgment on the extent to which persuasive advocacy plays a part in their decisions.

3084. *Professor Cairncross*: But, as you say in paragraph 12, in some ways it would be in the interests of the country if the big firm did not have this advantage over the small firm, because the small firm would have difficulty in coming back later and the large firm generally has other opportunities?——Certainly.

3085. *Chairman*: In paragraph 13 you draw attention to the continuing high liquidity of business since the war and the difference in the percentage of profits distributed, from 60 per cent. before the war to roughly 30 per cent. since.——*Sir Oliver Franks*: Do you consider that the phenomena to which you draw our attention in these paragraphs together constitute a major difference in fact, and therefore a major new circumstance with which policy has to deal in the general management of the economy? It seems to me that it is at least possible to argue that this change in the liquidity of companies in its effects on other actions that may be taken makes a difference in principle to the effectiveness of monetary policies. Would you go as far as that or not?——"Highly significant" I would certainly accept; I think I probably would accept "major". It is no more than a difference of emphasis between us, if indeed there is any difference of emphasis.

3086. *Professor Cairncross*: Some of this evidence really does substantiate the claim that there has been an increased amount of self-financing; but a large part of the change referred to in paragraph 14 is surely due to the higher taxation which you refer to in the last sentence, and another part is due to the need to make higher allocations to cover renewals because of the increased cost of equipment. Similarly, in paragraph 15, the rise in the proportion of turnover allocated to reserve is partly offset by the rise in the cost of equipment and renewal. So far as that is so, there is no increase in self-financing; it simply means that you need more money to carry on doing what you were doing?——Certainly; as we say in paragraph 16: but I think that over and above the need for that additional finance there is a greater desire to do self-financing, and therefore a determination to have additional funds available for that purpose, and to have a greater measure of independence of banks and other financial institutions.

3087. Is this also in part a hangover from the post-war years? Companies ended the war with a large liquid reserve which they have run down gradually, but perhaps they have got into the way of wishing to keep clear of bank advances, though they may not necessarily succeed in the long run in doing it, particularly while money is tighter?——I think that is an element there. As to the extent to which they will be able to maintain that position, I agree that that must be affected by more stringent financial conditions.

3088. *Professor Sayers*: If one goes back, not over ten or twenty years, but over fifty years, is there any reason at all to suppose that there is more or less reliance on self-finance now?——*Mr. Stafford*: I do not think there is any statistical information available, over the whole of industry.

3089. Was there not fifty years ago a very large proportion of firms that would not have dreamt of going to their bankers for help? If we are comparing the way in which Bank Rate and other monetary weapons are to operate as compared with pre-1914, is there any reason to suppose there is a substantial and relevant change in this particular?——I would have thought not if one went back, say, seventy or eighty years rather than fifty years; one might have found even the new issues market much less important than it is today. But I have no real knowledge of this.

3090. *Lord Harcourt*: Am I right in believing that English companies have consistently in the last ten years distributed a much smaller proportion of their income than American companies do?——*Sir Frank Lee*. I think that is true.

3091. *Professor Cairncross*: You mean of profits after tax; as a proportion of gross profits my recollection is that there was not a great deal in it?——I do not know.

3092 *Chairman*: In paragraph 16 you draw attention to the increased importance of self-financing as being a European and not merely a United Kingdom phenomenon. I am not quite sure how far that allusion takes us; does

it mean that in fact there is a greater measure in some countries of Europe of self-financing in industry, or that it is a thing which other conditions which you mentioned are likely to produce?——I think both are true.

3093. Then, in paragraph 17 you say:

"The Board have themselves rarely received complaints from firms that they are unable to find the money for extensions and development. Complaints have been rather about difficulties and delays in obtaining buildings, raw materials, plant and machinery. This is further evidence that finance has not generally been the limiting factor in the planning and execution of new developments."

And then you go on to say there is no observed difference as far as you know between large and small firms in that relation.—*Professor Cairncross*: You make an important reservation there, when you say:

" . . . no doubt the small and unknown firm may find the going harder in borrowing money than the large and well-established concern."

Some of these small and unknown firms may be on to a new development which in the long run could be of major importance in industry. So if some of these firms fell by the wayside it might have a substantial effect on British industry; do you think this is so?——In so far as we have evidence, which is partly derived from the experience of the Committee of the Revolving Fund for Industry, and partly from reports from and contacts with our regional controllers and people in the region, I would have doubted whether, save in the exceptional case of the mute, inglorious Nuffield, as it were, who may be unable to get money, there are real grounds for apprehension here.

3094. You do not feel there is a gap?——No.

3095. It is put to me very often that the disappearance of the rich patron of the small man has meant that the craftsman (I am not going higher than that) today who has literally no money, or very little money, cannot now hope to make a start. Do you think that is not necessarily true or, if true, not necessarily important?——I would not say that one could not find cases where it is true; I doubt whether it is true overall. And I think, as I say, that the availability of hire-purchase credit for capital equipment, the willingness of suppliers to give credit, and the ability of small firms to obtain financial assistance from relatives or friends, constitute evidence that there is not any gap of serious significance.

3096. Is the rate of introduction of technical innovations as rapid in this country as it is, say, in the United States? If it is true that nobody is held up by finance, it becomes important to know whether we are making as much progress as the other countries in new ideas, or whether there is some other obstacle. Have you any views on that?——That is a very broad question. I think that in a great many important fields we are not behind the United States at all, but perhaps even ahead of them in some of our major industries. In other fields we are not as advanced in the adoption of new technical knowledge and processes. I think that the primary reason for that is not the inability to find finance, but rests partly in the field of technical education and partly, I would have said, in the field of management; very largely in the field of management in the case of small businesses. I would have said that a great many small managements in England were more allergic to change, to bringing new processes in, than their counterparts in the United States.

3097. So you would not lay the emphasis on finance as the obstacle?——I would not.

Chairman: I think this would be a convenient time to break.

(Adjourned until 2.15 p.m.)

SIR FRANK LEE and MR. J. STAFFORD further examined.

3098. *Chairman*: Paragraph 18 and 19 are, I think, partly the published material which you have called upon in support of what you have been saying earlier?——*Sir Frank Lee*: Yes, Sir.

3099. On paragraph 20 I think you have probably gathered the question which was in our minds. You say: "The Board have no reason to think that any large part of the great increase in investment in recent years has been wasteful or expended on objects of little or no importance to the nation." Then you go on to paragraph 21: "Any attempt to say which kinds of investment are 'good' and which are 'bad' must involve some kind of judgment of which things are of importance to the nation and which are not". Then we pass to Part II, on Statistics, in which you set out what you are doing, what gaps there are that you would like to fill, and what the prospects of filling them are.—*Professor Sayers*: Some references are made to the considerable advance the Board of Trade has made in the collection and publication of statistics in the last ten years or so. I wonder whether the Board could tell us what the experience has been in approaching business men for statistics. It does seem to me important that there should be an advance in our financial statistics comparable to this advance there has been in the more general production of statistics, and it would be very useful for us to know how far the Board has encountered serious resistance on the part of business men, and what methods it has found the most efficacious to gain assistance?——Perhaps I could answer that in a general way, and Mr. Stafford could supplement it if he feels it desirable in any particular way. Our general experience is that we have had a very encouraging and favourable response from the business firms whom we have approached with requests which we have made for additional statistical material. We have had in reserve compulsory powers given us by the Statistics of Trade Act which was passed after the war but, although we are using that Act in some fields, we have hitherto been able to collect statistics that we required by voluntary agreement with the industries concerned. Certainly for my part I would like to say how greatly we have appreciated the co-operation of industry in this matter.

There are two reservations that I must make to that. The first is that we have been at pains not to press industry harder than we think they should reasonably be pressed, because we have valued the giving of statistics on a voluntary basis rather than having to operate compulsory powers. In a fairly wide part of the field, where we have made an advance it has been by feeling our way, by taking a sample, by personal approaches to the chairmen of the companies concerned, and then by widening those approaches when opportunity offers. It has been done on a fairly selective basis and with the express object of maintaining the co-operation of industry and not, as I say, pressing industry inordinately. The second reservation is that in a great many cases I think that industry have shown themselves prepared to co-operate with Government because they feel that they have been approached with tact and forbearance, and because they have sensed the importance from the national standpoint of the additional statistical coverage that we are endeavouring to secure, rather than because they have sensed the benefit of those statistics to themselves. In this I think there is a substantial difference between their attitude and some of their counterparts in the United States. It was a point which Sir Reginald Verdon Smith brought out in the Committee over which he presided, which was asked to consider our future arrangements for the census of production and distribution, and what should be the kind of measure of our effort in those censuses. They produced a report which gave a great deal of support and encouragement for what we were trying to do, but frankly said that this was ahead of its time in so far as the generality of industrial opinion which they had consulted would have testified. They were prepared to accept it as being not necessary for their own purposes but broadly desirable for the purposes of the State.

3100. *Professor Cairncross*: On paragraphs 26 to 29, do you obtain figures of sales of particular goods, such

as furniture, by retail businesses adopting hire purchase arrangements, to set alongside similar sales by retail businesses not adopting hire purchase arrangements?——*Mr. Stafford*: No, we do not collect figures of sales of particular commodities. We collect, for instance, figures of cash sales of furniture shops and figures of sales on hire purchase terms made by furniture shops, whether of furniture or of other things that are sold in furniture shops.

3101. Are you not able in respect of any of the commodities which feature in hire purchase to compare cash sales against credit sales?——Not for individual commodities.

3102. So that you are not able from such data to check the effect of changes in hire purchase terms?——In effect I think we can, with the information that we get. I think it is a fair inference that the sales of furniture shops very largely reflect the experience of furniture sales, though the furniture shop will sell a certain amount of electrical goods as well as furniture as a sideline. There is enough specialism in the retail trade to allow one to identify the broad effects of various measures of control.

3103. It sometimes looks as if, when the hire purchase restrictions are tightened, there can be a switch of custom in favour of businesses dealing in cash. Is this something which you have been able to detect from your figures?——Yes, we compute the percentage of trade done on hire purchase terms so that we can watch a movement from hire purchase transactions to cash transactions.

3104. Not from shop to shop?——The shops that report to us their hire purchase sales also report to us their cash sales, so that in the panel of reporting shops we can watch changes in between cash business and credit business.

3105. Are you satisfied that the information you have on hire purchase, or will have once the present proposals are implemented, is adequate?——Not wholly adequate, I think. Certainly the information that we have and shall have on the hire purchase business of financial houses is adequate. For the most part I think the information collected from retailers is good, but certainly could be improved. It is difficult, of course, to obtain a completely representative sample of reporting retailers. For some kind of businesses the sample is less good than we should like it to be, but we are doing what we can to make good the deficiency.

3106. For example, are you able to distinguish between secondhand and new motor car business on hire purchase?——Yes. Hire Purchase Information Ltd. make the distinction, and give figures month by month of hire purchase transactions in new and in secondhand cars, commercial vehicles and so on, separately.

3107. *Professor Cairncross*: On investment statistics (paragraphs 35 to 40) you now collect data about the plans of manufacturing companies for future fixed investment. Do you know whether any attempt is made in the public sector to aggregate the anticipated future expenditure on investment of local authorities, public corporations and so on, not necessarily for publication?——*Sir Frank Lee*: The Treasury do that centrally.

3108. On a similar basis?——On as similar a basis as is appropriate: they get a forward projection of plans and aggregate the figures.

3109. This information is not published?——No.

3110. Would you consider it desirable to publish that information? Do you see any objection to publishing it?——As far as the Board of Trade are concerned I would see no objection to publication; but it is not a matter for which I have any direct responsibility.

3111. Have you found that the information you collect about planned capital expenditure is borne out by actual expenditure?——*Mr. Stafford*: Tolerably well, I think. Our experience of this is limited to the experience of just a few years, but the movements have been in the expected direction; when the figures of expected expenditure have shown an increase the actual figures have gone up also, and not dissimilarly. How far the figures of expected investment would be reliable in a period of greater uncertainty, when things were more near to an equilibrium, is a matter for question. Certainly the figures for individual companies show very wide variations indeed between expectations and actuality. It is the experience of America and Canada too, that the total somehow behaves more predictably than the individual components.

3112. *Chairman*: Do they adjust their figures at all rapidly? I suppose they give you in good faith estimates based on fairly long term plans?——We only ask for an estimate for the next year ahead.

3113. I appreciate that; but probably that is extracted from a plan which covers a number of years?——I am not sure; in the case of some companies, probably not. I think there is probably a distinction between a long term investment plan and the financial assessment for the ensuing calendar year, and there are two different pieces of information; but that is only my impression.

3114. *Professor Cairncross*: In paragraph 38 you make clear that you do not cover the whole of the private sector in this figure giving the forecast of future capital expenditure, but that you do intend to try to cover distribution. Have you any intention of going on to include, let us say, private building and other elements in fixed capital expenditure in the private sector, such as the private dwelling houses built by private persons for their own use?——No, we have no intention of doing that.

3115. You would not propose to issue a forecast for the whole of the private sector?——*Sir Frank Lee*: I suppose that if it were were asked to do that as a matter of Government policy we would be prepared to do it. We have hitherto been dealing with the field for which we can be regarded as responsible.

3116. *Professor Sayers*: Mr. Stafford said just now that the experience had been that the planned figures and the realised figures had moved in the same direction as each other every time. The instructiveness of that conclusion depends on the movement of the figures at the time. Is it, for example, the fact that the figures of actual expenditure have gone up consistently, and therefore that the planned figures have gone up too, or have they sometimes gone down?——*Mr. Stafford*: No, we have been working on a rising curve. That was the reason for my qualification.

3117. People have been saying each year that it is going to be bigger, and each year it has been bigger; that has been your experience?——Yes, with the exception that the early forecasts we got last May for the year 1958 forecast a slight fall, I think, of five per cent.

3118. But for every occasion on which you have been able to compare the planned and realised figures, the movement has been upward as compared with previous variations?——Yes.

3119. *Professor Cairncross*: So now for the first time you are about to have a test case where there has been a change of trend in expectations, and you can soon begin to compare it with realised figures?——Subject to the fact that we are now receiving final figures of expectations for 1958, and the change of trend may not be confirmed by the revised figures, that is so.

3120. *Professor Sayers*: We may be going into a much more severely testing period for your figures?——Yes.

3121. Would what appears to be emerging from the revised figures for expectations, which you are getting in now, confirm the view that there would be a fall?——*Mr. Stafford*: I am not in a position to answer that question at this moment; perhaps in three weeks or so we could give an answer if you would like to have it.——*Chairman*: I should like to know.*

3122. *Professor Cairncross*: On the figures which you are now engaged in compiling from the accounts of public companies, do you make a special effort to trace the movement in liquidity of these companies through time? Is this one of the elements to which you attach importance?——I do not think one could call it a special effort; but movements in the liquidity position are thrown up as part of the analysis.

3123. In the general sense that you get data on holdings of cash and marketable securities together?——Separately, I think. In the great majority of balance sheets marketable securities are separated from cash; in so far as that is so the figures are given separately in our analysis.

3124. But you do not pursue the holdings of marketable securities further than the balance sheets permit, by

* See Appendix to Minutes of Evidence.

trying to discover exactly what marketable securities industry holds?——No, this is entirely an analysis of published balance sheets.

3125. This information is presumably made available to other Government Departments and to the Bank of England?——*Sir Frank Lee*: Yes, and it is published.

3126. How far behind are you in the analysis of balance sheets? What is the normal lag between the analysis conducted and the year to which figures will then refer?——*Mr. Stafford*: When we surmount these early difficulties and arrears, we shall run something less than a year late.

3127. You do not feel you could do even better with the quarterly balance sheets you envisage in paragraph 33?——*Mr. Stafford*: We are not really envisaging quarterly balance sheets in paragraph 33; we are saying how nice it would be if there were such things.—*Sir Frank Lee*: That is an aspiration.

3128. Do you feel that it might be useful to supplement the kind of sample analysis that you conduct on investment intentions with a similar sample analysis of the liquidity position of large public companies?——*Mr. Stafford*: We doubt whether the information could be obtained on a sufficiently representative basis to be worth while; that is, if one were thinking of balance sheets in their entirety.

3129. *Professor Sayers*: When you say you doubt it could be obtained, do you mean that you think that the firms you would have to approach would be very reluctant to give the information?——We think that it would be difficult except where they extract the information, and compile it in the form in which we should require it, for their own uses.

3130. *Professor Cairncross*: There must surely be some companies who do?——*Sir Frank Lee*: Yes, as we say in the last sentence of paragraph 33 of the report. But whether that would give us adequate coverage for a sample, or whether the results of that sample would be really valuable, is something on which we are still doubtful.

3131. I am not sure if you attach importance to this or not; the Committee has been led to believe that it is a matter of some importance whether industry is becoming increasingly liquid or whether its liquidity is evaporating, and that information as to this is also important?——Speaking for myself I do attach importance to it; whether I should attach importance to a quarterly assessment of the position if I was unable to trust the validity of the assessment is quite a different matter. Naturally, if I could have a quarterly assessment which I thought was valid and authoritative, I should be glad to have it.

3132. *Professor Sayers*: Going back to the annual balance sheet, have you considered the possibility of getting a sample of balance sheets with some further break down of the assets, so that the liquidity of a sample could be more precisely recorded?——*Mr. Stafford*: For example, to get a sub-analysis of the kind of marketable securities or that kind of thing?—*Professor Cairncross*: Particularly the holdings of Treasury Bills—*Mr. Stafford*: No, we have not attempted to do anything of that kind as yet.

3133. *Professor Sayers*: Would there be any difficulty about that?——*Sir Frank Lee*: In this work we have taken over the pattern started by the National Institute of Economic and Social Research, and have hitherto been content to follow that pattern, believing it to be a good one; but I see no real difficulty about some further breakdown of the kind you suggest at all, and I should be happy to consider it.

3134. *Professor Cairncross*: This is of cardinal importance to the Bank of England, much more than to the Board of Trade. Is it not curious that analysis of this kind should rest with the Board of Trade (although we are glad it rests with someone) rather than with the Bank of England?——It is one of those historical accidents which happen in the British way of things. This work was started by the National Institute; we felt that it was very desirable that it should be carried on and not allowed to lapse, and we carried it on, not with particular attention to liquidity, or in any pre-knowledge of a Radcliffe Committee, but merely as being a good thing in itself. That is how it has grown.——*Mr. Stafford*: One of the reasons why the Board of Trade undertook this work is because the accounts and balance sheets of companies are more accessible to the Board of Trade through the Registrar of Companies than to other Departments; in a sense it is a convenient place in which to do this.

3135. *Sir John Woods*: But the main reason, surely, is an historical one, that the Board of Trade, as the father and guardian of the National Institute, initiated this particular inquiry and lent staff for it; so it was quite a natural thing that the Board of Trade should take it on?——*Sir Frank Lee*: We have a double paternity: we are the father of the original inquiry with the National Institute, and we have a field of responsibility, or anyway of convenience, because of our responsibilities under the Companies Act.

3136. *Sir Oliver Franks*: Do the statistical people of the Bank of England go into consultation with the Department of the Board of Trade and see whether they agree with the basis on which the samples are constructed, and thus determine the extent to which they in the Bank of England will be prepared to take the results which you find as a basis of their own policy?——*Mr. Stafford*: All these statistical questions are considered interdepartmentally, with the Bank of England consulted and able to give their opinions. I cannot remember that we had any very considerable discussion on this particular issue. In this instance we are not in fact sampling; we are extracting all the information from all the balance sheets of the companies whose shares are quoted; so it did not arise in this case.

3137. *Professor Sayers*: Has the Bank of England shown great curiosity as to the results which you are producing?——It really would not be possible as yet. We are in the very early stages, as you know, and we publish our first results this month.

3138. *Sir Oliver Franks*: If, for example, in July, 1955, the then Chancellor of the Exchequer had had a relatively reliable sample of the liquidity of public companies at that time, would he not have been able more easily than he perhaps was to judge about the effectiveness of the policies that he had in mind to adopt?—Certainly.

3139. So both reliability and nearness in time are very important, when you are dealing not solely with an historical analysis of the situation but with the analysis of something so recent that you wish to base predictions and action for the future on it?——*Sir Frank Lee*: I agree with that.

3140. Do you feel that you are moving into a position in which another Chancellor would be in a position, if he chose, to use the information of this sort which you are collecting and make it help as a basis of policy?——Yes, I do think that.

3141. *Professor Cairncross*: As you say in paragraph 33, you are hopeful that there will be eventually quarterly figures of profits based on sample companies and derived from the Inland Revenue? *Chairman*: What is the basis of the Inland Revenue collection of profits from groups of companies? Is it to aid their estimates of revenue for future years?——*Mr. Stafford*: No, it is primarily an economic statistic, to help in the compilation of quarterly national income figures and changes in economic conditions generally. I understand the Inland Revenue also obtain forecasts of profits for budgetary purposes.

3142. *Professor Cairncross*: It is extremely difficult to know about the way in which innovations are taking place in an economy. Do you make any attempt to measure this? Have you thought of any indices that would throw light on this subject? One possibility which has been put to me is that you might ask the Bank of England for data on royalty payments to and from the United States to show the extent to which we are making use of American patents and American innovations, compared to the extent in which they are making similar use of ours? There may be other ways in which one can approach the subject. Do you try to keep your finger on the rate of technical innovation in any way?——*Sir Frank Lee*: We have not hitherto felt it possible to evolve any form of index or similar thing which would be a valid indication of that process. I think it is really rather a matter of our watching the economy as a whole for signs of that tendency or its contrary, and trying to form a general judgment. One gets general evidence on this from the attitude of industry towards the need for an increased

tempo of investment, brought about by the realisation that labour is likely to go on being a short commodity; towards technical and technological change; towards competition, as evidenced by its general attitude towards, say, the Restrictive Trade Practices Act and similar arrangements with which that Act has to deal; towards the proposals for the European Free Trade Area. Those are the broad indications by which we seek to make what is admittedly a broad judgment as to whether we think that industry at any given time is resilient and prepared to welcome change as an ally, rather than as something to be kept at arm's length if possible.

3143. But the Board does not attempt to inquire into the extent to which the latest methods of production are more expensive of capital than the previous methods, so that you have a rising demand for investment in industry from that source?——No, we have attempted nothing of that kind.

3144. *Chairman*: Then we come to Part III, on hire purchase controls. In paragraph 41 you allude to the first form of control which was in operation from February 1952 to July 1954 for a limited range of goods; a qualitative control to take the burden off the engineering and metal industries. In paragraph 42 you go on to the new set of controls, introduced in February 1955, on consumer goods generally; a quantitative effort to restrict consumer demand. The history of their extension is in paragraph 43; in paragraph 44 you point out that hire purchase is only one way of giving consumer credit, and there are others which may be resorted to; having started on the system of controlling hire purchase you have had to extend it to other forms of credit and to simple hiring as well, in order to prevent the control being avoided altogether. The point of that paragraph is that you have to extend your range once you start on this course?——Yes; although we think we have now covered the whole necessary field.

3145. *Chairman*: In paragraph 45 you say that the restrictions are under your control, and in paragraph 46 that no serious difficulty is experienced in administering it.—*Professor Sayers*: This control of hire purchase credit has fallen to the lot of the Board of Trade in the way these things do fall to Government Departments, by accidents of history. If the nation decided that it wanted to go on using this kind of control for purposes of broad economic policy, and particularly as an adjunct to more purely monetary measures, do you consider it would be right to leave this control in the hands of the Board of Trade, or do you think that it ought to be administered by the Treasury or, say, the Bank of England?——On the assumption that it would not be a long term control, and would be not dissimilar to the present control, I would say that it should remain with us, if only because we are the Department with the closest contact with both the industries concerned and the retail units concerned.

3146. Close knowledge of the particular industries and distributive channels are important in the administration of this control?——I think so.

3147. *Chairman*: In paragraph 47 you are dealing with the effects of the control; for the year 1956 you give the total amount of hire purchase credit advanced as under £270 million. Then in paragraph 48 you relate that to total consumers' expenditure in 1956; hire purchase business in the year comes out roughly at about 2 per cent. of total consumers' expenditure?——On consumer goods. We deal with capital goods in paragraph 52.

3148. *Professor Sayers*: Is this percentage not likely to increase over the next decade or two?——I would think that to be so. It may also increase outside the field of goods into the field of services, though perhaps not as noticeably as it has in the United States.

3149. *Mr. Jones*: What sort of services?——Travel is one; possibly even things like hospital bills or education.

3150. *Chairman*: In paragraph 49 you point out that this control lies in a narrow field so far as the goods affected are concerned; you say: "About half of "hard" furniture is sold on hire-purchase, and about half of television sets and about a third of radio sets are sold on credit"; and: "Over half of electric cookers, refrigerators and gas cookers are sold on hire-purchase"; and then: "About a fifth of all new cars are sold on hire purchase; about two-fifths of new motor cycles. The proportions for used vehicles are believed to be much higher."—*Sir Oliver Franks*: What reasons are there for the caution of the words: "are believed to be much higher"? Do you have knowledge which comes from someone else, and therefore you are not sure about it?—*Mr. Stafford*: We know the number of transactions in used vehicles financed by hire purchase, but we have not got the figures of total transactions in used vehicles to relate it to; so this is more a matter of common knowledge than statistical information.

3151. If it is an impression rather than statistical information, can you quantify the impression at all? Is it much higher than for new cars and motor cycles?——If I give an answer, it will be no more than a guess. I would have thought substantially higher than one-fifth for new cars; from my own information I would put it at 40 per cent. rather than 20 per cent. But I may well be wrong.

3152. *Chairman*: In paragraph 52 you say that, in addition to the consumer field, "there is a considerable hire purchase business in respect of the purchase of equipment, vehicles etc. by business users. In this sector, hire-purchase sales were probably between £120 and £150 million in 1956, of which about a half was for commercial vehicles and a quarter for industrial and farm equipment." You relate that to total expenditure on fixed capital in 1956 of £1,767 million. "Debt in respect of hire purchase by business users was some £50 million at the end of 1956, after a fall of about £20 million during the year." In paragraph 53 you say that the total hire purchase debt at the end of 1956 was at about £380 million, and you compare that with credit outstanding under other arrangements; bank advances £1,930 million, building societies £1,900 million, insurance companies on mortgages, policy loans etc. £550 million, and business credit £2,000 million. That is £6,380 million, against your figure of £380 million for hire purchase?——*Sir Frank Lee*: I did not want to make or stress that particular comparison. I put these figures in because I feel that the significance of restrictions on hire purchase is often exaggerated, in the Press and elsewhere, and I thought it was desirable to try and show it in relation to the other figures.

3153. *Sir Oliver Franks*: In very rough terms the proportion is 5 per cent.?——It is.

3154. *Professor Sayers*: There are other comparisons one could make; is not one that the proportion of people touched by hire purchase credit is much greater than this 5 per cent.? This is very widespread credit?——I do not think we have any other statistics or impressions to help us here.

3155. *Chairman*: In paragraphs 54, 55 and 56 you ask the question what would have happened in the relevant years if there had not been these restrictions. You point out in paragraph 55 that you had this drop by the end of 1956, and you say in paragraph 56 that that drop could not have come about but for the existence of the restrictions; so they were within their terms effective?——Certainly.

3156. Then you say: "Since the end of 1956, hire purchase has been rising, mainly as a result of the recovery and expansion in sales of motor vehicles." In paragraph 57 you draw attention to the fact that the restrictions have serious effects on sales of many classes of controlled goods. In paragraph 58 you bring us to this point: what happens to the spending or possible spending which is dammed up by the hire purchase control? Where does it go to? Have you any information or view as to what happens there?——In relation to the purchasers, we have given a view in paragraph 66, where we have implied that we believe that the effect on consumer demand is largely a once-for-all effect following the introduction of or a major change in the restrictions.

3157. Does not that suggest that the spending which is dammed up by the restriction does not go elsewhere, but is saved up until the new terms can be met and then starts again?——This is not something which we have attempted to put to statistical proof. We assume that some people give up the idea of buying; what they do with the money which they would otherwise have expended

on deposits or payments we do not know. But we assume that many people go on with their intended projects. They have to save more in order to meet the initial deposit, assuming that the initial deposit has been put up; that is at any rate a reduced dissaving, as we have said in paragraph 66. But as they come to pay the whole debt off the effect will wear off until they buy their next article on hire purchase, unless we have made the terms more stringent in the meantime.

3158. *Professor Sayers*: A change in terms operates as a once-for-all change in the amount of purchasing power coming on to the market, in the sense that it is limited to the period?——That is what we believe in the case of consumers.

3159. *Sir Oliver Franks*: Could we just work this out with an example? Suppose that we are dealing with the acquisition through hire purchase of 100 units of some object and that the down payment is 25 per cent. and, for the sake of argument, the remaining 75 per cent. is to be paid over one year. Then the down payment is increased from 25 to 50 per cent. Will you illustrate from there on what the once-for-all effect is?——*Mr. Stafford*: Substantially what happens is this. With the more stringent conditions the volume of purchases of these things under hire purchase terms falls. That is the immediate effect. Those people who are going to undertake the purchase in the future of these things under hire purchase terms begin to save up in order to get the increased deposit. In the course of time you get then a volume of transactions of hire purchase terms smaller than you had before. The result of this is that the ratio between what is borrowed in order to undertake the new transactions and what is repaid in order to liquidate the debt under the old transactions alters; more comes to be repaid and less borrowed while the old debts are outstanding. So you get a force in the direction of saving on two fronts: (1) to get the higher deposit, and (2) to liquidate the excess of old borrowings over new borrowings. That goes on for the year. With any movement from the old to the new position you get a forced saving which lasts for, say, 12 months and then the effect is liquidated, and you get into a new position of equilibrium in which again the totality of consumers' income, assuming for this purpose that there is no saving, is being spent.

3160. I was under a misapprehension which you have corrected; I thought that the once-for-all effect was connected with the numbers of units sold, I mean the drop from 100 to 50 and then rising to 75. In fact it is not to do with the level at which the units are sold in either period; it is to do with this period of time in which there is a total effect on saving as you have described it?——It is really to do with the level of borrowing. There is one qualification: that before the restriction the volume of hire purchase business may have been increasing, in which case there is a sort of dis-saving trend, that is, people were spending more than their incomes. After the restriction you may get on to a level movement, so that there is no secular tendency to borrow money for these hire purchase transactions. That is another effect, moving from a secular trend in which people are increasing their borrowings to a level movement in which there is no net increase in borrowing.

3161. *Professor Sayers*: Is there not also another residual effect, in the sense that it is a permanent effect which goes on after the year? That is that the ten million people who were having to save up deposits are now having to save up bigger deposits, and the total amount of saving at any one time is therefore bigger, if the amount of buying is unchanged?——*Sir Frank Lee*: We accept readily that the mere fact you have a 50 per cent. deposit instead of a 25 per cent. deposit forces that degree of saving.

3162. That is maintained on a higher level than before?——If sales are maintained; of course, it tends to be offset by a fall in the consumption of these things.

3163. *Professor Cairncross*: But equally repayments are higher throughout the period after the increase?——Yes.

3164. *Chairman*: That means that the money comes back again quicker to the people who lend money for hire purchase?——That brings us to the difficult questions on which we can make no real judgment, which are discussed in paragraphs 63 to 65 of our paper, on what happens to the facilities that the hire purchase firms have; on that we have really no information. It is a problem we pose, rather than a problem to which we endeavour to give an answer.

3165. *Professor Cairncross*: You must surely have evidence of the effect of hire purchase restrictions in particular cases, of the drop in consumption that takes place. You do not quantify that here. If you take all durable goods together, there was an actual reduction in 1956, but of quite modest proportions, in consumption, and that lines up with the figures for hire purchase debt during the year; but was the impact more substantial in some particular case?——Mr. Stafford can give you some figures of the falls in production and sales of durable goods. I only want to make one reservation, which we make in paragraph 69: it is our belief that in the latter part of 1955 and in 1956 there would have been falls in any event in the demand for furniture, wireless sets and domestic electrical equipment, irrespective of hire purchase restrictions. What part of the fall is due to the restrictions and what part of the fall would have happened in any event is a matter on which we can make no judgment; but I would not want to deny that the main reason for the fall had been the hire purchase restrictions.

3166. As it is put to us in the evidence here, we are left very much in the dark as to whether hire purchase restrictions effect any real reduction in overall consumption, or, if I put it the other way, whether there is any net increase in saving because of the introduction of hire purchase restrictions? I would have thought this was a matter which could be tested?——I think not by us. We can show you that the demand for the types of goods usually sold on hire purchase is directly and adversely affected by hire purchase restrictions. When you get into the wider question, whether the total effect of these measures has been disinflationary, either as regards the money required to finance those transactions on the part of the hire purchase firm or as regards what the consumer has done with his money, you enter a field in which we can give no sort of authoritative answer, on which we have a good deal of honest doubt (as we have tried to express in these paragraphs), but in respect of which we hope the Committee will give us some authoritative judgment at the end of the day.

3167. It would be difficult for the Committee to give you any authoritative judgment of the impact on savings of hire purchase restrictions without further data. If the amount of hire purchase debt is reduced in one year, as you suggest, by £95 million, then that ought to represent some reduction in consumer expenditure relevant to saving, unless you can establish that there was no change in saving by the group of people who normally deal in retail hire purchase transactions. I would have thought that a sum of £95 million as an addition to the saving of that group was quite perceptible and measureable?——I quite agree that, if you can assume that the whole of that reduction in debt was a true saving, it is a substantial and a very worthwhile saving. For the reasons we have already indicated we must have some doubt about that.

3168. No sample survey has been conducted to indicate movements in consumer saving at this time?——*Sir Frank Lee*: No.——*Mr. Stafford*: Perhaps I could add something here. I think there is no question but that the effect has been an increase in saving by persons. But it is difficult to get any measurement on what was done with the credit. £95 million less credit was extended for hire purchase transactions; was the £95 million extinguished or did it seek some other employment? It is on that we have no evidence to give you.

3169. *Chairman*: I thought you were uncertain on both aspects? You say in paragraph 58:—

"Nor is there any information about the effect of the restrictions on the spending habits of individual consumers."

——*Sir Frank Lee*: You are right; we have no information. We have doubts on both aspects, but on what has happened to the credit of £95 million, we have no information; that credit has, as it were, passed out of our purview into that of the Treasury. That is why we have added the words at the end of paragraph 64:—

". . . subject, of course, to such other controls as may be in operation from time to time."

On the other side I think that the fall in hire purchase debt is partly reflected in a real saving, or a reduced dis-saving, by persons; whether it is to the whole extent is, I think, open to doubt. It is doubtful how many people go on with the transactions, and this to some extent affects the once-for-all effect as described by Mr. Stafford; subject to the point put by Professor Sayers, that if they go on with the transactions the higher deposit represents a continued increased or forced saving on their part.

3170. *Professor Cairncross*: Offset by the fact that they have less to repay. You are now putting emphasis on some increase in investment in another direction, which is the outcome of the denial of the use of credit for this purpose. You must either be able to show a change on the side of saving or on the side of investment?——We do not know in the Board of Trade what has happened to the money which otherwise would have gone to sustain this amount of hire purchase debt.

3171. You appear to be expressing more scepticism about this than about the consumers' behaviour. Have you some reason to suspect that some specific form of investment had increased in direct consequence of the hire purchase restrictions?——No. With respect, you are reading more into my replies than I had intended. I had no such devious or dark suspicions in my mind, because I have really no knowledge.

3172. *Professor Sayers*: You are just pointing out that the failure to lend in this direction may have made it possible for other people to indulge in riotous living or put up palatial factories?——Perhaps I may be allowed to quote our own words which, as you will notice, have careful reservations in them. We say in paragraph 64:—

"As a general proposition, if hire purchase restrictions are imposed in a buoyant economy, it seems likely that these funds will find other outlets, subject of course to such other controls as may be in operation from time to time."

I must take my stand on that admirably guarded sentence!

3173. *Professor Cairncross*: If I may slip under the guard for one moment, the point we put to you is that other outlets may be completely unimportant, if those outlets represent no more than the acquisitioo of some bit of paper, such as a Government security. The real issue is whether other outlets involve an increase of effective demand in some other direction?——I accept that, but I cannot tell you whether these funds have been expended in gilt-edged or other pieces of paper; I do not know.

3174. Do you regard the cost of hire purchase in this country as reasonable, or do you feel that perhaps the effect of some of these restrictions has been to increase the cost to the consumer both in industry and as a private citizen?——This is a broad question, which invites a very broad judgment. I would not have thought that in general the cost of hire purchase in this country was unreasonable, though in using that word I am not really quite aware with what standard I am seeking to compare it when I say "unreasonable".

3175. Have you made any comparison with American costs?——In so far as I have knowledge of that I would repeat that I would not have thought that it was unreasonable, largely because I think there has been effective competition in this field for hire purchase facilities. One or two very enterprising people have led the way in this field. The restrictions have probably tended to make these facilities more expensive; but I do not think we have any information on that point.

3176. Have you not information about rates paid by finance companies for the deposits they attract; are not these substantially higher than the financial institutions like clearing banks?——The only information I have comes from advertisements in the press and from private knowledge. I do not think that information comes from any statistics or information that we collect officially.

3177. *Professor Sayers*: Is not that evidence pretty conclusive?——I think it is pretty conclusive; but I do not want to give the impression that we as a Department have been at pains to collect this evidence.

3178. *Professor Cairncross*: I think you are perhaps too much on the defensive in your attitude to hire purchase, particularly in view of the expressioo of opinion elsewhere in the paper that sales of durable goods to consumers are likely to rise sharply in the next ten years, and that consumer durables are likely to become an important export; particularly also in view of the growing importance of hire purchase to industry as a method of acquisition of equipment. Do you really feel the present facilities, looking to an expansion of hire purchase, are adequate and reasonable in cost?——I think I do. I am one of the people who feel very strongly indeed that hire purchase, and an increase in hire purchase, is a very valuable lubricant to our economy and a very important incentive to work, as we have said in this memorandum. I think that, subject to such restraint as may have to be imposed on it, it will increase in its importance. I have seen no evidence which suggests to me that the terms to which people operating hire purchase have asked consumers to agree are in general unreasonable. I would have thought that, from some points of view, though not from my own, some of those terms could have been criticised from the opposite angle: that they were over-generous and possibly encouraged improvidence rather than thrift.

3179. You would not welcome the incursion of other financial institutions into this field?——Nothing I said should he understood as implying that. One of the prerequisites is that there should be a healthy competition in this field. In so far as the joint stock banks, for instance, care to move into this field, I should welcome it.

3180. *Professor Sayers*: Could it not he expected to lead to an appreciable improvement in the terms under which credit was available, in that the clearing banks at present pay very much lower rates on deposits than do these hire purchase companies?——I think I had better content myself by saying that I should welcome any reputable recruits to this field.

3181. *Professor Cairncross*: In relation to producers' goods, do you feel that the institutions serving the producer are doing an adequate job?——I find the word "adequate" difficult to deal with; one has to have some standard of judgment by which to measure adequacy. I therefore have to answer in a rather negative way, which I dislike doing, that I have not had complaints about the inadequacy or expense of the service which these people run. In so far as I have looked at the details of small firms, or talked to businessmen, I had been impressed by the extent to which this service has been developed in the post-war period and I have no reason to believe, assuming that we can maintain, as I say, a healthy degree of competition in this field, that it will not go on being developed and improved.

3182. *Sir John Woods*: I do not know if you personally have had much to do with the affairs of the Revolving Fund for Industry; but in so far as you have seen that, would you agree that in those applications for loans there is a rather unexpectedly large number of small companies who do make use of hire purchase for capital equipment?——Yes, indeed. On a sample that we took out of the firms who applied for loans in 1955 37 per cent. used hire purchase for their plant and machinery (we have tried to exclude motor vehicles from the calculation), and in 1956 50 per cent.

3183. *Professor Cairncross*: You have no data on the rates of interest implicit in the agreements?——I do not think that the Board of Trade has any information on that.

3184. *Sir Oliver Franks*: Is there any department of Government which might be expected to know what was being charged?——I can only wonder whether the Bank of England in their general surveillance of our financial affairs should think it desirable.

3185. I am not clear what you take to be the justification for these restrictions on hire purchase. Is it simply administrative convenience, that the Government is able quite easily to put restrictions on this particular form of purchasing, and that it would be much more difficult to put similar restrictions on wider purchasing which might have the same effect of reducing demand in the economy; or are there any other considerations which you consider relevant to the choice of these particular classes of goods and this method of their purchase for restriction?——As

I said this morning, I take the view that in existing circumstances, in order to restrain excess demand on the economy, it is desirable, and indeed necessary, to operate on the basis of a range of measures. I do not think there is one single measure on which it is possible to rely to bring about the effect that the Government requires, particularly if we are having to deal with a persistent boom. Hire purchase restrictions have three merits in that connection: as you have said they are easy to impose and administer; they take effect quickly, unlike some of the other measures we were discussing this morning; and finally they have a certain psychological value. By that I mean that, if they were not imposed, I think that, however illogical it may seem in relation to their total significance in the economy and to the total amount of consumer expenditure or capital expenditure by business, it would look odd if it was thought that credit was being given without restraint in this form for the purchase of motor cars and other goods. Frankly, I think that to be an illogical standpoint.

3186. In other words the considerations which you have produced in favour of having some restriction on consumption in any packet of measures to deal with inflation apply equally to a wider restriction on the consumption of goods and to this relatively narrower restriction of hire purchase?——Yes. I wish there could be a wider measure; but it is not perhaps easy to see what it could be, and I am sure it is right that we should apply these restrictions, although I am uneasy about their effects on particular industries.

3187. *Sir John Woods*: You leave the impression with me that, looking at hire purchase restrictions as a general deflationary instrument, it is of very dubious value except from the psychological point of view. You yourself described it as rather an illogical argument, but you thought it had some force. On the other hand, you say at the end of your paper that these things have an extraordinarily disruptive and dislocating effect on the people who manufacture these things; I confess that here I disclose an interest. I am wondering whether it is really worth while, bearing in mind that there is such a thing in the wind as the European Free Trade Area. Most people would say, I think, that in the engineering field these lighter engineering goods are the sort of thing we have a good chance of selling in that market. There is also the O.E.E.C. view that there is liable to be a very large increase in Western Europe in the consumption of these articles; if you are going to sell them in Europe, admittedly as tariffs come down, but also against existing manufacturers, and probably against a considerable invasion from the American factories, I should have thought they could only be sold by people manufacturing in large quantities without disruption and dislocation of their production plans. From that point of view is this control worth while? Can you make any comments on that?——I did not wish to leave on your mind the impression that I thought the control of dubious value. We start from the premise that we have to take measures to restrain excess demand on the economy. Those are not easy measures to devise in order to be effective, or agreeable measures to put into effect; it is, of course, regrettable that any of these things should have to be done to keep the economy stable. What I intended to convey was that I did think in present circumstances, and in the present state of our knowledge and experience of restraints on the economy, that these restrictions, given the fact that they were easy to impose and operate, that they were quick in taking effect and that they had, as it were, a psychological rightness, were a necessary part of the measures which it has been necessary to take over the last two years or so. On the other hand, I would not want for a moment to retract what is said in paragraphs 70, 71 and 72 of the paper about the harmful effects of these restrictions on certain sections of the economy. From that point of view they undoubtedly give me considerable anxiety, all the more so as I very much agree with your views about the future importance of some of the industries directly affected by these controls in the general industrial field and particularly in the field of export endeavour in the Free Trade Area.

3188. *Chairman*: In paragraph 70 you say that you cannot find any evidence that by checking consumer demand in this country we send more on to the export market, and that to do so may even reduce competitive power in what might be a valuable exporting industry.——*Mr. Jones*: Is that not saying in another way that the restriction of hire purchase in a period of boom does not always really benefit the economy?——It was not intended to be as wide as that. It was intended to deal with the argument that, if these restrictions are imposed, thereby abating the demand at home for some of these goods, the almost automatic effect would be to increase exports of the goods in question. This paragraph is designed to say that we have no evidence that that is so in relation to the goods on which these restrictions have been imposed, and that, indeed, with any goods where low unit cost and, therefore, a high volume of production is of great importance it might perhaps operate the other way.

3189. *Professor Cairncross*: You say in this paragraph that furniture accounts for one-third of all hire purchase debt. You do not give us figures analysing hire purchase debt between commodities; you analyse sales but not debt. I think it might be useful to have that?——I can pass to you now an imperfect analysis, and I will send in a more elaborate one, if we are able to, at a later stage.*

3190. *Chairman*: In paragraphs 71 you make the point that the hire purchase restrictions fall heavily on particular industries, some of which are new and progressive, and the result may well be that the pattern of the economy, for example, in investment, is distorted in favour of industries which, while being of no greater importance to the national economy, are fortunate enough to escape from the hire purchase restrictions. You sum up in paragraph 72 by saying that these restrictions are easy to impose and operate, but can have a disruptive effect on the circle of industries that are affected by them. Then we come to the last section, on Finance for Exports. In paragraph 73 your first point is that most United Kingdom exports, including many capital goods, are sold for cash or on short-term credit, and the problem of finance does not arise in regard to them. Then you say that 8 per cent. of United Kingdom exports of capital goods require medium-term finance, which is equivalent to about 3 per cent. of our total exports. In paragraph 74 you come to the question of policy. You say:—

"As long as its reserves are deficient the United Kingdom can ill afford to see an expansion in the volume or the length of the credit which has to be given for its exports. The aim must be to obtain cash or early payment for exports wherever possible".

—*Lord Harcourt*: In stating that policy that we cannot afford unrequited exports in our present position, what do you consider is the effect on the long term position in a particular market if we are unable to meet the terms which that market requires? If we just say that we cannot afford unrequited exports to a group of countries at the present moment, how long do you think we can maintain that attitude without losing that market in perpetuity?——It depends obviously on what happens in the country in question and, of course, on the willingness and ability of others to give credit to it. I readily accept your implied point that there may be countries (Brazil, I suppose, is the instance that springs to one's mind) where despite the financial vicissitudes of the past it may be right, taking a long term view, for us to be prepared to agree that longer term credit should be given for, at any rate, certain projects, in order to keep a foot in the door against the day when a country may be economically stronger or, indeed, when we ourselves may be stronger and, therefore, better able to lend further sums to it. What is said in these paragraphs must be qualified by that judgment, that there may well be cases where long term considerations of markets that we might otherwise lose, but which are very likely to be of great importance, must be taken into account, and must to that extent be an exception to the broad considerations that we have set out in these paragraphs. It is a matter of very difficult judgment to try and assess what those exceptional markets, and (I would add) exceptional cases, might be.

3191. *Professor Cairncross*: There appears to be an inconsistency between the view expressed here and that expressed earlier in this paper. Earlier you take the view that investment inside the U.K. designed to increase the flow of exports is desirable, and in fact you give priority

* See Appendix to Minutes of Evidence.

to it; but here you regard investment which involves lending to another country from the entirely opposite angle as undesirable and to be discouraged. No one would suggest that you want to lend to other countries just for fun; but, if a loan is tied up directly with exports and is the price of the export, what is the difference?——I think, if I may say so, you have deliberately foreshortened the view and, therefore, heightened the apparent inconsistency within this paper. We are not saying in these paragraphs that all investment overseas is undesirable; that would not be in our thoughts for obvious political, social and economic reasons. Nor are we saying necessarily that for us to have a system of tied lending, such as indeed we have, almost as it were by accident, in many of our loans to the colonies and the arrangements through E.C.G.D., is wrong in our circumstances. We are saying that, given our overall financial position, there must be a limitation on the extent to which we can and should let goods go abroad on long term credit, if we can sell them on terms more acceptable to us in relation to our medium and short term position. Of course, that would not be true if resources were unused in this country; but hitherto there has been no evidence that the goods in respect of which credit might be denied to a given country.

3192. *Professor Cairncross*: This does not appear to me essentially different from the view on domestic development you take, that there is no need to invest more in industries producing exports than will offer you a satisfactory return. Equally, if you know your exports can be sold in some other direction without lending, that is fine; but the issue before us is: what do you do if you have exports you know you could make, of goods that could not otherwise be sold abroad, if the price charged is in effect on a loan of two to five years?——If that were the position we should have to make a judgment as to whether that was worth doing, in relation to the totality of investment we were doing and to the need to try to pay for our imports, which we have been paying for primarily in cash, and if possible to build up our reserves and meet our other external commitments. A marginal investment abroad compared with a marginal investment at home is a very difficult act of judgment; but if I had to make that judgment I should favour investment at home on the whole.

3193. *Mr Jones*: How does this link up with the external balances built up in consequence of our taking imports the payments for which have been left in sterling?——The balances are mostly short term debt due to the countries who lend that money on short term. Broadly speaking they can withdraw those balances at any time to meet their needs. A great deal of the money which some people suggest we should lend abroad would be on much longer terms, which we could not get back over a period of years. Therefore there is a very real relevance in relation to borrowing short but lending long, which (according to what I was taught when I was young, which I hope is still valid) is a bad thing to do.

3194. *Professor Cairncross*: Would these countries want to engage in this kind of transaction; they are the countries that have ready cash?——It does not necessarily follow that a country which has balances here eschews all forms of borrowing.

3195. *Professor Sayers*: If a concern that is proposing to import is in a country that has a considerable sterling balance, is it not rather odd that it should come to us here and say: "We want to borrow this money, because we cannot get hold of it at home"?——Putting it that way, it is odd; we have asked the Governments of those countries, particularly colonies, that have sterling balances here, to draw on those sterling balances to finance imports from this country rather than seeking to borrow from us, and I think that is done. I was only at pains to say that it does not necessarily follow in every case that, say, a power undertaking that wanted a five year credit for a power station would think it wrong to get five years credit from a supplier in this country.

3196. *Sir John Woods*: The U.S. Export/Import Bank, to which you refer in paragraph 77, appears to me to be a rather formidable kind of animal. I have an impression, derived from various sources, that it is being groomed for greater things, and maybe in Europe. It grants credit for a considerably longer period than we do, or indeed than the other Continental countries who subscribe to these self-denying ordinances in their credit arrangements. Moreover, with the possibilities of further recession in the United States, there seems to be every possibility that the U.S. will be over-provided with productive capacity for certain types of heavy capital goods (here I must declare an interest). They could quite easily start taking all markets in the world in which Great Britain has sold railway locomotives for generations past, offering much better credit and much shorter deliveries than we can offer, because they are overstocked, and because they make standard locomotives. In relation to heavy capital goods, anyway, I cannot believe it is right to take quite without qualification the view you take here of the activities of the Export/Import Bank. Am I, in trying to qualify your general doctrine in that sense, being completely wrong or unrealistic?——I do not for a moment suggest that what you say is completely wrong. Of course it would be very desirable that the Export/Import Bank, being the lending bank of a creditor country, should give untied loans, so that all countries could then compete on the basis of the buyer's preference as to price, delivery and so on. But we have to face the facts that the Export/Import Bank does not, and legally cannot, operate in that way. I agree with you that potentially the credit terms which the Export/Import Bank does give, or still more, perhaps, could give, particularly in the circumstances of a United States recession, could be a menace to us and to other European countries.

I would only remark in passing that the extent of the credit facilities which the Export/Import Bank customarily gives are in my experience normally exaggerated by a good many people who make representations to us about their activities. At the present time they normally only cover something like 60 per cent. of a given cost in the case of any contract, and the rest of the credit has to be found by the supplier or purchaser from some other sources, which contrasts with something like 85 or 90 per cent, cover available from E.C.G.D. But, leaving that aside, this paragraph was designed to say not that this is a perfect instrument or one we are happy about, but that, given the restriction on its lending, we thought it better that they should lend even on a tied basis, and strengthen the economies to which they lend, than not lend at all.

3197. I was jibbing at your suggestion that these operations are not harmful to the United Kingdom's export operations as a whole. I think they can be extremely harmful, and not only at a particular time; these are the type of exports that bring with them almost inescapably, year after year, orders for replacements. I do not suggest that we should have an Export/Import bank of our own (though sometimes I wish we could), but I think the generality of this is just a little too sweeping, if I may say so?——I can only say that I note that view.

3198. *Professor Cairncross*: Would you agree that, if there is any reduction in the level of activity in this country for one reason or another, the case for making medium term loans of the type we have been discussing would be stronger?——It would certainly be stronger, though whether it would be stronger than the desirability of re-encouraging greater investment in this country is, as I said earlier, a matter of judgment.

3199. Let me recur to a point I put to you earlier. The expansion of export trade involves investment in various directions, such as the erection or re-equipment of factories, or investment in market promotion and breaking into new markets; and it may involve additional credit in one form or another, short term in some cases, long term in others. Is there any real distinction in principle between granting credit, say, for three years, and granting credit for three months?——You get your money back more quickly, and the risks are therefore less.

3200. That is a matter of degree. In certain goods is it not normal to conduct trade on a three months' basis, in others on a three years' basis?——I agree that there is a basic period of credit or repayment which is normally appropriate to the goods in question; you do not expect someone to pay for a liner in three months.

3201. *Mr. Jones*: What risk have you in mind in thinking in terms of an incapacity to provide credit over long periods of time?——I am troubled about the potential

extent of capital demands from overseas, and the problem of how we pay our way in the meantime, if we stand out of our money for long periods.

3202. *Professor Cairncross*: If we are in a position, as we may be even now, where we have to make substantial efforts to maintain and increase our exports of capital goods, and if we have the necessary capacity, is not additional credit of some kind or another to other countries a necessary price? Does not the question then become one of whether existing financial institutions are directed to that purpose, and are strong enough to carry the credit that will be required?——I think we are only arguing about matters of degree. I readily agree that a higher percentage of our exports will probably be capital goods which, by their nature, will require a longer period of repayment; and that that is something we have got to sustain. I was anxious to say in these paragraphs that we should seek to do everything we possibly can to minimise that, and to continue to try to sell exports abroad on as favourable terms as we possibly can, and, if we cannot sell them in one market (subject to Lord Harcourt's very proper point about keeping a foot in certain markets), to sell them in others.

3203. If exports of capital goods are to account for a normal part of total British exports on a scale quite different from before the war, is not the issue whether the institutional arrangements are adequate to cope?——There is an institutional issue here, though I was not at this time addressing my mind to that, but to the overall ability of our economy to sell a large volume of exports abroad on (as I should say) unduly generous credit terms; I am trying to issue a warning, as I constantly do to my business friends, on that problem.

3204. But you do so in paragraph 82 where you say that the present arrangements seem to the Board to be as likely as any other in present conditions to ensure a satisfactory outlay of the limited capital available?——That is a point I was going to make. I do not believe by the creation of a new institution you *ipso facto* alter by that fact our ability to lend abroad. That is the reason why I deliberately strike this cautious note in this public statement. If we were to announce the creation of an Export/Import bank, I think it would be inferred by a great many people that our ability to lend abroad had been greatly increased. I think the present arrangements whereby credit is brought about largely through export credit guarantees of suppliers' risks is a very clumsy way of supplying export finance. I would much rather go back to normal arrangements of borrowing by purchasers, as we imply somewhere else. But the mere creation of an institution does not of itself alter the basic position, and I would be troubled that the creation of a new institution would be written up as "millions for export."

3205. *Professor Sayers*: I see the danger of that; but it may be that a new institution is the method to get administered in the most economical way possible the small resources we can put into this?——That is a perfectly tenable view.

3206. *Sir John Woods*: Have we not too many institutions?—*Professor Sayers*: Could not the banks do it all?——Those responsible for these institutions would no doubt find good reasons for their existence.

3207. *Chairman*: Your theme is that we have an aptitude for creating these institutions as and when the situation calls for them, and your view is that the situation does not call for any such new institutions at the moment?——My judgment is that the present method is not necessarily the most effective and convenient way of giving credit abroad, but in present circumstances it works not ineffectively, and I would be troubled that a new institution which would not alter the basic facts of the situation would give rise to a belief that somehow those basic facts had been spirited away.

3208. *Chairman*: Then you deal specifically with what you know about the Export Credits Guarantee Department. In paragraph 86 you outline the kind of complaints which reach you. The unresolved question left in my mind is whether in regard to some goods, possibly of importance to our export trade, the terms of trade are not changing round us?——That may be so. We must hope that our policy and methods are sufficiently flexible to take care of it.

3209. *Sir John Woods*: I understand that under the Berne Agreement we have agreed with other European countries not to guarantee for periods extending over five years from date of delivery. In some cases I would suggest that this is not the term of credit appropriate to the goods; for railway electrification the appropriate period would be 15 or 20 years?——This is a matter on which I am not an expert; it is something which you could take up with the Export Credit Guarantee Department. I would think that the rule you have quoted is the general one, but that it is not an absolutely binding rule.

3210. *Lord Harcourt*: The U.S. Export/Import Bank is not subject to any of the agreements?——No.

Chairman: Sir Frank, I think that concludes your day with us. Thank you very much.

(Adjourned until Tuesday, 16th January, 1958, at 11.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTEENTH DAY

Thursday, 16th January, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
W. E. JONES, Esq., O.B.E. (Questions 3253 to 3308 only)
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH (Questions 3211 to 3225 only)

GEORGE WOODCOCK, Esq., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, and SIR LESLIE ROWAN, K.C.B., C.V.O., a Second Secretary, of H.M. Treasury, called and examined.

3211. *Chairman*: Sir Roger, we have as the first item on the agenda points arising out of previous evidence on the relationship between changes in interest rates and movements of capital funds?—*Sir Roger Makins*: Sir Leslie Rowan is now in a position to make a statement on this point.—*Sir Leslie Rowan*: On the last occasion that I was here Professor Sayers raised the question whether the practice of covering exchange transactions forward in our view represents an important modification of the power of high interest rates to attract accretions to the reserves.*

Under the gold standard the position was, I think, fairly straightforward. In the absence of any need to take into account the possibility of changes in the value of the currency, funds were attracted automatically from the market with the lower rate to the market with the higher rate of interest. Now, however, it is deemed prudent to hedge the exchange risk. I will assume that in fact that risk is covered one hundred per cent. by forward transactions, although I think you would agree that that need not by any means necessarily be the case over the whole field.

I would like to start with a word or two on the mechanics, because I think that they are important. Let us assume that a non-resident purchases £1 million worth of three months bills for dollars. He acquires the sterling to do that in the foreign exchange market. It is important to note here that the Exchange Equalisation Account is not directly involved in particular transactions. It is involved only generally in its role of management of the official market within the limits (this is a point which has some substance in relation to what I am going to say later) to which we are committed under the International Monetary Fund. Although the Exchange Equalisation Account does not intervene in individual transactions, the purchase which I have mentioned of course supports the spot official rate and helps in the general process of adding to the reserves. Now the purchaser goes on to cover himself by selling the sterling forward for dollars. Again the Exchange Equalisation Account is not directly involved in individual transactions; and it is important to note that we do not have the same obligations in relation to forward exchange rates or the forward market as we have in the official spot market. There are no prescribed limits, although of course a heavy discount on forward sterling can have a depressing effect on the spot rate, and has therefore to be watched by the authorities. The effect of selling sterling forward is to increase the supply of forward sterling and thus to depress the forward rate; that is the point you were on.

Since the end of the war there have been two important factors which should be noted: (1) that in general forward sterling has been at a greater discount on the dollar—or at a lower premium—than the interest differential (this reflects the doubt which is felt by others about the exchange value of the pound compared with the dollar, and it is this doubt which gives rise to the policy of covering forward); and (2) that our experience has frequently been that market forces immediately adjust the forward rates to take account of the change in money rates, with the result that a switch of funds from one centre to another remains neither more nor less profitable than it was before the change in money rates took place.

In brief, therefore, a rise in money rates does not automatically attract money as it did under the gold standard because it is now deemed prudent to hedge the exchange risk, and the forward market tends to adjust itself here and elsewhere to changes of money rates. The view put forward by Professor Sayers is therefore correct.

But I would like to go on, and say that is not the whole of the story, as I think you yourselves would recognise. There is the question of confidence. An increase in the Bank Rate is taken as a symbol of determination to defend the pound and thus acts directly on confidence. If such an increase brings about a material change in confidence, then the forward rates become relatively more favourable than they were before, the intrinsic discount on sterling may disappear and short-term funds begin therefore to flow in.

This in fact is broadly what happened following the measures which we took in September last; perhaps I might just give you the sequence of events. Before the change in Bank Rate the interest differential between London and New York was just over one half per cent. per annum in favour of London; but the three months discount on sterling against dollars rose to over 5½ per cent. per annum, showing an intrinsic discount for forward sterling of 5 per cent. After the rise in Bank Rate the interest differential in favour of London rose to 3 per cent. per annum. The discount on forward sterling narrowed from 5 per cent. to around 4½ per cent. But that still left an intrinsic discount on forward sterling of around 1½ per cent. per annum. In fact this intrinsic discount has subsequently disappeared.

I am afraid that we cannot give any quantitative assessment of the various elements that go to make up the movements of funds.

The story is not complete at that stage, and there are two other important points which I should like to make: first, that a change in interest rates can affect the balance of short-term lending and the timing of receipts and payments by traders; and secondly, as I said earlier, that it is by no means the case that all payments are necessarily covered 100 per cent. forward; but even if they were we should consider such an inflow valuable, because, while any deposit of funds in this country would normally be for a fixed term or until the person required them again, the mere fact that he had covered himself forward on the initial transaction does not necessarily mean that he will not continue to keep his funds here provided our position continues to be strong. Indeed that is what we would expect him to do.

* See Qns. 2576–77.

For these reasons interest rates, in our view, have an essential part to play in the process of attracting funds to London, even though the process is by no means automatic as it was under the gold standard.

3212. *Professor Sayers*: Leaving aside for the moment the last qualifications you made, from all the rest of the analysis it would seem to follow that the Exchange Equalisation Account's open forward position is not allowed to vary substantially; that is to say the net weight of covering is left to be absorbed by the market, and so to come on to the spot position to the extent that the market cannot absorb it. Indeed I think your analysis is only correct on that assumption?——I think that I would go with you on that assumption, without wanting to indicate the position of the Exchange Equalisation Account in the market.

3213. You would agree that that is so?——I will agree that that is so.

3214. Is that a matter of policy?——Yes, I think it must be a matter of policy.

3215. *Professor Cairncross*: How well organised is the forward exchange market?——I think it is a very well organised market. After all, without a properly organised forward market, trade could not really continue, because payments are not made at the moment of order but after shipment, and there has to be a market in order to provide for that. As we are so dependent on external trade, the forward market has to be very well organised.

3216. What proportion of the transactions would you say is covered forward?——I cannot give you a figure as to what is or is not covered forward; it varies with the state of confidence.

3217. Can we hear more about who is engaged in the market? Whom does it comprise?——We have certain people in this country called authorised dealers.

3218. Are many of the transactions covered abroad also? Forward transactions need not necessarily be covered here?——Transactions are presumably covered through dealers in London, who then have some rapport, if necessary, with dealers abroad; but the essential operation is done through London.

3219. Are any forward transactions handled, for instance, through Holland or Switzerland? Is the position that it is not legal to do so?——If anybody in this country wants to operate in the forward market he has to operate through an authorised dealer here, who has the right to operate in foreign currencies and he can operate from London. If you want to get on to the technicalities of this it would perhaps be better to ask the Bank.

3220. *Professor Sayers*: Would I be right in supposing that, although there can be forward transactions in sterling in Amsterdam and Paris and so on, as well as in London, they cannot affect the spot reserve position in London except by resulting in transactions with authorised dealers in London?——I think that would be correct, though such transactions in other markets may cast a doubt on London rates, due to lack of confidence abroad.

3221. But they can only impinge on the spot reserve position by resulting in transactions with an authorised dealer?——I think so.

3222. *Professor Cairncross*: The position in September last was the outcome of dealings concluded between either persons in this country or abroad and authorised dealers in this country?——That is right, yes.

3223. *Professor Sayers*: Would you be prepared to say whether the sterling assets of the Exchange Account are held entirely in tap Treasury Bills and Ways and Means Advances?——*Sir Roger Makins*: I cannot answer that question at the moment. I think it might be for the convenience of the Committee if the Committee did not press the Treasury witnesses on this matter at this meeting*.

3224. *Chairman*: We can hold that over and return to it later?——I think that should be possible. I should also say that there are some outstanding points on the foreign side on which we have prepared answers; mostly statistics of one kind or another for which you have asked. They will be sent to you within the next few days. They are primarily factual or statistical answers to your questions, and I would hope that you would not need to examine us; but of course we should be available if you should want us.

3225. *Professor Cairncross*: There was the suggestion that we might be given information, I think from the Bank, on the specific association between movements of interest rates and movements of capital funds, to see whether it was possible to show in any quantitative form whether there had been a movement in funds in response to a widening of interest differentials. Is this still on the agenda?——*Sir Leslie Rowan*: I have not got immediate personal knowledge of that, I am afraid.

Chairman: We will take that up with the Bank. I think that we are now leaving it that the question about the nature of the sterling holdings in the Exchange Equalisation Account is left over. We shall consider what Sir Leslie has told us this morning. It may be that there will be further questions to follow up about the Exchange Equalisation Account; I do not know. If there are, I will give you notice, and we will arrange a day on which questions can be put. I think that is all the questions on the overseas side, Sir Leslie; Sir Roger, we look forward to seeing you later on with two other colleagues about the paper on alternative techniques.

(Adjourned until 2.15 p.m.)

SIR ROGER MAKINS, G.C.M.G., K.C.B., further examined; SIR EDMUND COMPTON, K.B.E., C.B., and SIR ROBERT HALL, K.C.M.G., C.B., called and examined.

3226. *Chairman*: Sir Roger, may we turn to your paper on Alternative Techniques?† I am not sure I quite understand the background of what you say in paragraphs 2 and 3:

> "It is generally admitted that this control [of the money supply] cannot in present circumstances be adequately exercised by existing techniques of monetary policy alone . . ."

The significant part of that quotation for my purpose is the words: "in present circumstances". As I understood the explanation given to us by the Bank, and I think the Treasury too, the basic defect in the control of the money supply has been related to the volume of the floating debt coupled with the position of the Bank of England as lender of last resort; so long as the volume of the floating debt is large enough, that sets up as it were a closed circle, under which, in so far as the banks wish, they can at any time replenish their supplies of money. I follow that; but it does not strike me that the volume of the floating debt is to be taken necessarily as an inescapable fact; the Treasury have, I think, put before us certain considerations which would alter this situation: a greater success in the funding policy pursued, or, I suppose, the taking of a larger part of the floating debt out of the banking system; or a taxation policy which would by itself reduce the necessity for maintaining the size of the floating debt; or a diminution of Government expenditure calling for the creation of floating debt. How much of this is covered by the words "present circumstances"?——*Sir Roger Makins*: By that we simply mean things as they are at the present time; those alternative approaches to the problem are not intended to be included in this phrase. This was merely a shorthand way of summing up the evidence which has been given; it was not intended to make any new point. Perhaps I should say that in putting forward this paper we realise that it touches on one of the main points, possibly the central point, of your inquiry; we have not therefore attempted here to do more than put up a few markers and make a few observations, without in any sense trying to press or support a particular view.

3227. We have to consider what this paper is about; you are commenting on the whole of the Bank's Paper

† Memoranda of Evidence Part II No. 13.

* *Note by witness, 7th February, 1958.*—In 1939 and 1956 the Exchange Equalisation Account did not hold and sterling market securities, and as a matter of policy none are held at the present time. Apart from a working cash balance, the Account's sterling assets are invested entirely in "tap" Treasury Bills—that is, Bills issued direct to the Account and not through the weekly tender.

No. 13, which deals with possible alternative techniques for the control of the money supply to the private sector. We shall want to get some idea as to how far these things referred to as "present circumstances" are the things we are to think about; your answer is that you are not trying to give us any view on that point?——No. This says that the techniques that are described as "monetary policy" are not sufficient to control the money supply, and goes on to say that monetary policy "has to be supplemented by other things". Then we go on to say that it is generally admitted, as I think it is, that the method of requests to the banks is not one which is desirable as a long continuing arrangement; in other words we do not feel that it should be regarded as a permanent feature of the landscape.

3228. *Professor Sayers*: May I pursue this point whether you mean by "present circumstances" something other than the present institutional set-up? It has been argued to us, I think, in evidence (I have certainly heard it argued in high quarters) that present techniques are sufficient, if only the climate would permit of a vigorous funding policy that would secure a substantial reduction of the short-term part of the debt. I would suggest that that vigorous funding policy would not be a change of circumstances that would be relevant to this. I would argue that the institutional arrangements would still leave the authorities in a vulnerable position in the business of the control of the money supply. Any arrangements we can reasonably foresee would include a continuance of a substantial volume of short-term debt. Our financial institutions are such that it is desirable, I would say, that the national debt should include a substantial block of short-term debt. At present, it is agreed, that part is rather excessive; but even if the excess is removed, even if the system has merely a comfortable amount of short-term debt to hold, this vulnerability of the authorities would remain because a change of climate of some kind could very easily make the short-term debt a nuisance. Would you agree?——In using those words we were not referring simply to the institutional set-up but also to the conditions in which present institutions are operating. I do not want to express a view on the opinion which you have just expressed, that, if there was a reduction in the volume of the short-term debt, the present institutions would necessarily or inevitably be vulnerable.

3229. We should like you to express a view on it. It has been argued that a vigorous funding policy would make the adoption of alternative techniques unnecessary; it is therefore a vital point?——It is a vital point, but it is an open question. In fact we state later on in this paper that alternative arrangements might well be operated without a change in the institutional set-up. I think that is the point at issue.

3230. I am asking you to agree that a successful funding policy would not remove the necessity or the desirability of some alternative technique. I suggest to you that the difficulty of the authorities in controlling the money supply at present is chronic, because the system appears to have an excessive volume of short-term debt to digest. We might hope that a vigorous funding policy would eliminate the excess, and that the system might run on then for many years without the authorities feeling under any difficulty at all in controlling the supply of money, because the volume of short-term debt was such that existing financial institutions were eager to hold that amount of short-term debt. But, having run on for a period of years, a change in the economic climate might then quite suddenly make the short-term debt an embarrassment, although it was much contracted as compared with the present level, and the authorities might suffer interference in their attempts to control the supply of money by the existence of their short-term debt, notwithstanding the fact that for many years it had been a comfortable volume to hold. Do you accept that line of argument?——*Sir Roger Makins*: That might happen, but I would not necessarily accept that that is a reason for altering the institutional set-up now.——*Sir Robert Hall*: I am afraid we have not completely explored what was in Professor Sayers' mind. By the "existing set-up" we have assumed that the banks wish to hold some conventional proportion, as it were 30 per cent., of their total assets in what they regard as extremely liquid form. I take it that you do not have in mind a situation in which the banks would suddenly alter their convention?

3231. I was not thinking of that, although it does arise; the banks are not compelled to stick to this ratio?——We would agree that the control might be vulnerable, if the banks suddenly decided to have some very different convention, on the ground that the lender of last resort would still come to their rescue or something of that sort.

3232. I agree with that; but there is short-term debt held outside the banks. Suppose that, after quite a large block of short-term debt had been comfortably held outside the banks for many years, for some reason the short-term debt outside the banking system tended to be thrown on to the market, and the market was unwilling to take up conversion issues and so on; then the authorities would be in just the same embarrassed position as they are now, and the short-term debt would then again become excessive?——*Sir Roger Makins*: All this seems to me rather hypothetical.

3233. I am sorry, but I cannot agree. We are considering the case that there is for the introduction of some new technique of monetary control. There is obviously a pretty strong case for emergency action on emergency grounds; there is this apparent excess in the volume of short-term debt. But whether one should introduce a new permanent measure to meet that emergency situation depends to some extent on whether one regards the situation as something quite extraordinary, or whether it is something that may recur from time to time. My suggestion is that it is the latter, and that therefore the case is stronger than it would be if we had only this present emergency to consider?——If the situation which you foresaw arose, or if the present situation were likely to continue indefinitely, then I agree that a change to some alternative technique would be indicated; but whether it is a case of introducing a new technique now or in the near future, or merely being prepared to introduce some new technique, is a debatable question.

3234. It is debatable; all I am asking is whether you accept the view that it is a stronger case than would appear just by looking at the present situation. If you accept the view that it is reasonable to manage the debt on the basis that quite a large block of the debt can reasonably be short-term debt, then it is surely arguable that the monetary authorities should have weapons at their command that allow them to deal with situations that may be produced by the existence of this debt, although there may be quite long periods when the existence of the short-term debt is causing the Government no embarrassment at all?——What you say is arguable, but I am not prepared to say that it is conclusive.

3235. Of course not; it is merely that the present circumstances are not to be regarded as unique?——No, certainly not.

3236. *Professor Cairncross*: In paragraph 3, are you thinking exclusively of control of the money supply? You speak of measures of supplementation by control of capital issues, hire purchase controls and so on. But none of these measures of supplementation operates directly on the money supply; and there are many other ways in which you could operate to restrict the level of demand in the economy. Your paper is, as I understand it, dealing primarily with what you can do by limiting the money supply. Can you envisage circumstances in which you might operate exclusively on interest rates or on Government debt and accomplish exactly the same effects, while the money supply remained constant?——In this paper our observations are limited within the framework of the Bank of England paper. In other words it is intended to cover that ground and not go beyond it.

3237. The Bank of England, however, appears to attach special significance to control over the supply of money. The measures that it takes might exercise effects of importance, effects one was anxious to register, without the money supply being altered; for instance, if rates of interest were changed, the money supply might not be changed, and yet you would have an effect?——*Sir Robert Hall*: I think that is possible; but you must read paragraph 3 in relation to paragraph 2; whatever the particular situation at any moment or the particular situation that you wish to bring about, it still is the responsibility of the Government to be able to control the money supply. The paper is about that problem.

3238. My question really relates to how far supplementation should be construed. Only one of the three measures of supplementation here is a measure involving intervention by the banking system?——Yes, the requests to the banks; and that, of course, could be used in other ways than it is at present to secure a result. But I think our central point is that we do not feel that the technique of requests is likely to be satisfactory over a long period, and that, therefore, if it were concluded that existing policies were not likely to enable you to dispense with requests to the banks, we should have to reconsider the question of whether the existing system did give us control.

3239. *Mr. Woodcock*: You are talking here about the method, not the object?——Before one can discuss the use of a particular instrument in order to produce a particular result, one has to decide what the instrument is capable of doing.

3240. Here attention is on the method of requests to the banks; you say that the method of requests to the banks is not desirable as a long continuing arrangement. Would you also say the same about some other method of limiting bank advances than requests to the banks?——We would say that in any system there must be some way to ensure that the total quantity of money, including bank money, conforms to the objectives of policy. If anybody who chooses can add to the money supply, the thing gets out of control.

3241. Are you afraid that this voluntary restraint by the banks will fail by the mere fact that it is voluntary?——We have said that we cannot be confident at present that on existing policies we shall necessarily be able to dispense with the method of requests, if nothing is done to change the present second line, which is the fact that the banks at present regard it as prudent to hold a particular volume of their assets in a liquid form.

3242. But you could decide that it was prudent for them to hold a much larger proportion? That is a different matter?——It would be a different matter if we said what they had to regard as prudent.

3243. I am still not sure whether it is the control of bank deposits as such that is not desirable, or whether it is the method of doing it by requests to the banks, which you regard as undesirable?——*Sir Roger Makins*: It is the method of doing it by request to the banks as a long continuing arrangement. That is all this was meant to say.

3244. *Chairman*: I read your paper as an essay upon the general content of the Bank's paper about alternative techniques. They ran through a number of legal impositions which might be added to the existing methods, and put the pros and also a number of cons on each; I thought that, except in so far as you commented, you adopted their general argument?——That is right. This was not meant to be a separate essay on the subject; it was meant to be such comments as we wished to make on the Bank paper.

3245. *Professor Cairncross*: That being so, I think it is fair to ask whether you attach the same importance to the control of the money supply *per se*, in relation to economic control, as the Bank presumably does?——*Sir Robert Hall*: We attach importance to the ability of the monetary authorities to control the money supply; the particular degree of importance that would attach to it would depend on what other things we were prepared to do.

3246. That is why I was asking the question about supplementation. The Bank would regard it, I think, as important that the money supply should be controlled; indeed they would think this was their normal function. The control of the money supply is only important in relation to the pressure of general demand on the economic system?——That raises the questions which we discussed in our general paper (No. 6) where we pointed out that there are a number of methods of influencing the economic system, and that the Government of the day would in our view be likely to select among these various methods. The point here is a fairly straightforward one: that if it is likely to wish to use monetary methods (I would go further and say that whatever was selected we should still have to have a monetary policy), then in order to be able to say that it had a monetary policy it must at least as a minimum be able to control the supply of money. That proposition would remain true whether it wished to lean more heavily on monetary policy or on budgetary policy or on direct controls. A very rigid system of controls indeed would be required to be able to control the system irrespective of the supply of money, I should say.

3247. Even within monetary policy it makes some difference whether you are thinking primarily of the money supply or of measures such as changes in interest rates, which are monetary measures but may have very little influence on money supply?——It would make a difference to the extent to which we used it, but it would not affect the initial proposition that we needed to be in control.

3248. It affects the emphasis; it determines which measures you look to?——When you come to what we are going to do with them your point is very relevant.

3249. *Chairman*: The run of the argument is that the control of the money supply is at any rate a weapon the Government ought to possess, and, if it ought to possess it, then it must be a weapon in working order. It has not, under the conditions you have outlined for us, been in effective working order and it has only been working tolerably because of the requests to the banks.—*Sir Roger Makins*: And other measures.—*Chairman*: For the moment my mind is on requests to the banks, because that is what you comment on. That system of requests is not one you can envisage as a long-term working arrangement. What is the next step from that? If that is so, and one considers the drawbacks to a permanent system of requests, it seems to me to follow, unless there is some significant change ahead in the future, that there must be some effective weapon added to make the control work. Is that not the conclusion?——*Sir Robert Hall*: We did not want to pre-judge that issue. In the general discussions we and, no doubt, the Bank have had with you, the possibility of a much more radical reduction in the floating debt by a change in funding policy has been put forward, and we were certainly not prepared to say that one could not contemplate such a possibility, or that it was out of the question to suppose that a funding policy could not produce changes in the size of the floating debt; we felt it was rather more for you than for us to express an opinion on whether the next step was inevitable or not.

3250. Yes; but it does leave me with this question: is there any radical change of the conditions that have been prevailing up to now which you envisage as likely to take place?——We are in a position of transition, or at least of experiment, at the moment. We have a much higher Bank Rate now than we have had in any of the previous periods, and what the effect of that will be on these underlying conditions we are just beginning to learn.

3251. *Professor Sayers*: I presume that you are not going to suggest that the higher Bank Rate will make the conditions in which some addition to the armoury is desirable entirely disappear?——We do not want to be dogmatic about it.

3252. How can a change in the level of Bank Rate remove the vulnerability of the authorities in their control of the supply of money as long as there is some short-term debt?——Sir Roger Makins agreed with you that your position was arguable on this.

3253. The Chairman asked whether you foresaw any change in conditions that would affect the *prima facie* case he sees for introducing some new weapon for controlling the supply of money. You say: "We have the higher Bank Rate; let us see what difference that makes". I am suggesting that the level of the Bank Rate can make no difference to this at all, though it may eventually ease the funding problem?——*Sir Robert Hall*: That is all I meant, that it may ease the funding problem.—*Sir Edmund Compton*: This is a point on which we touched in earlier evidence [*cf. Qn.* 2991]: our experience so far has led us to feel some hopes for, but not necessarily to place great confidence in, the future. We have, after all, some experience of recent years in which we have reduced the amount of floating debt, and the combination of funding with the assumption of suitable budgetary policies in the future might lead to a continuance of that process. The prospects of funding the floating debt have also to be

set against the heavy maturities year by year. The result of all that might well be a measure of funding in the future; but whether a large measure of funding and reduction of debt in the future would, in the situation described by Professor Sayers, give us adequate control over the money supply I do not think we know. The particular measure that is suggested later in this paper for control over excess liquidity is control over excess liquidity in the hands of the banks; it would not, as it happens, touch directly on the problem, if that became a problem of excess liquidity in the hands of persons outside the banks.

3254. *Sir Oliver Franks*: Is not the argument proceeding on two different levels? The one on which you are conducting it, I think, is empirical: you are saying that the situation up to now has not been in control, that it ought to be in control, and that it may be that certain things will happen to bring it sufficiently under control for us to be freed from anxiety in future years, or again it may not; you do not know. On the other hand, I think Professor Sayers is arguing *a priori* that, if the contention is accepted that, even though the volume of the floating debt is reduced, there must yet remain quite a considerable volume of floating debt, held both within the banking system and by outside bands, situations can arise in which, even though the floating debt has been reduced, there is still embarrassment to the authorities because of excess liquidity. That is a different line of argument from the empirical method you are following, and to that extent I think we may be at cross purposes? ——*Sir Roger Makins*: I think that is very well analysed, if I may say so. Certainly this paper goes on the empirical basis. I said that, while I agree that Professor Sayers' case is arguable, I am not prepared to say that I regard it as conclusive.—*Sir Edmund Compton*: The problem of potential liquidity outside the banking system is a much wider problem than we attempt to deal with here in discussing alternative techniques for operating on bank deposits. It is always with us as part of our debt management that we have the £6,000m. of small savings repayable on demand; that is one example of an area of liquid debt which is right outside this field, and on which it might be thought there was a potential danger that ought to be dealt with by a radical revision of our debt policy. But that would, I think, be a much wider study than this, which is really dealing with the particular problem of the control of the money supply as it may be increased or diminished by the banks.

3255. *Professor Sayers*: There are some contingencies that can be left for emergency action. There are others that are in the nature of things sufficiently likely to recur from time to time to make it desirable to have "long continuing arrangements", of a desirable rather than an undesirable kind, for dealing with them. I would suggest that the contingency of large-scale encashment of National Savings is of the first kind, and that the contingency of a considerable decline in the taste of the system for short-term debt is the second kind of contingency. Would you not agree with that?——I am trying to think through what is involved in your second contingency, the decline in the taste for short-term debt on the part of non-bank holders, that would lead to the conclusion that it was inevitable that we should exercise legal powers of control over bank credit. I do not see that the conclusion follows inevitably from the premise.

3256. *Mr. Woodcock*: Was it not you, Sir Edmund, who brought in the other one? Now you are taking it out again. You brought in this £6,000 million of small savings as a factor; now you take them out?——I was only saying that, once one brings in this question of liquidity outside the banking system, one is going much further than the question of distribution as between the banks and business of a certain class of short-term Government debt, namely Treasury Bills.

3257. Do you take this as being liquidity in the fullest sense of the word? What is the sum total of fluctuation; not much surely?——In dealing with Exchequer management these fluctuations which are small in relation to the total outstanding are important. They have been up to a hundred millions either way.

(SIR ROBERT HALL *withdrew*.)

3258. *Professor Sayers*: With respect, I think Sir Edmund has introduced a very fat and succulent red herring. I wonder if we could go back to the Chairman's question: are there any circumstances that lead you to suppose that there is some change coming? Sir Robert Hall suggested that the increase in Bank Rate might be producing such changes?——*Sir Roger Makins*: We are not attempting here to look into the future. We merely point to the fact that the present system has shown improving results in the time that it has been in operation. We are not able to say with confidence that the system will operate fast enough, or will in all circumstances be capable of effective control.

3259. *Chairman*: These results have been achieved, by common consent of yourselves and the Bank of England, by means of what has probably been an exhaustible instrument. If one accepts the view that it is an exhaustible instrument, what is the new set-up to be? It is almost inevitable we should ask your views on that. Can you see any material change in the conditions that have made it unsatisfactory but for resort to this exhaustible instrument?——*Sir Edmund Compton*: We are saying that our prospects of achieving satisfactory control by means of the orthodox pressure on bankers' liquidity are linked with budgetary policy and the other things affected, such as the progress of funding against debt maturities; and that, so far as we are looking to funding, the fact that we have had a freer use of interest rates improves our prospects. If I might follow up Professor Sayers' point, what gives me difficulty in his question is that throughout this we are really treating this as a problem of control over the liquid assets of the banks, whether they are liquid assets proper or reserves of liquidity. It is certainly from that point of view that I have been treating it, and I have been disregarding the question of liquid or near liquid Government debt held outside. I have been asking myself why it should be supposed, if we had succeeded in controlling bank liquidity, perhaps by selling Bills to non-bank holders, that the system had failed to operate.

3260. *Professor Sayers*: The link is this, I think: that if the institutions and the public outside the banks reduced their demand to hold short-term bonds, then the Government would be forced to deal with the maturing bonds by adding to the short assets to be held inside the banking system. That is why the liquidity of the whole system is relevant to the control of the liquidity of the banking system?——*Sir Edmund Compton*: I question whether that would necessarily follow. If the holder of a Treasury Bill did not want to hold that Bill, I wonder what he would do. He wants either cash to spend or cash to invest.—*Professor Sayers*: And the Government has to find the cash.—*Sir Edmund Compton*: The Government has; and one might expect that in the normal course it would find its way into that holder's bank deposit. By that means, if nothing else happened, it would be a question of an addition, I suppose, to the holdings of liquid assets by the banks. But whether that in its turn could not be dealt with by the existing measures of operating on bank credit I am not sure. In a situation of that sort which, after all, we have had from time to time already, you might quite well find that under existing methods the bankers themselves would be willing to take up suitable Government securities and not necessarily to add to their liquidity.

3261. You are retreating from my assumption of a general drop in the demand for short bonds; you are saying the banks may increase their desire for short-term bonds concurrently with the drop of demand outside the banks?——I am simply questioning the inevitability of the money supply getting out of control in those circumstances.

3262. It is not bow to guard against inevitability that we have to consider; it is a question whether we ought to have weapons to deal with the kind of situation that may arise from time to time?——I think in our minds the difference lies between being ready to deal with such a situation and agreeing in advance *a priori* that this situation was bound to occur and that we therefore ought to have an alternative system in operation. It was the second of those propositions that we were not ready to accept.

3263. If you do not have a standing arrangement, you fall back when the situation arises on what may well be a very fair expedient, as was done on the present occasion, but an expedient that you and the Bank, and I think most people, agree has very serious disadvantages when it trails on for six years. Would it not be better to have a permanent arrangement that did not have these particular disadvantages, and could be brought into operation at any time?——That depends on one's judgment about the merits in themselves of a legally compulsory system. That is where we come to paragraph 6 of our paper, where we express a presumption in favour of minimum interference with the system as it is, because of the shock and dislocation to the system that follows the transition to compulsion.

3264. *Professor Cairncross*: The system as it is functioning at present is one in which the money supply is a specific function of the floating debt, other than the part held outside the banks. The system is therefore one in which liquidity is determined unconditionally by the proportion of floating debt and the willingness of the public to hold floating debt. This would seem to introduce an element of uncertainty into the control of money supply; the liquidity ratio is fixed, and the conditions governing the floating debt are not always exactly the conditions that should govern monetary policy. What has been put to you by Professor Sayers is that this is a system in which the measures of control operating at present are not likely to be as effective as necessary and that you may need to deal with bank liquidity over a long time and quite independently of the size of the floating debt?——The difficulty that I feel in assessing what we are likely to need in the future comes from having lived through the past and the present. The fact is that the whole of our experience of this operation has been conditioned all the time by the existence of the regime of requests, first the qualitative requests, that have been with us ever since the war, and then the quantitative requests as to the actual level of bank advances. It is very hard to envisage *a priori* what would happen if the whole system of requests, which is built in to our system now, was done away with.

3265. The requests to the banks do not determine the liquidity of the system, but the specific assets the banks acquire. You could quite well have the maintenance of a system of requests without any impact on the money supply as such. What you are doing by your system of requests to the banks is not to limit the power of the banks to create cash but to determine that the flow of credit to industry or private borrowers shall be limited because that will have a direct effect on demand in the system and on employment. You are not really operating on the money supply?——We think we are. Take the two forms of requests: the request that bankers should observe a restrictive attitude following the same criteria as the capital issues control would, I suggest, have an effect upon the level of advances, and therefore on the money supply resulting from that. The more specific requests that they hold the level of advances at a given figure must have a direct effect upon the money supply.

3266. Only if they are prevented by other means from buying Government bonds?——I was assuming that so far as the banks buy securities as an alternative to making advances they do not add to the money in circulation by doing that because of the existence of the departments selling securities in the market, and therefore by selling to the banks adding to the supply of securities.

3267. Either the banks increase their total liabilities or they do not. If they buy securities they increase liabilities, and therefore deposits.—*Professor Sayers*: Wherever the securities come from.——I was trying to deal with the point that we have certainly thought that the money supply was affected by the bankers' advances policy, and that, when the bankers have been asked to advance less than they would otherwise have done, that would be bound to have a restrictive effect upon money supply.

3268. *Professor Cairncross*: It may in practice. It need not if the bankers are prepared to lend up to 30 per cent. If you tell us that, because they are inhibited from acquiring one particular type of asset, namely, advances, they hesitate to lend up to the hilt, then I should agree that that may be so; but they have an option, if they think the gilt edged market is sufficiently stable, of acquiring Government securities. That may be of advantage to you when you want to have that result, but if you do secure that result do you not add to the money supply?——If the bankers find themselves with excess holdings of Treasury Bills and liquid assets, and as a result of being restricted on advances decide to convert some of those Treasury Bills into Government stock which, in fact, has been supplied to them by the Government, that process surely does not add to the money in circulation. I know that it goes through the market; but it is, as far as the banks and the Exchequer are concerned, a plain exchange of a liquid asset for a non-liquid asset.

3269. If the bankers for their own reasons wish to become less liquid, certainly they are free to do so; but the possibility which Professor Sayers was drawing to your attention was that there might be a change in the liquidity requirements of the entire economic system without any corresponding change in the disposition of the banking system, that this would certainly be awkward and would require control, and that it could not readily be controlled through the present methods of intervention by the Bank of England (from "present methods" I am excluding requests to the banks)?——It seems to me that a situation of that sort would probably require a remedial measure which would go considerably wider than such a measure as the Bank have put forward to you, and which we discuss in this paper, which is in effect to convert compulsorily a certain amount of the liquid assets of banks into non-liquid assets.

3270. The proposal of the Bank would deal with the situation in a rather effective way, because it would take effect on the liquidity of the banks directly, and not through manipulations of the money market. Counterbalancing a change in the liquidity position outside the banks there would be a sterilisation or release of liquidity within the banking area by this technique. It might be more effective in those circumstances than would be the manipulation of the Bank Rate.—*Professor Sayers*: The virtue of the technique the Bank prefer is that it would force in the banks a change in their liquidity position to compensate for a change in the liquidity position of the outside public. Given the possibility of changes in the liquidity position of the public, is there not a *prima facie* case for some machinery for forcing this change of liquidity in the banks?——At the moment when the request is made, and if nothing else happens, the banks, instead of having a minimum liquidity of 30 per cent, have a minimum liquidity of whatever is the result of the equation of holding the level of bank advances. This particular technique would, so far as I can judge, enforce that by translating that excess liquidity into a non-liquid investment. That is much the same effect as would happen if a bank voluntarily applied, say, £50 million of its Treasury Bills to a new issue of Government stock; and the whole difference is that in the case supposed they are made to do so.

3271. This arrangement can come about through the ordered use of a weapon that has previously been deliberately put in the hands of the authorities, or it can be brought about by an extraordinary request to people to act in a way contrary to their own interest, and in a way that entails a number of disadvantages that increase as time goes on. Is not that the choice we are facing?——That statement would not do as much as some of us would like to indicate that the compulsory alternative also has its difficulties; for example, one has got to determine the amount of the compulsory deposit, and that is really in obverse the same sum as has to be done when one determines what the level of advances should be; and it runs counter to the natural business inclinations of the banker concerned; and the circumstances of individual bankers are different. It is in that area, once you start to leave voluntary measures and go for compulsion, that difficulties begin to crop up and the dislocation of the existing system begins.

3272. *Professor Cairncross*: The issue which we would like to put to you is whether you think the banks would in effect voluntarily fund, since that is pressing the alternative that you are visualising to its logical conclusion?——There are too many assumptions in that question for me to give it a direct answer. The extent to which the banks would voluntarily fund raises the question what sort of funding they would do; whether they would go into near-liquid assets, or not; in fact, whether they

would voluntarily dismantle their reserves of liquidity; and, consequently, what rate of interest would be required to produce that result, which would really be inviting the bankers to cease to be bankers and become investment trusts. Taking it to its logical conclusion, if we made it so worth while to earn large sums of money from the Government that they did not want to do any more banking, no doubt you could reach a conclusion.

3273. *Chairman*: That brings to a head, I think, our discussion on the opening assumption. Has anybody any questions on paragraphs 7 and 8? In paragraph 8 you say you prefer the alternative of special deposits. Are there any questions on paragraph 9?—*Sir Oliver Franks*: You say that the question of alternative techniques includes the question whether the banks, if they are to be compelled to lend, should lend to the Bank or to the Treasury; and then you say: "This raises the question where the initiative in the control of credit policy should lie under an alternative system". It clearly does. I can see that you might not wish to give a positive view of what you think the answer to the question should be, but you must have had certain considerations in your mind, which made you feel that the question was in one sense open, and a proper one for discussion. What were the pros and cons in your mind when you wrote that last sentence?——*Sir Roger Makins*: Paragraphs 10, 11, 12 and 13 are supposed to be a discussion so far as we feel that we ought to, or can, discuss that question.

3274. Would it be right to infer from what is said in paragraph 11 that you feel that the existing position of the Bank of England in regard to all these questions is such that we shall either have to proceed to overt independence, or alternatively to the placing of the initiative somewhere else, whether in Parliament or the Treasury, and that there is a certain indistinctness in the existing situation that you feel needs remedying? Is that fair?——No, it is not. We are saying here that, if you are going to have a compulsory system, that is to say if legislation is required, then the question under that system, not under the existing system, is where you put the initiative in the control of credit policy.

3275. Does not that question arise with equal force about the existing system? The existing system is designed to do, by methods which we all agree are not entirely satisfactory, exactly what the alternative techniques are supposed to do; if there are questions of initiative in the one case I would suppose there were in the other?——Under the present system the situation is, shall we say, uncertain; at all events the interpretation of the Bank of England Act is open to debate. For the reasons given here and earlier in evidence, the Bank of England Act gives certain powers both to the Government and to the Bank which in practice have never been used. While the legislative history of the present Act leads to the supposition that the initiative lies, and was intended by Parliament to lie, with the Bank of England, in fact it has never been necessary to use those powers, and it is a debatable question whether that situation should continue under the present system, or should continue, as it probably could continue, under an alternative system. That is the question that we leave open.

3276. But it seemed to me that, when you dealt with the hypothesis that some form of compulsory system had to be introduced, the drift of your thought was fairly clearly that the check on Government borrowing which is made so easy by any compulsory system should in the end perhaps lie with Parliament, rather than with the Bank of England or with the Treasury?——Yes.

3277. You sketch one or two possible ways in which this might be effected?——They were put in purely as a matter of illustration, to put up markers.

3278. If this is the way that your thoughts move in considering a compulsory system, surely your thoughts must move in the same way about the existing system, because in its own fashion it does exactly the same thing. While the nature of the compulsion is different, moral, if you like, rather than legal, nevertheless the requests are obeyed as the direction would have to be obeyed, and restrictions on lending to other quarters have made borrowing by the Government easier. Must we not, therefore be right to construe paragraphs 11, 12 and 13 as a comment on the existing system as much as on the hypothetical one in which compulsion is introduced?——That construction was not intended.

3279. No, but I was just wondering whether it did not logically follow?——I do not think it does, because what we are really saying is that there is a presumption in favour of not interfering with the existing system. It may be that there are circumstances which overturn that presumption.

3280. I follow that; but the existing system involves direct Governmental intervention in what are called the supplementary measures, not simply the ordinary operations of the market, whether by price or by quantity; and if the difference is only a difference between a moral request and a legal direction, the directness of the intervention remains the same, and the effect is the same, that lending to the private sector is made more difficult, or impossible, with the corresponding result that it is made easier for the Government to borrow. Am I not reasonable therefore in suggesting that the suggestion which you make here might equally well apply to the existing system?——I agree that you can, if you wish, imply it, or state it, but it was not intended.

3281. *Sir Oliver Franks*: I do not want to persist, but it does seem to me that that argument cuts both ways equally.—*Chairman*: I find this a very difficult point. It seems a great nuisance that nobody knows exactly what the Bank of England Act meant. I dare say nobody considered at the time exactly what it was meant to mean; but is not the extreme interpretation of it something like this, that the Government, which is responsible for the control of the money supply, cannot get at any other organ of the whole system than the Bank of England under the powers given by the Bank of England Act, because the right to do that is vested in the Bank: whereas the Bank can get at these other organs if it itself makes a suggestion to the Government, and the Government says: "All right". The Government is therefore cut off under the Act from any direct powers over the system as a whole, except those that the Bank of England likes to suggest and put forward to it. Is that too extreme?——That is an extreme interpretation of the system; it does not work like that.

3282. I am not saying it does, but unless that is the position there is no difficulty, because the alternative would be that a Government which regarded itself as responsible would be able to say to the Bank: "We think that you must take this or that action with regard to other banks", and then the Bank as an organ of Government would say: "Yes, we will". It really lies between the two alternatives?——As a matter of legislation and the exercise of powers it does; but it has been admitted by everybody, including the Bank of England, that under the present system the Government has an overriding responsibility in these matters. No issue involving a conflict in which it would be necessary to exercise these powers has arisen, either as between the Government and the Bank of England under section 4(1), or between the Bank of England and the banks under section 4(3). All that we have tried to say is that, if such a conflict did arise, and if it appeared that the existing powers in either direction were proved to be inadequate, then the Government of the day would clearly seek to obtain the powers which it considered necessary to deal with the situation. I suppose there is a question whether in view of a possible defect in the Act a Government should take powers in advance of the issue arising. Clearly that is a possible course, but it is not one that we are recommending or suggesting, or indeed that we, as Treasury representatives, are in a position to recommend or suggest.

3283. Is it the experience of the Treasury that there is no live issue as between the Treasury and the Bank at present as to who has the initiative about any measure of credit policy?——*Sir Roger Makins*: I should say that there was no live issue.—*Sir Edmund Compton*: It is really a two-way traffic, speaking in terms of practical administration, in the sense that a suggestion that some change should be made, or that some action may be required, may come either from the Bank or from the Treasury and we act jointly. The initiative, in the sense of who initiated the discussion, may, and in practice often does, come from one side or the other.

3284. *Professor Cairncross*: You draw no distinction between debt management and credit policy?——I do not think that I do. For example, on the Government debt, I would say that we would expect the Bank to

initiate or to make the first proposal more often than not that some new move should be made in debt management. Equally there have been occasions when it was from the Treasury that the initiative came to suggest that there should be some new move in credit policy.

3285. In the paragraphs we have been discussing the particular proposition is one that would involve compulsory powers over the commercial banks in relation to debt management, whereas the present policy does not involve debt management, at least so directly. I wondered whether you were laying any stress on this as a point of distinction between current techniques and proposed techniques, or whether this was passing through your mind?——*Sir Roger Makins*: I was thinking in terms of the present system when I was talking just now.

3286. The present system does not involve, as between the central Government and the clearing banks, any exercise of powers involving the banks' investments in Government stocks; they are involved only indirectly. The new arrangement outlined would involve a direct conflict, if your suggestion were implemented and the Government took powers independently of the Bank. But you do not attach any importance to that?——I do not think I do, no. Coming back to what the Chairman referred to as a "live issue", I take it that the issue could only be live in that sense if, for example, the Government thought that something should be done and the Bank of England said: "No, you can't do that, because the initiative lies with us. You are powerless in the matter, and we are not going to entertain your suggestion". It is, of course, conceivable that that could occur, but we regard it as most unlikely in any circumstances that we can foresee at present.

3287. *Chairman*: I follow your view that, if it ever came to a head, as it were, if the power was not there the Government of the day would probably ask Parliament to give it as quickly as it could, even though that might not be the best way of dealing with it. I was wondering whether in the two-way traffic that Sir Edmund spoke about it does or does not aid the position on either side to say: "On that matter the initiative lies with us". Is that position ever taken up?——*Sir Edmund Compton*: Under the present system I do not think so. Whether it might assume importance under a compulsory system, I am frankly not so sure. As I would envisage the operation of the system, I do not think it ought to; but it is quite possible that it might have some psychological effect upon the readiness or otherwise of either of the parties to initiate action.

3288. *Professor Cairncross*: Does not initiative rest very often on the information at the disposal of the person taking the initiative? The information at the disposal of the Bank of England is not always the same as the information at the disposal of the Treasury. Each has fuller information about some things than the other?——Yes, and in our work we try and pool that, so far as we can, as part of our joint work.

3289. Have you ever had any occasions on which you met with a refusal from the Bank of England to give you information?——*Sir Roger Makins*: I should regard it as almost inconceivable.—*Sir Edmund Compton*: It is not as if we entered into a battle with each other armed with secret briefs!

3290. *Professor Sayers*: Has there never been any occasion when the Bank has expressed such extreme reluctance to disclose information to the Treasury that the Treasury has decided not to press the matter any further?——*Sir Roger Makins*: Not in my brief experience.—*Sir Edmund Compton*: Nor in my experience. That may have been due to a certain delicacy on the part of the Treasury, in not asking for information which we knew in advance the Bank would find great difficulty in disclosing, as for example about the internal affairs of customers; there is that area in which we apprehend that the Bank of England are in a sense keeping the confidence of their customers, and we regard the maintaining of that confidence as important.

3291. *Professor Cairncross*: May I ask if you have, and have had throughout the last six years, access to all the information listed in the document submitted by the Bank as their Appendix 3?——We have had access to it.

3292. In all cases?——I have never had any experience of asking the Bank of England and the Bank refusing to give it to us.

3293. Do you think the Bank of England equally has access to all the information the Treasury has that is relevant to its initiative?——Yes.

3294. Do you know of any case in which they have felt that they have been denied information that they would have liked to have, and that they could quite reasonably have asked for, as bearing on credit policy?——*Sir Edmund Compton*: I could conceive the sort of information that they might like to have but they know quite well they must not have; for example, it would be indeed very useful for them for their purposes to know the Budget proposals in advance, but they would not think of asking. I call that to mind as an obvious example of information that they would not ask for and we would not give them.—*Sir Roger Makins*: Of course, the relations between government and central bank vary very much from country to country, and it would not be proper for me to comment on or to describe, the system in other countries; no doubt if you feel it desirable you will be obtaining such information as you want from authorised quarters. But it occurs to me, just as an observation, that it may well be that the *modus operandi* in other countries varies as much from the actual written constitution or document as the *modus operandi* here differs from the actual provisions of the Bank of England Act, in as much as they have never been applied. It may well be that the relationship in many cases depends, as I think it does here, less on the statutory position, although that may have the same sort of psychological or ultimate sanction, than on the actual day-to-day relationships between the Government departments concerned and the central bank.

3295. *Chairman*: That may be so; but I have been trying to find out from you how far the Bank is an independent entity in the set-up with a position of its own, and its duty or interest to maintain. If you do not count the legal position (as nobody knows what it is, it is just as well not to do so) I do not quite see what is left, except the discussions which Sir Edmund referred to, which run on and from which hitherto you have always emerged without open conflict?——As I said at the outset [*cf. Qn.* 974] there is a clear division of labour between the Treasury and the Bank; the Bank is recognised as primarily performing certain functions as the Treasury is recognised as performing other functions. So in practice the Bank clearly takes the initiative in certain matters and the Treasury takes the initiative in certain other matters; that is a matter of the efficient operation of the system.

3296. *Sir Oliver Franks*: In the light of that discussion I wonder what you think is the answer to the question in the last sentence of paragraph 9, but related to the existing system. Who would you say has the initiative in control of credit policy as at present? Would the answer be on the lines of Sir Edmund Compton's suggestion that the initiative, in the sense of starting a discussion, may begin in either place, while the general overriding responsibility must be located in one, namely, the Treasury; or would you put it differently?——No, I think that that is about right, and that the Bank itself has recognised the overriding responsibility of the Government. Either party can take the initiative, but in relation to the division of labour between the two it is natural that each should normally take the initiative in those things in which it takes the predominant part; there would then be a discussion, and in the last resort it is recognised that the view of the Government should prevail.

3297. *Sir John Woods*: It would follow from that that, though you would regard the control of credit policy as being something for the Government, certain things within that field belong naturally to the Bank of England and certain things to the Treasury?——*Sir Roger Makins*: I was thinking, as an illustration, of market management which would be primarily a matter for the Bank.—*Sir Edmund Compton*: I think Sir Oliver Franks was working backwards from the suggestion that, because the compulsory system led to compulsory lending to the Government, there might be a case for giving formal initiative to the Bank as opposed to the Treasury there. What we have said later on in the paper in effect puts you on warning that that is not something which we think would be very likely to commend itself to the Government which has accepted responsibility for control over the money supply. In effect the result of the present system is more lending to the Government than would otherwise

occur, so that the fact that we would continue to expect the Government to have control over the money supply under a compulsory system implies, I think, that whether the system is voluntary or not there is a case for expecting that the overriding authority should rest with the Government and not be formally separated from it. I have made the point in rather a long way, but I do not think that the fact that under the present voluntary system there is, as it were, a by-product of compulsory lending to the Government makes it any less valid to say that the overriding authority should rest with the Government at the present time.

3298. Suppose, for example, that there were a compulsory system of special deposits. Could it be, under your interpretation of the relationship between the Government and the Bank of England, that, even though all that was done by the Government with legislation, the initiative might still come from the Bank of England?——*Sir Roger Makins*: Yes.

3299. Though the overriding responsibility for credit policy still lies with the Government?——*Sir Roger Makins*: Yes.—*Sir Edmund Compton*: In practice, so far as one can look forward to practice under a system that does not exist, one would, I think, expect that initiative to be a Bank initiative under the particular technique which the Bank of England put before this Committee.

3300 *Sir Oliver Franks*: It would be a very natural comment (and this is not intended critically) to say that the net result would be that the responsibility would lie with the Treasury and the power would lie with the Bank.—*Chairman*: I do not see any important power or responsibility in this except that of determining when to act, and on what volume to operate. If that is going to be decided by the Bank I do not see what remains for the Treasury. You seem to say that you could satisfactorily leave details, like "how much" and "when" to the Bank of England, with the Treasury controlling the matter, as it were, in the background. I do not see what there is left to control?——I do not want to seek to discover a situation of cleavage between the Bank and the Treasury in a hypothetical situation; but you might have, for example, such a situation as this: that it was common ground between the Bank and the Treasury, as the facts were known to them, that the banking system was in a state of excess liquidity, but the Bank, shall we say, might consider that that could be dealt with by more orthodox means, or perhaps that the excess liquidity was not such as to justify a dislocation of the system, and on looking at it from the standpoint of the money supply and the inflationary potential the Treasury might take a different view. The question would arise whether that would be a situation in which you might in practice have the Treasury wishing to move the Bank to take the initiative.

3301. *Professor Cairncross*: It seems to me that in paragraph 12 you do prejudge a good deal of what is valuable in the Bank of England proposal. You say:—

"... it is doubtful whether a Government would propose or Parliament would accept any arrangement which restricted the exercise of governmental responsibility in this field."

You go on in paragraph 13 to say:—

"It appears to us, therefore, that any check on Government borrowing under a compulsory system would be likely to lie with Parliament. ..."

Those two sentences taken together imply that the special deposits proposal would restrict the exercise of governmental responsibility in the credit field?——*Sir Roger Makins*: It is not intended to say that. This is directed to any compulsory system, not this special one; all it really says is that, whatever might be the advantages which one might see in giving by legislation a degree of independence in action, position or initiative to the central bank, it seems to us unlikely in the present circumstances that such a solution would find acceptance. That is all that we are trying to indicate here; it is obviously a question of opinion.

3302. As put it implies that any compulsory system, whether the special deposit scheme proposed by the Bank of England, or the institution of compulsory ratios, would restrict the exercise of governmental responsibility, provided the Bank of England were, whether initiating policy or not, at least intermediary in instituting the compulsory ratios or compulsory deposits. That does not appear to me to be inevitable; there does not seem to be any unfavourable restriction of the exercise of governmental responsibility in a system of that kind by comparison with the present system. Must it not depend on the degree of consultation, and on the decision as to where the final powers lie?——This supposes legislation giving defined powers to the central bank.

3303. We had such an Act in 1946. I thought we were putting legal action on one side for this purpose?——This only refers to legal action.

3304. I do not mean that there would be no legal action, but that legal action might not necessarily determine the operation of the system?——That is really what I have been saying.

3305. *Sir John Woods*: In paragraph 13, when you say:—

"There are no doubt a number of ways in which this could be secured, for example, by a requirement of Parliamentary approval for measures of compulsion ..."

do you mean Parliamentary approval each time the measure is to be operated?——Yes.

3306. *Professor Cairncross*: The special deposit system described by the Bank of England is a little akin to the system pursued in Australia. I understand that in that country it was instituted partly because the banks were making large profits during the war. Might not a system of this kind lend itself to control of the banks for purposes that were not originally present in the minds of those framing the legislation?——*Sir Edmund Compton*: That has the implication that the special deposit would be not only compulsory lending but also lending at a nominal rate of interest.—*Professor Cairncross*: It could so be.—*Sir Edmund Compton*: To put it in concrete form, I suppose that would be one way of reducing the profits that a bank made. In so far as one has tried to put this scheme into concrete form, one had envisaged it as one in which a bank was in effect required to convert its liquid assets, that is its Treasury Bills, into this deposit with the Bank, but on terms which involved it, as far as that particular transaction went, in neither profit nor loss; that would imply that the deposit earned a rate of interest in line with the Treasury Bill rate. Whether that should or should not be spelled out in legislation, if it was made the subject of *ad hoc* legislation, would be debatable; I suppose a system of special deposits could be used as you have suggested, if safeguards were not introduced

3307. Does the Treasury know of any other country in which a similar system has been inaugurated?——No. I suppose that it happened here, in the sense that the Treasury Deposit Receipt was at any rate asked for from the banks, and was an investment on which the banks earned an interest at a rate which was related very closely to the Bill rate. But the essential difference between the Treasury Deposit Receipt and the special deposit scheme is that the Treasury Deposit Receipt was part of the normal process of Government borrowing, and the amount was fixed week by week, whereas the special deposit scheme is envisaged as an *ad hoc* measure to deal periodically with a particular situation, analogous in operation, as the Bank say in their paper, to a change in Bank Rate.

3308. *Professor Sayers*: As discussions have tended to crystallise around this proposal, and it is the one most favoured, or least disfavoured, by the Bank of England, and by the Treasury, I think perhaps it would be worth our having before this committee a more detailed scheme. I wonder if the Treasury would be prepared to circulate to the Committee a paper containing an outline plan of this kind, showing what it would involve and how it would work?——*Sir Roger Makins*: May I have notice of that question? I think that we should be able to do that, but I would prefer not to give a definite promise. Probably it would be for the Bank, who have taken the initiative, to do it, but we can consult about it.

Chairman: Thank you very much, Sir Roger and Sir Edmund.

(Adjourned until Thursday, 23rd January, 1958, at 10.30 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

SIXTEENTH DAY

Thursday, 23rd January, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR ANTONY MACNAGHTEN, BART., Chairman, HUGH COLVILLE, ESQ. and A. W. TRINDER, ESQ., representing the London Discount Market Association, called and examined.

3309. *Chairman*: Sir Antony, I understand that you are Chairman of the London Discount Market Association. Will you give us an outline of the constitution of the Association, and its main functions?——*Sir Antony Macnaghten*: The Association consists of twelve discount houses. We do the same as the clearing banks, I think, in that we appoint a Chairman annually, but the custom is that he goes on for two years; at the end of two years, he has to retire, and the Deputy Chairman, who is also appointed annually, and also goes for two years in the ordinary course of events, then succeeds to the Chairmanship. It has been the custom in the past that one of these two officers is drawn from one of the three old public companies. All twelve houses are now public companies, but in the old days the Union Discount Company, the National Discount Company and Alexanders Discount Company were the three public companies, and the others were either private companies or partnerships. The Chairman and the Deputy Chairman of the Association have a weekly meeting with the Governor of the Bank of England on Thursday afternoons, to tell the Governor anything we want to tell him and to hear from the Governor anything he wants to convey to the market. Then, on Fridays, we have our own market meeting, at which the Chairman and the Deputy Chairman report to the others what the Governor has said, and what we have said to the Governor, and we discuss anything that is important to the market. But the principal job and the main purpose of that meeting is to make up our minds at what price we should tender for Treasury Bills. We settle that; the tender has to be at the Bank of England by one o'clock on Friday, and the Treasury, as you know, go up to the Bank of England to open the tenders; and the result is announced very speedily. Then we know what proportion of our tender has been accepted. We have the option, unlike in America, to pay for these Treasury Bills on any weekday in the following week. We can take the whole amount on the Monday, or any other day.

3310. Each member may take his own line in regard to the day when he actually takes up his bills?——Entirely.

3311. *Lord Harcourt*: Are all the houses bound 100 per cent. by the agreed syndicate price, or is there any latitude allowed to them?——There is some latitude. We have a rule of our own which allows us to abstain from tendering at the agreed price for the full amount of our quota, up to a certain percentage, which at the moment is 15 per cent.

3312. That quota is based on the capital and reserves?——That quota is based on the capital and reserves and is weighted by a variable multiplier, which means that the houses with the smaller capital resources can go for a rather bigger percentage of their capital and reserves than the larger people. That was brought about because, at the time when we made this agreement, the smaller houses in practice did a larger Bill business in proportion to their capital.

3313. *Mr. Woodcock*: You change your officers every two years, I gather; is that not a disadvantage in connection with the meetings with the Governor?——I do not think so; I think it is an advantage. The different firms have a chance of being represented. I must say that although I very much enjoy being Chairman of the Association, I should take rather a dim view if I thought I was going to go on being Chairman indefinitely. I believe the clearing banks have the same arrangement; I should have thought it was a very good one. It is not really two years, because one has two years as Deputy and two years as Chairman, so the full cycle is four years.

3314. This is a voluntary association?——It is.

3315. What would happen if one firm did not observe this agreement?——It is a voluntary association, and we have not really got any sanctions. I suppose that in the end, if somebody kept on ignoring our rules, we should say: "We shall expel you from our Association."

3316. What would happen to an expelled member?—*Chairman*: I suppose that he would lose his contact through the Chairman and Deputy Chairman with the Governor of the Bank of England. Would he lose anything else?——*Sir Antony Macnaghten*: We have never done it, so we do not know. It is a question of what attitude (1) the Bank of England and (2) the other banks would take.—*Mr. Colville*: Members of the market are required to be registered as members of an association under the Prevention of Fraud Act. It seems to be uncertain whether, if a member were expelled from the Association, he would get the necessary licence to act as an individual.

3317. *Mr. Woodcock*: According to your paper* twelve major houses form the Discount Market Association; is not the assumption there that there are people who are not in the Association but who are nevertheless carrying on this work?——*Sir Antony Macnaghten*: There are others, yes.

3318. Would an expelled member be in the same position as these others?——In theory he would be in the same position, of not being part of the club; but in practice he might have damaged his position in the City. A man who has been expelled from an association is not in the same position as somebody who has never been in it.

3319. Would that not depend upon the reasons for his expulsion?——He would only be expelled if the reasons were pretty serious.

3320. What is the method by which you secure adherence to this agreement?——It is only a gentleman's agreement.

3321. Is there a method laid down for applying for membership of the Association?——*Sir Antony Macnaghten*: It is all very informal.—*Mr. Trinder*: It would have to be a house of a certain size, and the Bank

* Memoranda of Evidence Part VI No. 6.

of England would have to agree to giving them certain facilities before they would be considered by this Association. It is not laid down clearly because it has never happened, just as we have never expelled anybody. This is a small, haphazard Association; we do not think about the jumps until we get up to them.

3322. Have you a written constitution?——*Sir Antony Macnaghten*: We have a set of rules which we sometimes find difficulty in understanding. I would have said that it was very similar to the Committee of London Clearing Bankers, which is a voluntary association. I do not think they have any sanctions, if a clearing banker breaks the rules.

3323. *Chairman*: When was the last new entrant to the Discount Market?——The Clive Discount Company in 1946.

3324. *Professor Sayers*: What facilities do the members of the Association enjoy at the Bank of England, which are not enjoyed by other firms?——The members of the Association all have accounts with the Discount Office at the Bank of England. That means that, if they have suitable security, approved bills or short-dated bonds, they can go round to the Bank of England and ask for a loan, and the Bank of England is bound to lend them money. At the moment their custom is to lend at Bank rate, which is 7 per cent; but that is a minimum rate, and the Bank of England might say: "We are not going to lend you money at 7 per cent. but at 8 per cent.", or more.

3325. Do I understand they accept no such obligation towards others not members of the Association?——*Sir Antony Macnaghten*: They accept no obligation to anybody who has not an account at the Discount Office.—*Mr. Trinder*: There are two kinds of accounts. A member of the Association can go to the Discount Office. Other discount houses outside the Association can apply to the Chief Cashier of the Bank of England for a loan. One has a recognised right to borrow, and the other is almost applying for overdraft. I think they would all maintain a balance there.

3326. *Mr. Woodcock*: Are they members of your Association because they have this facility, or do they have this facility because they are members of your Association?——They had the facility long before the Association was formed.

3327. *Professor Sayers*: Your Association consists of all the people who have been enjoying that facility?——Yes. The twelve members of this Association are the only people that I know that have the right to go to the Discount Office of the Bank of England and borrow money.

3328. *Professor Cairncross*: Can you tell us what gave rise to this Association?——It is a haphazard thing through the years, but it actually became an association because of the Prevention of Fraud Act in 1945.

3329. It was nothing to do with the underwriting of the tender?——*Mr. Trinder*: No, not the actual formation of this Association.—*Sir Antony Macnaghten*: It has grown up. There has always been some kind of liaison between Bill brokers. In the old days there used to be a sub-committee of the discount market; I do not think the word "Association" came in in those days. They used to meet together, only, I think, at times when the Bank Rate changed, to agree a rate at which they were going to advertise for money at call and short notice. We always used on a change of Bank Rate to put an advertisement in the paper saying that we were prepared to pay such a rate of interest for money at call and such a rate of interest for what in those days used to be money at three days' notice. The sub-committee had not any real powers, but the market more or less agreed to accept its ruling.

3330. *Professor Cairncross*: Does the system of quotas go back before the formation of the Association?——*Mr. Trinder*: About 1938 saw the beginning of some agreement as to the amounts of the tenders.

3331. Then at the same time when you had already an understanding you would cover the tender there were then no quotas?—*Professor Sayers*: Does not the agreement to cover the tender go back only in fact to 1940?——It was about 1940, I should think, that it started; it has rather been adjusted through the years since then. The tender, of course, was £40 or £50 million in those days instead of £250 million.

3332. How does one relate the quota arrangement to that? Did it precede it by informal agreement between yourselves?——Informal to start with. It later became an accepted thing. If we are talking still about 1940 or round about then, we all had a certain basis we tendered on, but it certainly was not as cut and dried as it is now.

3333. *Professor Cairncross*: Would you agree that so long as the understanding to cover the tender continues the quota arrangement is likely to be necessary?——*Sir Antony Macnaghten*: I think so.

3334. Do you retain the right to ask for rather more than your quota at a higher price, or is there no possibility of bidding at two prices?——There is a possibility; as I had started to say, a house can abstain to the extent of 15 per cent., and it can also pay a higher price for 15 per cent. of its quota. At the moment we are allowed to pay 2d. more for our 15 per cent., which means, of course, that, if at the rate we have all agreed on we are allotted a percentage of our tenders, the tenders that we put in at 2d. higher get allotted in full. On that 15 per cent. abstention, we do not now abstain, but we tender at a lower price, which means that the tender is covered; we have made that slight adjustment. These things are changing all the time; for instance, this tendering for 15 per cent. at a lower price has only been brought in in the last couple of months.

3335. *Chairman*: The intention of that is that, although the tender is thus covered, that 15 per cent. should not be an effective tender. What happens to the 15 per cent.?——That falls to the ground. Furthermore, is somebody thinks that Bank Rate is going up, or does not want to take Bills, he can say: "I am not satisfied with the price that the rest of you wanted to tender at, and I am going to abstain to the tune of 5,000,000 Bills, which I will put on the table." Then it is for the rest of the market to make up their minds whether to take those Bills, or to ignore it, or to say "Perhaps you are right about this, and we had better have second thoughts on what price we tender at." That has happened, but it is rare.

3336. *Lord Harcourt*: The 15 per cent. arrangement is merely to allow individual houses to adjust their portfolios?——Yes.

3337. They can either reduce them by putting in a lower bid, and even perhaps getting the Bills at a lower price, or could make sure of getting 15 per cent. by bidding over the syndicate price?——Yes.

3338. *Professor Sayers*: Is it not also a way of giving individual houses a way of dissenting in part from the decision of the Association? Might not a house decide to take advantage of this arrangement if it took a view decidedly different from the majority view of what the rate should be?——Yes, but it does so without disclosing; it does not have to say: "I am going to abstain to the tune of 15 per cent. or I am going to put 2d. on." A house only has to come out into the open if it is going to put Bills on the table.

3339. If you abstain, is it agreed in the Association that somebody else must take up that amount?——No it is not. It would be a matter for the Committee of the Association to make up their minds whether the amount put on the table was sufficiently large that they must be taken up by the rest of us. In point of fact, when it has happened and the abstention has been of any size, there have been other houses who have been ready to take the Bills. I think there have been cases where it was a small amount, and we ignored them.

3340. *Sir John Woods*: In commenting on this procedure you say that "the general outlook and the level of market portfolios leads to agreement on a fair price which can be bid to the Treasury for the entire issue of Bills, though houses which have special commitments may bid a slightly higher price for a percentage of their proportion of the tender." Can you define what you mean by "special commitments"?——Some houses might have special orders. Some large industrial company might say: "I would like you to sell me 5,000,000 Bills on Tuesday"; that would be a special commitment.

3341. By "commitments" do you in general mean orders you have got from customers?——*Mr. Trinder*:

Any individual house might have a lot of maturing Bills in the next week. If they had to replace them they might be more anxious to get Bills than if they had not maturities.

3342. *Sir Oliver Franks*: That is the point Lord Harcourt was making: bidding at a higher price for 15 per cent. as a means of adjusting the portfolio of Bills. The phrase "special commitments" to which Sir John Woods was referring would appear more naturally adapted to special orders you had to meet rather than to this other thing, which would appear to be normal?——"Commitment" is not quite the right word; we may be running into money for orders, bills due, or it may be a question of making up balance sheets.

3343. *Sir John Woods*: It seems to me that you can do this for any reason which happens to suit your circumstances at that moment?——*Sir Antony Macnaghten*: That is so. We have perfect freedom of action.

3344. *Professor Sayers*: Would you like to tell us the way in which you do come to a decision about the factors which influence your price? It appears to the outsider that, given the level of Bank Rate at any time, there is a certain range within which the tender price will move as long as the Bank Rate remains at that level. What makes you hit on the precise price you do hit on, within that range?——We are proposing to lend money to the Government for 91 days, so the most important thing is what we think the price of money is going to be during those 91 days. For instance, when the Bank Rate went up from 5 per cent. to 7 per cent. in September, we had just tendered for Treasury Bills at the price of 4½ per cent. When the Bank Rate went up to 7 per cent., the cost of money went up; we were finding money was costing us nearly 5¾ per cent. So the Bills we bought just before Bank Rate went up were extremely expensive.

3345. This factor which you describe as being the most important is in effect guessing at what the authorities are going to do about the Bank Rate during the next three months?——Yes; and also what price lenders of money are going to succeed in getting.

3346. *Chairman*: But have you not the certainty that the clearing banks will regularly adjust the price of call money to you according to the movement of Bank Rate? Is that not a fixed convention?——*Sir Antony Macnaghten*: It varies. There are two kinds of call money. We have what the clearing banks call their "regular" money, which is by custom fixed in proportion to the Bank Rate. At the present moment the Bank Rate is 7 per cent. The clearing bankers will give no rate of interest at all on current accounts, and 5 per cent. on money left with them at seven days notice. The discount market in their turn will give 5 per cent. on money at call and 5¼ per cent. on money at seven days' notice to anyone who is not a banker; and the clearing bankers lend their "regular" money to the discount market at about 5½ per cent.—*Mr. Trinder*: The clearing banks adjust themselves more or less as the Bank Rate moves. When the Bank Rate goes up, money rates go up too.

3347. *Professor Sayers*: This is one of the reasons for the level of the Bank Rate being such an important consideration in your determination of your price?——*Sir Antony Macnaghten*: Certainly.

3348. When you guess at what the Bank Rate is going to be on each of the 13 Thursdays ahead, how do you go about the guess?——*Mr. Trinder*: We read *The Economist*!—*Sir Antony Macnaghten*: We read a lot of papers. In the old days, when it was a little more automatic, before my time, I imagine one looked at the gold figures.

3349. But you do not have any special indicator now? How do you guess?——We consider the gold and dollar reserves when they are published; we consider the foreign exchange position: the strength or weakness of the pound in terms of other currencies.

3350. *Professor Cairncross*: You try to put yourselves in the position of the Court of Directors and decide whether you would put up the Bank Rate in the next 91 days?——Yes.

3351. *Mr. Woodcock*: Have you a staff of experts who read *The Economist* for you?——*Sir Antony Macnaghten*: No, we do it ourselves.—*Mr. Trinder*: There is often strong disagreement between us; you must not think that we just have a friendly meeting, and all say the same thing. We have bitter arguments about it, and every decision is decided on a majority vote; often it is a very near thing.

3352. Is the majority vote provided for by rule?——Yes.

3353. *Professor Sayers*: Irrespective of the size of house?——*Mr. Trinder*: Yes.—*Sir Antony Macnaghten*: One thing is that we have to arrive at a result by a certain time.

3354. *Professor Cairncross*: You indicated that you have also to take into account the rate of interest at which other lenders are likely to be offering money. When you speak of other lenders, who in particular have you in mind? Is this foreign money, or from some other sources?——*Sir Antony Macnaghten*: By far and away the most important lenders are the clearing banks, but in addition to them there are the other banks, the Scottish banks, the overseas banks, London branches of foreign banks, American banks; and of course, there are other people that lend us money. A certain amount of money comes from big industrial organisations, though not much; they mostly do their business with the clearing banks, but there are occasions when they lend us money. We are always hearing a lot about foreign money in London but my impression is that that is exaggerated.—*Mr. Trinder*: It largely goes into Bills; foreigners obviously do not lend to us at rates for us to make money out of. In London there are about a hundred odd banks, including the Canadian banks and the American banks. Every bank that has an office in London is called on, and they have a certain amount of money; that is true: but when Sir Antony was talking about foreign money, I think he was thinking about money that comes direct from, e.g., Germany.

3355. You are interested surely in your success in obtaining the Bills you want, that is, the proportion of the tender ultimately allocated to you: if other agencies obtain more does that not mean that the discount market may get less than they were hoping for?——Yes, certainly.

3356. So that has an indirect effect on rates?——Yes.

3357. You do not attach much importance to these movements as determining the course of rates?——It is not important enough at the moment. There is not real confidence in sterling and such operations as foreigners do in buying Bills do not amount to very much at all. If we thought there was a very serious demand for Treasury Bills when we talked about it on Friday we would probably see what we could do about that.

3358. *Professor Sayers*: You used the phrase "at the moment" at the beginning of that answer. Have things been materially different in this respect during the last few years at any time?——Not in the last few years, though Canada had a bit of a go at one time. But twenty years ago the foreigner was quite content to buy Bills and have permanent investments in English Bills. That does not happen today. (I am not talking about Governments but the foreign banker.) That is a question of sterling, not a question of bill business.

3359. *Chairman*: I got the impression from your memorandum that about half the money in the discount market came from the clearing banks and half from other sources? ——*Sir Antony Macnaghten*: It varies, but that is about the average.

3360. The clearing banks have their fixed relation with Bank Rate; it is not so certain at what rates you will get your money from the various contributors to the other sources?——No. They get what they can, and during the present time, when the Bank of England are having a tight money policy, of course that favours the lender compared with the borrower. The lender can say: "If you do not take my money, you will have to go round to the Bank of England and pay 7 per cent. for it for a week; therefore you had better pay me 6½ per cent.", or whatever it is. The market has to pay attention to that, but there comes a limit when we say: "We are not going to do it; we prefer to go to the Bank of England."

3361. *Mr. Jones*: Your loans from the clearing banks can be recalled on call by the banks. On what terms do you borrow from the other half of your depositors?

——Practically all the money we borrow is repayable on a day-to-day basis. The convention in the City is that they should let us know by noon.

3362. *Professor Sayers*: When you receive money directly from abroad, as distinct from borrowing from a bank office in London, is that also on a day-to-day basis?——*Sir Antony Macnaghten*: Pretty well always.—*Mr. Trinder*: 99 per cent. of our money is repayable on demand.

3363. *Lord Harcourt*: Except at certain times of the year?——*Sir Antony Macnaghten*: Yes; people will lend money over the turn of the year; and some people lend money for a week or sometimes longer; but it is a very small proportion.

3364. *Sir Oliver Franks*: Do the indications which the Chairman and the Deputy Chairman of the Association may receive on the previous day from the Bank of England at times play an important part in determining what price you tender for Treasury Bills?——*Mr. Trinder*: The tender is entirely our own affair. The Bank of England do not tell us what price to tender at; we do exactly what we like. If sterling has been weak, and we have talks about it at the Bank, that might affect our tender price; when sterling is weak, one begins to think of the possibilities of a rise in the Bank Rate, so we might bid less for the Bills and put the rate up. That is the only way we react to anything the Bank of England would say; and that would be a general reaction to things published and already known anyway.

3365. So that the level at which you tendered for the first six or seven weeks after the change of Bank Rate last September arose out of the cosiderations you have named?——We were trying, actually, to get some money back.

3366. *Chairman*: What is the substance of your interview with the Governor?——*Sir Antony Macnaghten*: I have generally tried to give him a story of the previous week in the money market; to tell him if there have been any new kinds of bills, foreign bills perhaps. I tell him anything there is to tell him about the short dated bond market, the kind of turnover there has been, and whether they have been strong or idle.

3367. To report upon your market is the purpose of your visit?——Yes.

3368. And the other way, as between him and you; what can he contribute to you?——*Sir Antony Macnaghten*: We generally ask him about the foreign exchange position.—*Mr. Trinder*: This weekly visit of the discount market to the Bank of England started in 1921 at the request of Mr. Montagu Norman, but there was not the formal reporting to the market each week as there is now. It is generally speaking just to have a weekly gossip.

3369. *Professor Sayers*: Must not the rate at which the market is going to tender on the next day be present in the minds of both parties at this Thursday afternoon meeting; is anything said about it?——*Sir Antony Macnaghten*: No, not really. I would rather go out of my way not to embarrass the Governor.—*Mr. Trinder*: The tender is our affair. If we are wrong, we are wrong: if we are right, we are right. The Bank of England can, of course, correct us afterwards, if they think we are tendering at too low a rate; they can make money penal. And if we tender at too high a rate they can put it right in next week's tenders, by putting in tenders themselves, and underallotting to the market.

3370. *Mr. Jones*: Six or seven weeks ago you were discounting Bills at about $6\frac{5}{8}$ per cent.; and now it is somewhere in the region of $6\frac{1}{2}$ per cent., although you are probably getting your money at the same rate. Under what circumstances do you feel yourselves entitled to vary the tender by such broad sums?——The Bank Rate went up to 7 per cent., and we had to wait and see the way it looked like working. The gold and dollar figures improved; we brought the rate down slightly. Now, if we are going to have the Bank Rate cut down in the next few months, we bill brokers have to make a living and go with the tide.

3371. To the extent that Treasury Bills cost more the management of the National Debt costs more. I assumed from your replies that under certain circumstances the Bank of England came in competition with you on the tender when your prices were too low. What does that mean to the money market and to the Exchequer in terms of extra money required for the management of the debt?——The bill broker is interested in a margin. We would be quite content to tender for Treasury Bills at $3\frac{1}{2}$ per cent., if we could borrow money at $2\frac{1}{2}$ per cent. We are not here to hold up money rates at all, but to live on a margin. In May or June of this year we thought the Bank Rate might go down, and we put the Bill rate down; and we were wrong. The Bank of England, who sit there and see the figures, might think we were tendering at too low a price for the circumstances of that week. Equally the Bank of England would correct us if they thought we were tendering at too high a price, probably by making money short.

3372. *Professor Sayers*: If the Bank had been apparently keeping you very tight, in the sense that you had had to go to the Bank on four days in one week, when Thursday afternoon came round would your representative consider it part of his duty to ask the Bank why they had been making money so tight during that week?—*Sir Antony MacNaghten*: We might do so. I think what I should say would be: "We see money has been very tight; the discount market have had to borrow £40 millions of money. We shall almost certainly increase the rate and lower the price at which we tender for the Bills tomorrow." I should probably say that to him, but I should not necessarily expect to get any answer.—*Mr. Trinder*: We are only interested in the overall cost of our money. The more we have to borrow from the Bank of England at 7 per cent. the more the cost of our money goes up. We are interested in the margin between the cost of money and the Bill rate. We hope to have a margin; for the four or five weeks from September 19th onwards the Bill rate was $6\frac{5}{8}$ per cent., but for a month before that we were taking Bills at $4\frac{1}{4}$ per cent., which we had to sell at $6\frac{1}{2}$ per cent. So there are two sides to the picture.

3373. *Professor Sayers*: The Treasury Bill business has come to be a very large part of your business. Supposing that as a result of deliberate policy on the Government's part the volume of Treasury Bills available for the market was substantially reduced, by something like a third or a half? What would be the general effect on your business? What sort of effects would you expect to follow on the structure of rates, on your day to day business, and so on?——*Sir Antony Macnaghten*: We should lose the chance of making profits out of that extra quantity of Bills. It would not necessarily mean a reduction in our actual portfolio, because that is governed by the amount of money we are able to borrow, roughly speaking.

3374. You would not borrow it if you could not get the Bills?——*Sir Antony Macnaghten*: The first thing is that you have got to persuade somebody to give you the deposits. Having got the money, you then employ it either in Treasury Bills, commercial bills or short-dated bonds As far as the Treasury Bill is concerned we keep in our portfolios something like 25 per cent. of the total of Bills that we tender for, so that we apply for and sell about 75 per cent.—*Mr. Trinder*: If the hypothesis is that Treasury Bills are reduced by a half, we would first have to ask how the Government was going to reduce them by half.

3375. *Professor Cairncross*: Let us assume some kind of funding operation.—*Professor Sayers*: I was wondering what sort of future you could envisage for yourselves. One answer is that the Government might be keeping up short bonds at such a volume that you would increase that part of your portfolio to compensate. That would make your business rather different in nature?——Yes.

3376. *Professor Cairncross*: Would you increase your short bonds very much in the circumstances? Is there a limit to what you hold?——There must be a sharp limit. You can risk having the discount market short bond business broadly built up in times of cheap money rates, and then you can take a much braver view than you can today. As for the Treasury Bill business, by means of our business we act as a money centre. If we are going to continue to act as a money centre we have to have some security to provide; so I think any serious reduction in Treasury Bills would be detrimental to us.

3377. *Sir Oliver Franks*: It might be argued in a general way that the Government debt was too liquid;

that it would be a good thing if a major reduction in Treasury Bills could take place, and presumably an important reduction in the quantity of short bonds maturing year by year. These are the things which make it difficult for the Bank to control the money supply generally. If it was desirable that both Treasury Bills and short bonds should be considerably diminished in quantity, in those circumstances could the discount market live? Does it depend on too liquid a state of the Government debt as judged by other considerations?——*Sir Antony Macnaghten*: Yes, I think it could live. There was a long period, you will remember, between 1932 and 1951, when we had a Bank Rate of 2 per cent., and no thought of any other rate. It is quite true there were considerable quantities of Treasury Bills, but there was very little profit in them because there was very little risk in them.

3378. *Professor Sayers*: But you had a very good margin in those days on your short bonds. Supposing that the short bond profit went as well as the Treasury Bill profit; what would there be for you to do?——*Sir Antony Macnaghten*: It would be hard for us.—*Mr. Trinder*: It would be a question of commercial business. If there was a funding operation, it would be difficult for us; but then what would the clearing banks do with their call money? How would they lend that, if they wanted to go on with present liquidity rules? The banks have a degree of liquidity which is largely based on the supply of Treasury Bills. It goes rather a long way.

3379. Yes; we were asking about your part in it?——*Sir Antony Macnaughten*: Of course we existed satisfactorily before 1914 (my company started in 1810), and through the last century we made our money first out of what we should now call trade bills; that was before merchant bank acceptances came in.

3380. *Professor Cairncross*: These trade bills have now largely declined. Do you expect to see them increase again?——*Mr. Trinder*: Ours have certainly increased, partly due to the credit squeeze. My own company last year had a record total of commercial bills; by that I mean bank bills and trade bills of various kinds. But those are just the conditions of one year.

3381. *Chairman*: Do you think the experience of your company is typical of others?——*Mr. Trinder*: I think so.—*Sir Antony Macnaghten*: Yes.—*Mr. Colville*: I would agree.

3382. *Professor Sayers*: Have these bills been confined to a few trades or spread over a wide number of commodities?——*Mr. Trinder*: They have been spread over a wide number of commodities: oil, wheat, sugar, timber (timber of course we have always had); practically any trade you can think of.

3383. You mentioned in your memorandum a total of about £800 million of such bills drawn in the course of a year. Could you say offhand whether £500 million or £600 million of those are drawn in three or four or five major trades?——Yes, I would think so; mostly in oil. Oil is one of the predominant things today.

3384. *Lord Harcourt*: Oil bills, presumably, are growing a great deal?——They did grow very fast. For the moment it may be that the rise in rates has stopped that. It is rather expensive borrowing on bills today; an acceptance credit, with a merchant bank giving his promise to pay for a commercial customer, would cost today 7½ or 8 per cent. A lot of these oil people only come here firstly because it suits them to finance in sterling, and secondly, perhaps because it is cheaper.

3385. *Mr. Woodcock*: These are three-month bills?——Yes.

3386. *Professor Sayers*: What else is there besides oil?——Timber, wool, sugar, tobacco, wheat; very little cotton now, I am afraid; that seems to have gone.

3387. *Mr. Jones*: What about minerals: copper and tin, for instance?——Yes, there are credits for that sort of thing.

3388. *Professor Sayers*: Is there anything about these trades that makes it likely that they would want to go on using this kind of credit whilst the majority of other trades in the country hardly use this kind of credit at all?——I am trying to think which important trades do not use them. One I left out (if you can call it a trade) is hire purchase.

3389. *Professor Cairncross*: The list you have given us so far relates almost entirely to imports to this country, presumably; or does it include trade between other countries?——It does include trade between other countries; there are bills drawn against commodities which are moved from one country to another, not coming to this country at all.

3390. Is there anything of any importance on the export side?——*Sir Antony Macnaughten*: Yes.—*Mr. Trinder*: Yesterday there were quite a lot of bills representing oil to Scandinavia; that was financed by a syndicated credit, which is a combination of merchant bankers who give credit.

3391. You were speaking of refined oil, not crude oil? Crude oil is hardly a British product?——It is handled by British companies.

3392. Do any British manufacturers make use of trade bills except to finance their imports?—*Sir Antony Macnaghten*: Certainly they do. We have seen bills drawn against export of cars. You use the expression "trade bill"; I think we can get wrong with that. "Trade" has a special meaning here. We mean commercial bills.

3393. *Sir John Woods*: I am a little confused about the language in paragraph 12; you refer to commercial bills as settling "internal commercial transactions". What do you mean by "internal"? If you are financing the import of, say, tobacco, that transaction may take place internally, but it is a movement internationally. When you say "internal commercial transactions" do you include that, or do you mean genuinely trading movements inside this country?——*Mr. Trinder*: We include both. Tobacco credit is given, and the credit represents the import of tobacco here; we would call that an internal credit, because the credit, as far as we see it, is given to an English company here. So it can be the financing of imports; or it can be the financing of goods internally. We finance purchases of leather by people here to make boots and shoes.

3394. You finance the export of electrical goods, if it comes to that?——Yes.

3395. *Professor Cairncross*: But when you say that there has been an increase of these bills, from what source has the increase come? Is it the turnover of the particular firms you are dealing with, or of materials you are financing, that has increased, or is it a new group of people and trades who have bought bills for financing in the discount market?——The answer to that again, I think, is both. We have more customers, and the amounts vary of course with the price of commodities. A commodity grows up, and a man wants to borrow more money; that leads to an increase perhaps in the amount of the bills. Then before the last year or so hire purchase grew very fast, and would of course grow now if it was allowed to grow.

3396. Would you agree that the long-term trend has been against bills of this kind, and more in favour of straight financing through the clearing banks?——Yes. There is no doubt that some of these bills we see now are the direct result of the credit squeeze.

3397. *Professor Sayers*: If the banks were free from Government restrictions on their lending you would therefore expect the demand for credit through these bills to go down?——Yes, unless we were sufficiently cheap to beat the banks in their overdraft rate.

3398. Is there anything in the nature of your business or in the nature of this credit which would enable you to hope that you could beat the banks in this kind of credit?——*Professor Cairncross*: With bank money?—*Sir Antony Macnaghten*: That is the difficulty; we are in the middle of everything. We must not do anything to upset the banks; we must not do anything to upset the merchant banks; and the merchant banks and the clearing banks are to a certain extent in competition. We have to bear in mind our relationships with these people. And you can always put a curious complexion on any transaction; you may say that we are borrowing money from a clearing bank, and with that money are financing one of his competitors.—*Mr. Trinder*: On the other hand, the two things can be a little different. A bank lends me money and I give them Treasury Bills, but I do not necessarily give them the same bits of paper.

3399. *Professor Sayers*: With your experience of how some items have gone up and some have not, and some trades are almost untouched by this kind of thing, do you think that over the next ten or twenty years this commercial paper is likely to increase or decrease?——*Sir Antony Macnaghten*: I should have said that it is likely to decrease.—*Mr. Trinder*: I should myself have thought it was too difficult to answer.

3400. *Professor Cairncross*: Do you deal in accounts receivable at all?——*Mr. Trinder*: Do you mean book debts?—*Professor Cairncross*: I mean taking over open accounts.—*Mr. Trinder*: No. On the fringe of the money markets there are houses that do this kind of thing, but nothing to do with discount houses.—*Sir Antony Macnaghten*: The discount market have always to consider what sort of security they are going to get, what bit of paper. Unless we can put that bit of paper in to secure the money we have borrowed from the banking system we cannot take that piece of paper; unless we put it into our own portfolio, which is a thing we should look at very carefully.

3401. *Chairman*: So it is the judgment of the clearing banks on the one hand, and the Bank of England on the other, as to the kind of bits of paper you offer, that your business depends on?—*Professor Sayers*: Do you see any possibility of the development of medium-term credit providing bits of paper that would be useful to you?—*Chairman*: Let us look at what you say in your paper:

> "It is difficult to see how the discount houses can assist in providing such forms of credit. It is essential that they invest the money they borrow in negotiable instruments (i.e. freely acceptable by the banks as collateral) and in buying commercial bills a discount house acquires a highly liquid asset which it can use as collateral against borrowed money and such bills are also rediscounted with the banks. However, the discount market would probably provide short or medium term finance for transactions involving exports or agriculture as long as a negotiable instrument was thereby created."

What kind of negotiable instrument have you in mind as being satisfactory?——*Sir Antony Macnaghten*: It has got to be something that we can use readily, and it has got to be a piece of paper that the Bank will take. It would probably have to be a bill drawn at three months, or possibly six months, and renewable.—*Mr. Trinder*: The Export Credits Guarantee Department at the moment give an alongside policy when they insure an export. That is not much use to us. If the Board of Trade, or whoever it was, would put their endorsement on the piece of paper, that would put it in a different class. We might be able to get facilities against it.

3402. It is not so much the length of the credit given that matters to you; as long as there is an endorsement for ultimate payment that is absolutely valid?——*Mr. Trinder*: Yes. Between the wars on some of the exports to Russia payment was guaranteed by the Board of Trade. There were special pieces of paper created for that.—*Mr. Colville*: The U.S.S.R. Trade Delegation issued five-year promissory notes which were unconditionally guaranteed by the Export Credits Guarantee Department, and those were accepted from us as collateral by the banks, though I do not know whether they were ever actually accepted by the Bank of England. If we had a negotiable instrument like that, which the clearing banks and the Bank of England would take as security, we should be able to use it as a short bond.

3403. *Sir John Woods*: Does not the E.C.G.D. have a shipment policy which produces insurance of that kind; a series of promissory notes extending for, say, five years?——*Mr. Trinder*: They do not actually put their name on the bill, as far as I know.

3404. *Lord Harcourt*: I think that is the difficulty. The instrument which arises does not have the export credit guarantee on it. The only way in which that is related to the E.C.G.D. is by a policy which is issued to the company?——Yes.

3405. *Professor Sayers*: These Russian transactions, if I remember rightly, began about 1924 or 1925. There were discussions between the Board of Trade, the Governor of the Bank of England and the Russian trade delegation about it, and ways and means were found for satisfactory bits of paper to be provided; is that right?——*Mr. Colville*: I do not know when it started; I did not come into any actual contact with that until about 1937 or 1938, when these things were being done, and rather freely, as and how goods changed hands. The last, as far as I know, matured in 1945; they were issued between 1937 and 1940.

3406. Could what was done then by way of a special arrangement be done again?——*Mr. Trinder*: It is being discussed, but I do not think at the moment the export credit thing is a suitable way of doing it. I do not think we can really answer that.

3407. What is there now that inhibits these arrangements, that apparently was not present 32 years ago?——The answer we get today (I can only tell you what I am told) is that it is inflationary.

3408. *Chairman*: You mean that as a matter of policy the E.C.G.D., do not want to give credit of this kind?——They do not want to create these instruments.

3409. Did the Russian promissory notes carry current interest?——*Mr. Colville*: The bonds carried interest at 5½ per cent., payable every six months. They were marked by Lloyds Bank here, the bankers to the U.S.S.R., and the dividend was paid by them.

3410. *Sir Oliver Franks*: When the original arrangement was made about 1940, by which the market as a whole covers the whole tender, was the initiative in coming to that arrangement taken from the side of the Bank of England or from the side of the market?——*Mr. Trinder*: I should think we probably moved. In 1940 we were not quite sure what would happen, so we were trying to be a bit careful. It was not quite clear, as you remember; things were a little uncertain.

3411. Given that that was so, and that the year in which this arrangement came into being had certain characteristics, what are the reasons why you wish this arrangement to continue when circumstances are different?——*Sir Antony Macnaghten*: We think that it is our function to do it; we think we are helping in doing it.

3412. *Professor Sayers*: Do you mean helping the Government to finance itself in a very easy way?——Yes. In fact I would have said that there are periods when they could not finance themselves in any other way.

3413. *Professor Cairncross*: Treasury Bills form a very high proportion of the liquid instruments in the country, but from your point of view you would see very great difficulty in the Government raising liquid funds if left to their own devices without your support, unless they went to the Bank of England; is that your understanding?——*Sir Antony Macnaghten*: Yes.—*Mr. Colville*: I think that some of the money that we use to finance these Treasury Bills would be virtually unobtainable except through a mechanism something like ours, because we deal in surpluses of cash among possibly a hundred different banks in London, and it would be very difficult to invest that if it had to be collected by direct methods.

3414. What do you think the banks would do with the surplus cash?——I imagine they would have to hold more cash.

3415. *Chairman*: There would not be such an efficient instrument for collecting it?——My point is that we level it out. A bank dare not run the risk of a deficiency; so if we were not there at the end of the day sixty or seventy of the banks in London might find that because of their prudence in waiting for calls over the counter they were in surplus, and there would be that idle cash in the banking system in London on that night. In present conditions they have got our mechanism; we take that idle cash from them. It is an economy in the use of cash in the banking system by using a small mechanical unit like ours.

3416. *Professor Cairncross*: If the Government wants more money, it is in fact the Government that produces it. You have no means of adding to your resources unless the Bank of England makes cash available to you?——Unless it is coming in from outside.

3417. Do you think that happens often? Are you able to attract money if the Government's short term requirements increase?——*Mr. Colville*: Only from the banking system, in so far as it comes through from the Government to the banks and then comes to us.—*Mr. Trinder*: Canada has recently created a discount market.

One of the reasons it was created was to use up the surplus requirements of the banks. The banks in Canada until fairly recently used to sit and look at their balances at night, but now a discount market has been created there, and that is more efficient.

3418. Is this not a very different function from the discount market's original function? Originally you had no Government paper to speak of; now I take it that the original function has largely ceased, and you rely on Government paper?——Yes. That is the same throughout the whole of the banking system; as the Government debt has grown it has had to be financed.

3419. Do all the discount houses still make really extensive use of their knowledge of the market in commercial paper? Do they know the credit standing of their customers as they always did?——*Sir Antony Macnaghten*: I think so.

3420. You stand ready, if there is an expansion in the demand for commercial bills, to meet it?——Yes.

3421. *Chairman*: We should like to know, as you have alluded to your function of being a clearing office for bank cash, what kind of organisation and staff is involved in maintaining the houses in the discount market?——*Sir Antony Macnaghten*: The staff is very small because, although, as you have seen from our paper, our turnover is enormous, it is just as easy to write down £1,000,000 in a book as it is to write £1, or practically so. In my business we have a staff of 20, and our turnover in Treasury Bills is in the order of £2,000 million; that is a good many millions of pounds per head.—*Mr. Trinder*: I should think the total number of staff in the discount market would probably be about 400 in the twelve houses. We have about 60 in my business.—*Mr. Colville*: We have about 24; I agree the total would not be more than 400.

3422. *Chairman*: We have had a good general discussion; we will now come to particular points by running through your memorandum.—*Professor Cairncross*: May I ask you on paragraph 3 if all of the twelve major houses are now public companies?——*Sir Antony Macnaghten*: There is one which is a company but has not a quotation for its shares on the Stock Exchange. You can buy shares if you want to in any of the eleven companies.

3423. The figure of £30 million given here refers to the eleven major houses, rather than the twelve?——*Mr. Colville*: We have included all twelve.

3424. On paragraph 4, where you talk about short-dated stocks: is five years the limit of maturity in which you are prepared to deal, either in Government paper or any other paper?——*Sir Antony Macnaghten*: Yes, broadly speaking.—*Mr. Trinder*: It is largely governed by the Bank of England requirements, the rules they make.

3425. *Lord Harcourt*: On paragraph 3 again, is the capital of the discount market very widely spread?——*Sir Antony Macnaghten*: Not very widely spread. There are the old families who owned the old businesses. In my case the Alexander family owned the whole capital at one time, but with death duties and so on their holding has been reduced very much over the years. And we have institutional investors: insurance companies and investment trusts have blocks of shares in discount houses. I think the total number of shareholders of my company is about 2,000.—*Mr. Trinder*: The Union has between 6,000 and 7,000 shareholders.

3426. *Professor Sayers*: The Union would be the largest?——Yes; because we have never been a family business.

3427. *Professor Cairncross*: Is there any tie-up between particular discount houses and the commercial banks? Is the capital of any discount house owned in large measure by a commercial bank?——*Sir Antony Macnaghten*: I should have said not.

3428. There has been no effort on the part of the commercial banks to buy their way into the discount business?——*Mr. Trinder*: No, it is not a good enough business.

3429. *Chairman*: You have answered some questions already [Q. 3354 *et seqq*.] about the part that foreign money plays in contributing to the resources of the market, but I wanted to see if we could draw anything more from you. You say in paragraph 6:—

> "Variations in interest rates between London and other centres should, according to orthodox prewar doctrine, affect the volume of specifically foreign money in the market. In present times this is regrettably no longer so. Recent years have demonstrated that high rates in London will no longer attract funds—except on a very temporary basis—unless there is confidence in the stability of sterling."

Are we to understand from that that in fact the funds are not found to be attracted, or that they are attracted in some volume but on a very temporary basis?——I should have thought not on any great basis at all at the moment, because there is always a limit to the amount you can do in spot and forward in foreign exchange; that would limit the amount.

3430. *Professor Sayers*: It is the limitation of the size of the forward market that limits it, is it?——Yes. Of course every bank in the world has tended to be short of money. American banks have not really got surplus money for this kind of thing at the moment.

3431. *Chairman*: What kind of period is covered by "recent years"; since the end of the war, or since 1951?——*Sir Antony Macnaghten*: I should have said before that.

3432. *Professor Cairncross*: Could you give us any idea of the amount of foreign money deposited in the discount market from banks abroad or branches in London?——Branches in London would be fairly considerable, because there are American banks who have at times quite a bit of money in London. For banks who have no office in London the figure would be exceedingly small, of the order of a million or two.

3433. Figures were given to the Macmillan Committee for banks abroad. Is there any reason why you could not provide us with some figures indicating the position today?——*Mr. Trinder*: We could easily give that figure.* We do not happen to have it with us, but it is supplied somewhere.—*Mr. Colville*: It is in a return which we make to the Bank of England.

3434. *Mr. Jones*: But there would be no spot and forward buying in that department of your borrowing?——*Mr. Trinder*: No. Why an American bank has sterling I cannot tell you. It may be a spot and forward. He may be holding it for somebody's account.

3435. *Chairman*: To what extent do the resources of these banks that have offices elsewhere rise and fall with the differential in the interest rate in London as against other centres?——*Sir Antony Macnaghten*: At the moment there is a considerable difference in money rates between London and New York. The U.S. Treasury Bill rate in New York is 2¼ per cent. and our Treasury Bill rate is 6⅛ per cent.; but we do not see that it has much effect.

3436. *Professor Cairncross*: Do you think this is due to lack of confidence in the stability of sterling, or do you think it would remain true even if there were confidence?——I find it very difficult to answer that question. As Mr. Trinder said, it may be that they have not got the money.

3437. *Professor Sayers*: One sometimes hears it said that overseas banks in London have their ordinary working balances here, but that, when there is a bout of particular distrust of sterling they run down those working balances. If that is at all a sizeable movement, one would expect it to be felt by the discount houses, in that those overseas banks in London would be calling money from the discount market at these periods of increasing distrust?——*Mr. Trinder*: Yes. What happens is that the American bank sells sterling and perhaps goes back into dollars, and the Bank of England presumably would buy the sterling; and then we are short of money.

3438. If you go back over the last five years there have been variations in the distrust; sometimes it has been very acute, sometimes less acute. On what sort of scale, taking the market as a whole, are these variations in the working balances held by overseas banks in London?——*Mr. Trinder*: We know of foreign banks that have had £30 million or £40 million lent to the discount market, who possibly have nothing at all at the moment. I am speaking of an exceptional case when I say that; but I

* See Appendix to Minutes of Evidence.

suppose it could amount over the market as a whole and over a period, including the run down of £30 million or £40 million, to something up to £100 million. I am not saying it would happen in one day or one week.—*Sir Antony Macnaghten*: There was a period when the Commonwealth Bank had enormous deposits in the discount market, when the price of wool was right up in the sky. They were larger lenders of the money than the clearing banks.

3439. But that was not a matter of trust or distrust in sterling; it was the automatic result of the behaviour of the wool market, given Australia's banking arrangements?——Yes.

3440. *Lord Harcourt*: It cannot be easy for the market to identify foreign money, unless it happens to be deposited direct, because all foreign banks, and particularly the American banks, do a considerable sterling domestic business; a proportion of the money which they have on the market will represent balances which are employed in this market and likely to stay here, because they do do a British banking business?——Yes.

3441. And if the banks call on you, you have no means of identifying that money; it may be a run down in foreign balances, or it may be for entirely different reasons?——No, we cannot do it at all.

3442. *Chairman*: Given the fact that a lack of confidence in sterling will tend to drain the market of a large part of its resources from overseas, you do not think that that is corrected by any favourable differential in the interest rate which London may be showing?——*Sir Antony Macnaghten*: I should have thought not.—*Mr. Trinder*: Not unless there is confidence in sterling.—*Mr. Colville*: It is very rarely that one is told that money is moved on foreign account; occasionally, in conversation, but no more.

3443. *Professor Sayers*: You say in paragraph 7 that there is a practical upper limit to discount houses' bond portfolios, and you mention how in recent years the slumps in the gilt-edged market have emphasised the difficulties on short bonds. I take it that the amount of short bonds that a discount house will hold will be a matter for discussion between that house and the Bank of England?——*Mr. Trinder*: Not necessarily. We all make returns to the Bank of England of our holdings, and the Bank of England could, if they thought we were being unduly reckless, speak to us about it.

3444. Have you any convention among yourselves as to what should be the upper limit?——No. It is difficult to give a proper answer to that, because you could hold £100 million bonds with one year to run, and it would be much safer than holding £50 million bonds with five years to run.

3445. Does the proportion of short bonds to your total portfolio vary greatly?——*Sir Antony Macnaghten*: Yes, I think it does.

3446. What are the circumstances that lead to variations in this proportion?——Just as, when we make up our minds to tender for Treasury Bills, we have to consider the cost of money during the next 91 days, so, when we make up our minds whether to buy three, four or five-year bonds, we have to take a view about the cost of money for 3, 4 or 5 years. If the market thought that there was a risk of a sustained rise in money rates over the next period, they would try and have their bond book as short as possible.

3447. Because of the changed relationship between the price at which you are borrowing and the yield on the bonds?——Yes.

3448. So that your portfolio of short bonds is influenced in size primarily by the view you take of the market?——Yes.

3449. You say in this memorandum that you operate as jobbers in short bonds. That appears on the face of it to be inconsistent with your saying that the size of portfolios is governed by the view you take of the market?——I do not think so.

3450. Has not a jobber to buy or sell whatever he is called upon to do at any time? Supposing that the market is suddenly very bearish, one would expect the portfolio for a discount house operating as a jobber to increase, although one would also expect the prices to run down?——*Sir Antony Macnaghten*: I think you can do both functions.—*Mr. Trinder*: We do it partly for profit, but we do have some sort of service in our operation; we try and make a market in short bonds. I do not think there has ever been a time when anybody could say that they could not sell short bonds, at a price; it might not be a very good price. But it may be impossible to get a market in longer stocks; a jobber on the stock exchange has to make prices, but he can make very wide prices and in very limited amounts.

3451. So that you would say that you perform the service of a jobber, but in such a way that the price reflects pretty quickly and pretty fully the feeling of the market as a whole?——*Sir Antony Macnaghten*: Yes. I would say that in normal times the market in the securities that are dealt in by the discount market (securities with less than five years to run, and maybe less than two years under certain circumstances) is infinitely superior to the market in any other Government securities. The volume that you can deal in without really moving the price by more than a very small fraction is remarkably great; I should say £20 million or more.—*Mr. Trinder*: Exceptionally, yes.

3452. Is that because of the operations of the discount houses, or are there other factors?——There is always the Government itself; the departments hold British Government securities, some of them short-dated, and they may operate. Then there may be oil companies using short funds in short bonds. But broadly speaking at any one moment it is the discount market that makes the prices of short bonds.

3453. This supports the view that the discount market operates efficiently as a jobber but does not substantially steady the price?——No. It depends on the volume. If someone was to sell £30 million or £40 million it would be difficult to keep any market up.

3454. You said just now that discount houses substantially make the short bond market. What is the position of the Government broker? Does he not very much make the price?——The classical operation of Government brokers is always to collect if they can the next maturing bond, and to sell something else against it. At the moment the shortest bond yields higher than anything else. The bond due in June pays something over 6 per cent., and the bond due in eighteen months' time yields 5½ per cent.

3455. Which is another way of saying that people expect rates to go down on the whole?——That is right.

3456. When the Government broker is operating in this way be is on the whole buying bonds in the nearer part and selling bonds in the later part of the five years?——*Sir Antony Macnaghten*: If he can, yes.

3457. In selling those later bonds surely he is the dominant influence in the market, in that he is the main source for such bonds, and the price at which he elects to deal will be the main influence in making the market price?——*Mr. Trinder*: Yes, but he might not have certain of these short bonds; the departments do not have every bond.

3458. Is he operating a great deal, to your knowledge, in the market in these short bonds?——At the moment I imagine that you could, if you wanted to, sell the shortest bond due in June, and buy the new 5½ per cent. Exchequer Stock 1966; that would be a bit long for us.

3459. Would the two be tied together?——Not necessarily. It might be so because the Bank of England might want to control the money supply; but they might not want people to go and buy the 1966 Stock.

3460. When the Government broker is selling these bonds, does be in effect say what the price should be, or does he just get whatever price people offer for these bonds?——There is a market price, and be would deal in accordance with the market. He would sell so much at that price, and then probably sell some more a bit higher up; he does the best be can.

3461. Do you know what people mean when they say that the Government broker has been edging the price up?——No, I do not think I do. You can always sell better on a rising market than you can on a falling market; that is correct. It sounds odd, but it is so. When he edges the price up he sells so many at one

price and then another so many millions at a bigger price, or something like that. In this sort of market, as it has been the last month or so, he gets his own way.

3462. You would say then that there are some times when the Government broker, operating in his normal way of edging the price up if he can, is able to put the market in short bonds up?——Yes.

3463. Do you know whether he was doing that in the first fortnight of September of last year?——Not in short bonds. This was discussed elsewhere recently, and the accusation was that prices had been edged up in medium dated securities, but not in shorts.

3464. *Chairman*: When you act as jobbers in short term bonds, do you operate through the Stock Exchange?——*Sir Antony Macnaghten*: Yes. There are a number of stockbroking firms who specialise in the gilt-edged market and in particular in the short-dated bonds. They are going round the discount market all the time; they go into the Stock Exchange, where they deal with the jobbers; and they go to the banks. Our dealings are done almost entirely through a stockbroker. There are occasions (they may be more frequent with Mr. Trinder than with me) when we do a direct business with a bank, as they do in America, but they are very seldom.—*Mr. Trinder*: Yes; the broad basis is that we deal with brokers, and transactions go through a jobber in the Stock Exchange. I cannot deal direct.

3465. *Professor Cairncross*: What would happen if the banks felt they were getting near their 30 per cent. ratio and wanted to realise some short bonds? Would you be willing buyers of short bonds from the banks in the circumstances?——Yes. The banks did do that; and I would say they would continue to do it as their liquidity ratio shortened. It may be that the discount market may buy; it may be the Government broker; it may be an oil company; I do not know. I rather stress oil companies because they have a lot of funds.

3466. There would be some limit, presumably, to the extent you wanted to take over short bonds even if you had additional money?——Yes; and these very large transactions which I spoke about, which used to go on to a large extent under more normal conditions, are very often not outright purchases or sales of securities, but exchanges. We look at the yields on these different bonds all the time; and if they get out of line I might say: "I will have the 2 per cent. 1960s rather than the 2 per cent. 1959s."

3467. *Professor Sayers*: Has the falling market of the last few years led to any general drawing in of horns by the discount houses in this field?——*Sir Antony Macnaghten*: I should have said there was a considerable tendency for the turnover to decline.—*Mr. Trinder*: And the books.—*Sir Antony Macnaghten*: When we have these tremendous falls it does rather freeze up the situation, because people do not want to sell, and take a realised loss. So you might get a state of affairs where in normal times it would obviously be right to switch out of this bond to that bond, but you did not want to take the loss of the bond you held.

3468. So, if the authorities go in for a policy of varying rates of interest that would tend to reduce the scope for the discount market in this business?——It would tend to make them go shorter. They might hold the same amount, but it would be more likely to be in bonds of one or two years than in bonds of four or five years.

3469. During the two months mid-December to mid-February, 1957, the portfolio of short bonds held by the discount market increased by something like £200 million, I think; what were the reasons behind that big increase?——Largely that there was available an attractive short-dated bond. It was the one falling due in November, 1957, so it had under a year to go; and it gave a high yield compared with the Treasury Bill. So that was bought in large amounts. And even, I think, the 4 per cent. 1958s were bought up. I know it has been suggested that the market bought these bonds because they could not get enough Bills, but I do not agree with that. I think they bought the bonds because they thought they looked attractive, and there was this talk of a reduction in money rates, which in point of fact took place. Would you agree with that Mr. Trinder?——*Mr. Trinder*: Yes. Of course, you have to see the whole picture at once; what was happening to the Bill rate, what was the comparison in yields between one and the other. At the moment the discount market is concentrating more on Bills than on bonds, because Bills yield something over six per cent. and bonds yield something under six per cent.

3470. *Mr. Woodcock*: You are by far the biggest buyers of Treasury Bills?——*Sir Antony Macnaghten*: Yes.

3471. Does that mean you can fix the price?——We fix our price.

3472. Yes, but do you get it at the price you fix?——We get a percentage, which varies with the demand from other people; it may vary very considerably.

3473. *Lord Harcourt*: Do you find that the higher the discount rate the greater the competition from outside sources?——I think so.

3474. In fairly direct proportion?——Yes.

3475. *Mr. Woodcock*: Suppose that you tender this Friday and make a mistake: you find you cannot get the money in the subsequent week at the price you thought you could. Can you re-adjust the position in subsequent weeks? Are you in a position in the market to do that?——That is what happened in September. We had taken a lot of Bills at 4½ per cent., and Bank Rate went up to 7 per cent.; that meant a thumping great loss on our portfolio. In subsequent weeks we tendered at 6¾ per cent., on which of course we made a profit.

3476. And you are so tied together that, when you decide to tender, you know you are in such a position in the market that you will get a sufficient proportion of the bills to recover your losses?——We do not know what proportion we are going to get. There may be other people who tender.

3477. In any one week?——Every week there are other people.

3478. *Mr. Jones*: Is the allocation on the basis of the competition in the tender?——Yes.

3479. *Chairman*: What is the lowest percentage you can recall the market having got?——It went down to about 10 per cent. about this time last year; but I believe it has been lower than that.

3480. *Mr. Woodcock*: That was at a time of year when the Treasury Bill offer is always less?——Yes; at this time of the year the revenue is going in, so that the Government is reducing its borrowing.

3481. You would not expect in any year as a whole to get as little as 10 per cent.?——No, we should not.

3482. You could guarantee to get more than that because of your position?——*Mr. Trinder*: Not because of our position, but, let us say, because of the lack of other tenderers. The discount market tenders, central banks tender, and there is a large volume of outside tenderers: colonial banks, clearing banks for their customers, and so on.

3483. But over the year you are by far the greatest tenderers?——Yes.

3484. *Lord Harcourt*: What is the average allocation: about 40 per cent.?——I should think a bit more.

3485. *Sir John Woods*: In paragraph 26, you talk about the "basic" or "good" money (which I think is the same as what you called "regular" money before) and the other money lent on a day-to-day basis. Is the basis of good money that which you have always with you?——Yes.

3486. And that also is on a day-to-day basis?——Yes.

3487. So that when you say: "In addition, the above banks lend a considerable amount on a day-to-day basis", that is not making a distinction as to term? It is all on a day-to-day basis?——It is.

3488. What sort of proportions are there between the "regular" money and the additional amount on which you pay a higher rate?——*Mr. Trinder*: In our case we have about four times as much "regular" money as overnight money; in other words a clearing bank which has £10 million "regular" money would have perhaps £2 to £2½ million overnight money.

3489. I am still not clear on the distinction between "regular" money and overnight money, and why you pay more for one than for the other. It is all at call; why is there a distinction?——*Sir Antony Macnaghten*: Because that is the way the market has always been, going

back a long way. We have got money on our books which we may have borrowed for over a hundred years. Suppose that system were changed; suppose the banks said: "We do not see why we should go on lending you this money at 5½ per cent. when every day in the paper we see these other people getting 6 per cent." If they did that, under present conditions the market would not work because if the Bank of England has got us on a tight string all the time, the boot is on the lender's foot and not on the borrower's; the banks could screw up the rate and our only protection would be to raise the Treasury Bill rate, which would then approach the Bank Rate. Supposing it gets to Bank Rate or slightly over; what happens then? It pays the market to tender for Treasury Bills and finance itself with money out of the central bank. The next thing would be that Bank Rate would have to go up. I do not know where the limit would be.—*Mr. Trinder*: This was written in the time of the credit squeeze. That 5½-6 per cent. for overnight money might be 5½ in a time of easy money policy, whereas the "regular" money might still continue at 5½ per cent.—*Mr. Colville*: And it is quite possible that the money could not be lent; whereas the banker knows that on that proportion of call money he keeps with us he gets the "regular" rate. The overnight, for which we may be charged a half per cent. higher, comes back next morning; he does not know that any of the market will want that back later in the day. He takes rather less for his money in order to ensure that he has it out on call at a reasonable rate all the time.

3490. *Lord Harcourt*: What it really boils down to is that, as far as the clearing banks are concerned, for 80 per cent. of the market's requirement there is steady money, and for the remaining 20 per cent. you bid if you want money. You bid up if you are very short of money; on the other hand you refuse to take it if you do not want it and therefore it is unworkable or workable only at a better rate. It is the marginal money which is open to bids from hour to hour?——Yes.

3491. *Mr. Woodcock*: How is the price for good money fixed?——*Sir Anthony Macnaghten*: By reference to the Bank Rate. When the Bank Rate changes the clearing banks have a meeting and agree the rate which they are going to give for their deposit money, and the rate at which they are going to lend "regular" money to the discount market.

3492. Does that always satisfy you?—*Professor Sayers*: Is there a process of bargaining about it? Do you make representations to the clearing banks?——It could be. There have been cases where we have asked them to make some slight adjustment, and I think they have done so; but in the first instance it is the decision of the clearing banks.

3493. *Mr. Jones*: But spot lending, even by the banks, is at a premium?——The overnight money, at the moment, with tight money, is generally at a higher rate than the "regular" money, which is fixed by the Bank Rate.

3494. But that money too is raised from the clearing banks. Is there competition in rates there, or is there a uniform method of charging for this spot money?——No, the rate is the market rate.

3495. It is a question of a bid?——Yes.

3496. You have no idle money, or very little? You do not allow your money to rest at all. To the extent that you want money you ask the Bank to supply it, to the extent you do not need money you carry on with your own resources?——*Mr. Trinder*: We expect to balance our books every day to a penny.—*Sir Antony Macnaghten*: We are overdrawn through the day with our clearing bankers, because we have had to pay out money and buy bills. So we are "in the red" all through the day, and it is our business to square it up by three o'clock.

3497. You are taking such liquidity as there may be in the banking system, keeping money at work. Is not that what you have been saying, in effect?——*Mr. Trinder*: That is right.

3498. *Professor Cairncross*: The rates quoted in this paragraph are, I take it, on the 7 per cent. basis?——Yes; they would vary with Bank Rate. If the Bank Rate went down by 2 per cent., they would be 2 per cent. less.

3499. *Mr. Jones*: Do you in any sense overwork money? You are keeping in circulation the amount of money available in consequence of the way you work; it is always working to the limit. Is that a good thing for the economy, for the present situation we are facing of inflation?—*Sir Antony Macnaghten*: I think so.—*Mr. Trinder*: We do not create money.

3500. No, but you make it work a lot faster. Is not that what you are trying to do?——I would not have thought that. A banker has a balance and he lends it to me, and I give a Treasury Bill for security. Whether that is making money work faster I do not know.

3501. *Professor Sayers*: It still appears that money is abnormally tight around the half-year and turn of the year. Do you know why that occurs?——*Sir Antony Macnaghten*: I suppose it is because people want to put money in their balance sheets.

3502. Which people?——Anybody bringing out a balance sheet may want to show a larger amount of cash on that particular day than on other days.

3503. Is there anything about the business in call money on those days that gives you a clue as to which people do this predominantly?——I should have said not. It is very difficult. It may come through a bank; a bank may call money, and we do not know what the reason is.

3504. It is not a group of overseas banks, or anything like that which you could notice?——No. I should have said nowadays it is on a very small scale.

3505. *Chairman*: Why in paragraph 28 do you refer to bankers' deposit rate as the "keystone of money rates generally"?——That is the most important factor in what we have to pay out. I suppose the keystone of money rates is really the Bank Rate, and the clearing banks' deposit rate and their lending rate to us are governed generally, although not always, by the Bank Rate. There may be a bigger or a smaller differential between the Bank Rate and the deposit rate, but broadly speaking the pattern keeps much the same all the time.

3506. *Sir Oliver Franks*: Is there some clue in the order of fixing them? The Bank Rate is taken first; then, in my recollection the Chairmen of the clearing banks determine their deposit rate, and the other rates are determined by chief executive officers of the bank, but in the light of the deposit rate so determined. In that sense it is a governing rate?——Yes.

3507. *Chairman*: But it all begins with the Bank Rate. I was wondering why you had chosen bankers' deposit rate as a keystone?——That is probably slightly misleading. It all begins with the Bank Rate.

3508. *Professor Sayers*: But you have to try to begin 13 weeks ahead of the Bank Rate?——That is right.

3509. *Sir John Woods*: You say, in paragraph 32: "In Canada a market already exists, and even now Australia and South Africa are seeking to establish similar markets." Is the Canadian market very like the London discount market, or is there a very marked difference?——*Mr. Trinder*: It probably has in some ways more relationship to America than here; but it is not very different, except that in Canada banks have discount facilities with the central institution which English banks do not have.

3510. Does it consist as here of separate institutions like the discount houses, or is it a market which is run and created by the banks themselves?——There are separate institutions as there are here. The discount market is an elongation of certain existing stockbroking houses and bond houses, as it is mostly in America, and as it will probably be in Australia. This is the only country I know that has houses just doing the two particular things, short-dated bonds and bills.

3511. *Professor Cairncross*: There are some issues upon the figures which you have given us which I should like to put to you. From what you told us earlier, you supply a return to the Bank of England giving information about your assets. This information is not made public to any extent, and presumably is provided confidentially. Do you see any reason why the main items in the returns you furnish should not be published as aggregates of figures for particular houses? I have in mind particularly figures of your holdings in Treasury Bills and short bonds?——*Sir Antony Macnaghten*: We all give our figures of holdings of Treasury Bills and short bonds when we publish our balance sheets.

3512. Balance sheets appear on different days, in fact in different months, during the year, and they are not always easy to aggregate; indeed there is one house that does not publish one at all. Could not the figures you already provide to the Bank of England be published in respect not of individual houses but in the aggregate at, say, quarterly intervals?——*Mr. Trinder*: I do not think the market would have any objection to publishing their holdings in Treasury Bills and short-dated bonds.—*Sir Antony Macnaghten*: I cannot answer for them all, but I do not think you would find anybody objecting to that.

3513. *Chairman*: Can you think of any solid reason why it should not be done?——*Mr. Trinder*: The only reason I can think of is I do not see what good they would be to the British public. I think we would on the 31st December or some given date all add our figures up and publish them, for Treasury Bills and bonds. That would be a real figure because it would be all our combined totals on one given date.

3514. *Professor Cairncross*: This applies equally to something you do not give us here although it has been referred to this morning: the sources of funds for the discount market; for instance, the extent to which you get money from the clearing banks and other sources. You may be a little reluctant to see that published, but again I wonder if there are any reasons why they should not be made available in aggregates, not for individual houses?——*Sir Antony Macnaghten*: I see no objection to it.*

3515. *Chairman*: I think we want to distinguish between information which we are asking for for purposes of our own inquiry and questions as to whether you would see any objections as a matter of principle, supposing it was thought to be valuable to inform members of the public. I think Professor Cairncross was directing himself to both?—*Professor Cairncross*: To both, Sir. —*Mr. Trinder*: I do not know how we would publish them. Just a bald statement in the Press?—*Professor Cairncross*: They might appear in the Government's Monthly Digest of Statistics, or, if the Bank of England resumed something like its old Statistical Summary, that would seem to be an appropriate channel for the information. You would then leave it to the Bank of England; you would make your normal return, and they would presumably publish it somehow.

3516. *Mr. Woodcock*: What is covered by "contingent liability on endorsement" in your first table?——*Mr. Trinder*: That is the amount of commercial bills which we sell of which we guarantee the payment.—*Sir Anthony Macnaghten*: Every bill we sell we back ourselves.

3517. *Professor Cairncross*: There are two minor matters on the first table. There is a column headed "Capital Employed"; I take it this relates to the twelve members of the Association but not to the whole of the market?——Yes.

3518. And are bonds shown at their nominal value, their market value, or betwixt and between?——*Mr. Trinder*: I think it is the market value.*—*Sir Antony Macnaghten*: Most years we hope they coincide.

3519. May we ask if it would be possible for you to furnish us with comparable figures to these, if it is still possible, for some pre-war year; 1938 or 1939?——If we can dig it out, certainly.*

3520. *Chairman*: On a general point, I have the impression of your position, from the answers you have given, that your fortunes really lie in the hands of the Bank of England and its actions: what it does in lowering or raising Bank Rate, or keeping it fixed, and what action it then takes to bring you or not to bring you into the Bank for seven days?——Yes. We depend on the Bank of England, and, of course, on the clearing banks.

3521. For your resources; but it seems from what you said as if it is the action taken with regard to Bank Rate that sets your forces in motion; it even affects the rates at which you get money from the commercial banks and, I dare say, from other sources too?——Yes.

3522. *Professor Cairncross*: You are also a little dependent on the Treasury, in the sense that unless there is a plentiful supply of Treasury Bills you may have fewer liquid assets than you would like?——We are dependent on them, and we think they are dependent on us.

Chairman: We are very much obliged to you both for the memorandum you have put in and for the answers you have given us today.

(*The witnesses withdrew.*)

(*Adjourned until* 3 *p.m.*)

D. J. ROBARTS, ESQ., Chairman, A. W. TUKE, ESQ. and A. D. CHESTERFIELD, ESQ., representing the Committee of London Clearing Bankers, called and examined.

3523. *Chairman*: Good afternoon, gentlemen. As regards the giving of your evidence, I know that in some cases you will find that you are speaking from different experiences, while in other cases you will be speaking from more general experience which is shared between yourselves. We shall leave it to you how you divide it between you. It would help us if we directed ourselves first to one or two of the more general questions that arise out of the paper† you have given us, for which we are most grateful. Then perhaps we can get on to detail about banking techniques tomorrow, when we see you again. Could we first take up the answer to question 4 (c)? We should like to follow up with you what your views are about the effects in the past of the Government's requests to bankers as to the limitation of advances, and your view as to what the place of that instrument (if that is the right word for it) should be in the future. Here you are drawing attention to the fact that one effect of the Government's request was that it necessarily led to agreement between the banks, and in some aspects no competition. That, you say, left other forms of competition between the banks still open. What would be the fields in which competition was left open and is still active today?——*Mr. Robarts*: The competition between banks which is left open is, by and large, service to the customer. The only form of competition which has been modified is the competition in lending. In all other fields, as I think we have said, competition remains keen. The local bank manager, who really conducts all this personally, is still competing and, I would say, competing more actively than he did before, in the service that he will give his customers: in the handling of their orders and in the minute attentions which go to make up a good business. The fact that they cannot compete in their judgment on lending risks so freely as they used to has probably directed their attention more acutely to getting to know their customers better and serving them with the utmost diligence.—*Mr. Tuke*: I agree with Mr. Robarts. There is competition even in the field of lending. There is an understanding between us only in respect of occasions when one bank is trying to get an account down, or, more probably, refusing to make a new advance, because of the credit squeeze; but there are other occasions when one bank may take a different view from another bank on a proposition which has no relation to these requests, or would not be affected by them to any great extent.

3524. Could the borrower go across the street and try his luck with the other bank?——*Mr. Chesterfield*: Yes; he not only can, but does.

3525. *Professor Cairncross*: Would you say this is common?——Yes.

3526. *Chairman*: How is it sorted out? Suppose that a man has a regular arrangement with a particular branch of a particular bank, and he finds that he cannot increase it but that rather he may be called upon under the general squeeze to reduce it; is it communicated to the other banks that that decision has been taken, so that they do not accommodate him? Or does nobody give a new accommodation to someone without ringing up the other banks and asking them whether they have been dealing with this customer?——In practice, if a manager had a request for accommodation which looked as though it might conflict with the Chancellor's directive, he would ring up the existing banker and say: "Have you declined

* See Appendix to Minutes of Evidence.
† Memoranda of Evidence Part VI No. 13.

* See Appendix to Minutes of Evidence.

this on 'Chancellor' grounds?"; if that were so, he would say to the customer that he was sorry but it was a proposition that he would not be able to entertain. But if the case had been declined on banking grounds, and was one which he was himself inclined to do as a normal banking operation, he would do it on those grounds under the existing arrangement. You may be interested to know how keen competition still is. One of the banks in the course of three years had well over 20,000 current accounts transferred from other banks. That is better than would appear at first sight, because it happens to be a bank with only a relatively small number of branches compared with the larger banks; so it is not for geographical reasons. The reasons for the change are known in the main to be the result of the extremely keen competition to provide a slightly better service.

3527. *Professor Sayers*: In what proportion of those 20,000 accounts has the transfer been connected with the desire of a customer for an advance?——I do not know.

3528. *Chairman*: Have you any impression you can draw upon to give us the order of magnitude?——No, I am afraid not exactly. It would certainly be the smallest factor in influencing the transfer. Service would be the first consideration, without any question.

3529. *Professor Cairncross*: If you took a period further back, would you expect to find the number of accounts transferred to that bank higher than 20,000?——I purposely quoted the last three years as being up to date; but I think that would be fairly constant for the last seven years. Before that it would not be nearly so great. This competition since the credit squeeze is very much more keen than it was ten years ago.

3530. *Mr. Woodcock*: That is not what you say here. You quote Sir Oliver Franks, who says that in normal times "one of the most valuable safeguards to the public is the very real competition that exists between the banks. The dissatisfied customer can always go to the bank across the road. But at present while we are carrying out the Chancellor's wishes, this safeguard is to a large extent in abeyance as an inevitable consequence . . ." As you have just summed that up, it seems that since the credit squeeze the competition has in fact increased?——*Mr. Robarts*: The competition in respect of service is much greater than it used to be, as we say in the paper; after dealing with the credit squeeze, we go on: "In other directions competition among the banks remains keen."

3531. *Sir John Woods*: I have not got the directives in my mind; but if a customer comes into, say, the Westminster Bank asking for accommodation, is it clear that this particular request either falls within the Chancellor's directive or it does not? Might there be some type of situation in which bank A might refuse it on 'Chancellor' grounds, but bank B might say that it was all right on 'Chancellor' grounds, and thus be free to look at the proposition on its merits?——*Mr. Tuke*: There are a great many cases when it is perfectly clear on one side or the other, but there are a certain number which fall into the rather dubious ground in between.—*Mr. Robarts*: That could happen. I do not think we find ourselves in any great embarrassment because we have undertaken to carry out the Chancellor's request, and we are doing our best to do it; but if there is any doubt, as Mr. Chesterfield has said, a manager would refer to the bank from which the account is likely to come and ask whether they had refused that request on 'Chancellor' grounds.—*Mr. Chesterfield*: There are occasions where, as a result, the original bank has come to the conclusion that it was wrong and has eventually given the increased accommodation.

3532. *Professor Cairncross*: Surely you are bound to be faced with a lot of propositions about which you are in doubt, if you are operating to a certain ceiling. There must be applications which you might consider were creditworthy but for the ceiling, and some which you would reject out of hand as distinct from any limitation; but the two must shade into one another and it must be extremely difficult to distinguish them, given that you are working to a ceiling. If the pressure on accommodation is great, do you simply tighten up the conditions under which you grant accommodation?——*Mr. Robarts*: We have cut down on the "non-essential" categories, and that has given us a certain amount of leeway which we can use to accommodate the "essential" categories.

3533. *Chairman*: Would you say then that the quantitative restriction there has brought about a qualitative restriction too?——*Mr. Chesterfield*: Certainly.—*Mr. Robarts*: Qualitative restriction has been there for a number of years; the quantitative one really came into force in its full vigour in 1955.

3534. But it must have depended on individual instructions which you issue to branch managers all over the country. As regards the overall reduction or limitation that you observe, you must choose between one kind of advance and another, and you must have chosen in the qualitative categories, and some would be more favoured than others; for instance, defence, exports, agriculture, Commonwealth?——*Mr. Robarts*: Without looking back at our circulars which were issued at the time, I could not be quite sure; but the qualitative restrictions have been going on for a long time.—*Mr. Tuke*: The percentage was not, at any rate in my bank, applied down to the level of branches. It is not reasonable to tell every branch manager that he must get 10 per cent. off his advances, because it may be that some ought to go up; we had to do it on a bigger scale.

3535. *Professor Sayers*: When instructions have been given to branches following a new directive from the Chancellor, has there been any comparison of action between the general managements of banks before circulars have gone out to branches?——*Mr. Chesterfield*: I cannot ever remember asking to see or being shown the draft of another bank's instructions; but there has certainly been prior consultation; we meet and discuss it very freely amongst ourselves. I have no reason to doubt that the instructions bear a marked similarity to one another.

3536. *Chairman*: How often do they meet?——*Mr. Chesterfield*: The Chief General Managers meet once a month, and *ad hoc*.—*Mr. Robarts*: The Chairmen meet as a matter of routine once a month, or specially if necessary.

3537. When a refusal has to be made in implementing these directives, is the borrower given reasons?——Yes; we must do that in fairness; otherwise it would create ill will between the bank and the customer.

3538. Do you find that by now they accept that kind of explanation as one of the facts of nature, as it were?——*Mr. Robarts*: We have had very few problems with our customers. They have been extremely reasonable about it.—*Mr. Tuke*: I think it probably depends on the way they are handled. Some bank managers do it better than others.

3539. *Lord Harcourt*: By this time do you think there is such acceptance by the borrowing public at large that, when you tell a customer that you are sorry that you cannot give him an advance or increase his advance, he does not kick very hard; that in other words they are getting used to the directive?——They do not kick the bank, anyway.

3540. *Professor Sayers*: Do they go to the bill market?——Yes; and of course the private individual goes to one of the hire purchase companies. A great deal of our pressure on private accounts, which was the first category we were told to deal with, has been completely stultified by the fact that they can get money without any Governmental control from hire purchase companies—of course at double or treble the price.

3541. *Chairman*: They only go to hire purchase companies normally for a certain limited class of goods, do they not?——It is extraordinary what you can get on hire purchase these days.

3542. Do you think it is spreading into a variety of services as well as goods?——It spreads very widely over the field in which the private individual wants to borrow, I should say.

3543. Then you mentioned accommodation through the bill market. Do you think that has spread as a result of the Government's policy of restricting bank advances?——*Mr. Tuke*: It was spreading at one time, but we frowned upon it and it contracted a bit.—*Mr. Robarts*: Acceptance credit is pretty expensive at the moment, and that has perhaps slowed it up. There are more trade bills though; no doubt a certain amount of shift in borrowing would account for that: people who cannot get loans and overdrafts would get a bill.

3544. *Professor Sayers*: Has that shift into bill finance been confined to just a few trades, and if so which?——Timber; tobacco, though less than it was; sugar; there is a mass of commodities in course of movement.

3545. *Chairman*: Oil we have heard mentioned?——Oil, certainly.

3546. *Professor Sayers*: Timber and sugar are commodities that have clung to the bill continuously. This is not a return on the part of trades that had discarded the bill?——It very much depends on the ability to borrow from the bank, and the cost of that compared with the cost of bills.

3547. Are there certain trades, such as sugar for instance, where firms are quite sharply competitive, and the method used swings from one to the other, according to the price and other conditions?——*Mr. Chesterfield*: Yes, Sir; I would agree with that.

3548. Has there been any tendency for bill finance to become popular again in trades that had become almost completely dependent on bank finance?——*Mr. Robarts*: That is a difficult question to answer.—*Mr. Tuke*: There are two sorts of bills: there is the old-fashioned traditional bill, the genuine import or export bill; that is the real bill, which is sacred; then there is the other sort of bill which came into force in Liverpool in the cotton warehouses in about 1932, and then spread to other trades. With this type there is no genuine movement of goods corresponding to the bill; it is a bill drawn on goods in a warehouse which are going to be sold. That is the sort of bill which tends to increase, if banking accommodation in respect of certain classes of customers is being restricted. I do not think that our restrictions, on the other hand, have much bearing on the financing of imports and exports.

3549. *Chairman*: Your second class of bill is carrying stocks?——*Mr. Robarts*: Or there are shipbuilding bills. That is a bill which cannot possibly be described as covering goods; it is a bill drawn on the shipowner for building a ship. They have always existed. There are various opinions as to their merits, but they still exist.

3550. A lot of the money which would be financing those bills in the money market would in fact be raised on loans from the banks; therefore, you say, you frowned upon that. Could you discourage your money being used in competition against you, if you were refusing the finance because of a restriction that was being imposed?——Yes; our sanction, if we choose to exercise it, is not to lend money on those bills.

3551. *Professor Sayers*: Am I right in thinking that certain of the banks do not take those bills as collateral?——Some are more selective than others.

3552. In exercising that selectivity, are they thinking at all of competition with their overdraft business?——*Mr. Robarts*: I would not think that was really a factor. I think they just have an established principle, that they take certain bills and do not take certain other bills.—*Mr. Chesterfield*: They also apply a differential in the rate where a parcel of bills contains more than 5 per cent. of that kind of bill; the rate is higher.

3553. On the whole, a bank's bill business is done by somebody different from the man who is deciding at what points credit should be restricted?——*Mr. Robarts*: On the executive level undoubtedly that is so.—*Mr. Chesterfield*: But he is in very close touch; for instance, the man who does my bill market is in very close touch with me every day, and that is the case with all banks.

3554. This activity of lending to the bill market is co-ordinated with general lending policy?——Definitely.

3555. *Professor Cairncross*: Have the banks applied any measures which would operate against the intrusion of the bill market into business formerly financed by bank credit, or indicated any view about transactions of this kind, where bills of a character which would normally be financed by a bank overdraft are coming over to you?——*Mr. Robarts*: I do not think we have, because we do not look at it in that way. We either sell bills or lend money against them; those are our transactions in bills, other than bills we accept ourselves. Perhaps I might deal with the third class first: bills we accept ourselves we would only do in conformity with the squeeze; we should not deliberately accept bills when we could not make a loan. The bulk of the bills which the banks handle come to them as security for money which they lend to the discount market. Some of us will take no bills which are not immediately rediscountable with the Bank of England.—*Mr. Tuke*: The Bank of England does not in fact frown very severely on these second-class bills.—*Mr. Robarts*: It does on some; it will not take shipbuilding bills, for instance, and it never has.

3556. *Professor Sayers*: But some banks do, and others do not, take from the bill market bills which are not readily discountable at the Bank of England?——*Mr. Tuke*: I am not prepared to say that any bank takes bills in that department at the low rate which are not rediscountable.—*Mr. Robarts*: As a policy, we would not want to.

3557. *Lord Harcourt*: I imagine that one way in which one can make a switch from bank advances to bills which would be very hard to identify is by the drawing of a standard import bill, which in the normal course of events might have been renewed once but which, under the credit squeeze, might be renewed twice or three times. It starts as being a movement of goods, and instead of being paid off after the goods arrive, it is in fact renewed once or twice for ninety days, and it really becomes a finance bill, and the customer may be living on the renewal of that bill instead of drawing on his clearing bank. Do you think that bills are being renewed more often and that therefore they turn into finance bills?——I do not know the answer to that.

3558. *Chairman*: Are there any other sources of alternative finance?——*Mr. Chesterfield*: There are innumerable finance companies and small banks that might be possible sources; there are a lot of them operating, and it is not hire purchase all the time. It is so-called industrial banking.

3559. *Professor Sayers*: What kind of lending do they do?——They do a lot of lending which we should normally be prepared to do. There are several concerns with resources of up to £10 million or £15 million, who are doing our normal type of business for our customers which we have had to decline; of course they are charging them much more.*

3560. *Professor Cairncross*: How much more?——Possibly twice as much.

3561. You think this is the direct result of the credit squeeze?——I am sure; there is no other reason for it.

3562. Would any of these institutions have existed before the credit squeeze?——They might have existed, but they would not have prospered as they have.

3563. *Chairman*: From where do they draw their deposits?——*Mr. Robarts*: From the public, by advertisement. They pay a higher rate of interest on deposits and they charge more for loans.

3564. What is the most attractive feature of their advertisements?——The high rate.

3565. Do you think the word "bank" or "banking" has any attraction in the advertisements?——I suppose it does; I suppose it adds to the depositor's feeling of stability.

3566. Is most of their money taken on sight, or do they ask for fixed term deposits?——*Mr. Chesterfield*: I believe they are very well run, and that they take deposit and sight money. I saw an advertisement of one this morning, quite a small concern, where the deposits over the last twelve months have increased by over £1 million; they are currently offering interest on money on six months' notice at 8½ per cent., and three months' notice at 8 per cent.

3567. Would you say there was now a large group of operators who want accommodation for, say, a period of six months, who would fail to get it if they were not prepared to pay these rates?——*Mr. Robarts*: Yes.

3568. Let us assume that they are people who have normally been given credit by the banks and have now been refused?——Some no doubt borrow from finance companies at high rates.

3569. *Professor Sayers*: What kinds of people are not able to get it? Is it a matter of the size of the concern, or what?——Size undoubtedly has some influence on this; if the concern is big enough to go to the capital market, and provided it can get the consent of the Capital Issues Committee, then it can get the money. Coming

* See also Qn. 3646.

down to the smaller businesses and individuals, there must be a number of people who would like to borrow money for a thousand and one purposes, who have found it difficult and are finding it difficult.

3570. *Sir John Woods*: That is the result of the credit squeeze?——Yes.

3571. *Mr. Woodcock*: Surely that is the intention of the credit squeeze?——Yes.

3572. *Professor Sayers*: These people are not able to get money even if they are willing to pay the high rates which these new concerns charge?——*Mr. Robarts*: It is difficult for one to answer that question when one has never been inside one of these new hire purchase companies, and does not know the full extent of their business. In theory they should only lend money on actual goods; the theory is that the buyer pays for whatever it is over a period, and that is financed by the hire purchase company. How far they will go into unsecured finance I really do not know.—*Mr. Chesterfield*: They do a lot of financing of debtors and stock which we should normally have been prepared to do.

3573. *Professor Cairncross*: Since the credit squeeze was instituted, the level of activity in this country has not fallen off; it is reasonable to assume that enough people are getting short term accommodation to maintain the level. Is it your view that, if some of your customers have been crowded out of the market for advances of a short-term character, others have stepped in and got money, who would not otherwise have got that money; or do you think there were already too many people getting accommodation at the current level of activity?——*Mr. Robarts*: I do not think that other people have come in and got money which has been denied elsewhere. The level of advances has fallen; what we have done is to cut down the less essential categories so as to accommodate the more essential.

3574. But the general level of activity of the country has not fallen; people have got credit somehow or other, have they not?——Not all the business of the country is done on credit.

3575. A good deal would be financed on trade credit?——Yes, but a lot is financed on people's own resources; after all their deposits with us are around £6,000 million, of which we only lend about £2,000 million.

3576. You think people have been able to get money from relatives and other resources to make up the advances which have been refused?——*Mr. Robarts*: To some extent.—*Mr. Chesterfield*: I think it must be so, because the level of activity has been so high.

3577. Can you name any type of customer who has not got accommodation, or has not been able to raise money in some way, who would have been getting it from you before the credit squeeze, or would now be getting it if the conditions of the credit squeeze did not apply?——*Mr. Robarts*: Undoubtedly: for instance, lending on Stock Exchange securities has almost disappeared. Years ago we used to lend a lot on Stock Exchange securities.—*Mr. Chesterfield*: Then there is house building and estate development.—*Mr. Tuke*: The man who complains of the credit squeeze most is the little shopkeeper; we start squeezing at the top, and everyone passes it on: but the little man on the street corner has not anyone to pass it on to. He is the man who really does suffer: not that his bank is squeezing him, but perhaps his wholesaler is.

3578. *Mr. Woodcock*: What exactly are you saying? The credit squeeze has undoubtedly restricted your advances, but are you saying that the restriction that has been imposed upon you has been counterbalanced by other forms of lending, or lending by other organisations?——Not entirely, but to some extent; and to that extent the restrictions imposed upon us have been stultified.

3579. That is what you mean when you say it is not good for the economy? Surely you cannot say it is bad for the economy that your advances have been restricted, unless it can be shown that they have been made good in other ways?——*Mr. Chesterfield*: That is so.

3580. I am not sure what is your answer to the question to what extent your failure to meet credit-worthy people has been made up by other people. Do you say it has been made up to the full or to a considerable extent?——*Mr. Robarts*: To a considerable extent. You cannot get statistics which will show this; you can get statistics of our advances simply, but you cannot arrive at the total borrowings from other people.

3581. Then what has been bad for the economy has been the failure to follow up the restrictions imposed on you by equally stringent restrictions on other people?——Your premise depends on whether or not you think it is a good thing to restrict credit in the country.

3582. *Professor Sayers*: But what you are saying is surely that there has not been a restriction, in that certain people have been forced to pay higher rates for advances than bankers would have charged them, because they have been forced out of their normal channels of borrowing?——The most efficient lenders have been deprived of some of their ability to lend, and therefore some of the more expensive lenders have been given much more play.

3583. *Mr. Woodcock*: It would have been all right if you could have lent it?——We would have lent it much more cheaply.

3584. And then it would have been all right, for the good of the economy?——I would say, that, allowing for the exercise of qualitative restraints, it would have been very much better.

3585. But the whole idea for the credit squeeze is to restrict?——*Mr. Tuke*: Our case is that it is not effective.

3586. Your complaint is that, despite the limitations placed upon you, there are not equal limitations upon other people?——Exactly.

3587. *Mr. Jones*: Is that tantamount to an admission that there is a degree of licence within the operation of the financial system at this time?——*Mr. Robarts*: Yes. We are easily controlled, because we do carry out to the best of our ability the requests of the Government of the day, whatever that Government may be. Those restrictions are carried through simply on a system of goodwill, but it is a very effective system. That does not apply to all these other sources of lending which we have been discussing; that is our complaint.

3588. The monetary system is not working on the basis of direct controls: it is working on the basis of direct controls plus licence within the financial system?—*Professor Sayers*: There is a diversion of credit?——Yes.

3589. Which involves people paying much more for credit?——Much more.

3590. Has that arrangement in your view had any effect on economic activity, on the level of prices and all that?——It must have had.

3591. In what way?——I suppose that every time the price of anything rises, whether it is goods or services or the borrowing of money, it is an inflationary movement.

3592. Are you arguing that the making dearer of credit has aggravated the rise in prices?——I would say that it is a factor in wages. If a man has to use hire purchase money for his furniture, or whatever he is buying for his house, when that money costs more (and it costs a good deal more from these hire purchase concerns) that is going to be a factor in the urgency with which he will seek higher wages.

3593. Is that equally true when the cost of a bank overdraft rises from 4½ per cent. to 8 per cent.?——I think it does not impinge in the same way, because we do not lend, by and large, for those sorts of purposes. We have restricted our personal loans very strongly.

3594. I am sorry: I am thinking of your argument that in effect the volume of credit has not been restricted but that there has been a diversion, which has involved a very great rise in the average price of credit, in that some people have come to pay much higher rates than they would have paid if they had been accommodated by the banks. Do you think that that raising of costs has had any important influence, and if so what, on the inflationary situation?——It has undoubtedly had an inflationary influence. I would say that it has been a factor in the pressure for increased wages from people who are using hire purchase money extensively.

3595. Would you use the same argument with regard to the raising of the Bank Rate from 2 per cent. to 7 per cent.?—*Professor Cairncross*: Do you think that would aggravate inflation?——It may perhaps have some effect in that direction. But in general the people to whom the banks lend are borrowing for purposes somewhat different from those who borrow from the finance companies.

Of the total of bank lendings, a higher proportion will go to industry than, I should say, in the case of finance companies. The rate of interest industry pays for its borrowing is not a very big factor in the ultimate cost of the goods, because so many other things come into it: the cost of labour, for instance, is very high: and there are raw materials and so on.

3596. *Sir Oliver Franks*: This argument is going rather faster than I can follow. We seem to be asking which way the market in money is related to questions of inflation. One normally supposes that, if a thing gets dearer, people want a bit less of it; and, if it gets cheaper, people want a bit more of it. The effect of the diversion of credit from the banking system, as it has been described, to other sources of finance has been to make the credit given dearer; and from that certain consequences were drawn. Then Professor Sayers drew attention to the fact that in the sphere of bank advances, the outcome, following the increase in Bank Rate, was that the rate charged for advances had gone up. I do not quite know where we are in that situation; one line of argument would lead us to the view that where the price of a commodity (in this case money) is made dearer, that will tend to make people want to use a little less of it, whereas another line of argument would be that, in so far as the use of money is made dearer and people have to pay more for it, and in so far as that enters into prices and then into wages, it makes people want to use more money, and it therefore produces the paradoxically opposite effect?——*Mr. Tuke*: I think that we have perhaps got wrong by switching from volume to cost. Our case is that, presuming that the Government were right in their repeated requests to us to restrict the volume of our lendings and, at one stage, actually to reduce them, and to alter the quality of them, the intended good effects have been diminished by the fact that the people who could not borrow the money from us have gone elsewhere to borrow it. That is really our case; it is not primarily a question of cost.

3597. But those who have gone elsewhere have been charged much higher rates, and therefore, in so far as people have not been prepared to pay the higher rates the credit squeeze has been effective?——Yes.

3598. That does not square with what you say in your memorandum?——I prefaced my remarks by presuming that the requests were right.

3599. Are you saying that the requests were wrong? ——Requests are a form of a direct control, which is part of another sort of monetary management. You either have what I hope Mr. Woodcock will forgive me if I call the Socialist method, of which direct controls are the main element; or you have the other method (I will not call it the Conservative method, because that is not quite a parallel), that acts, or should act, by means of monetary measures; keeping money short. The Government and the Bank of England, taking the two as one, should be able to operate a squeeze on us without any request or anything of that kind, but by simply making money short: then we have to do something about it.

3600. This Socialist method, as you call it, is intended to make money short. What is the alternative; to make money dearer?——The dearness of money follows from its shortness. If a thing is in short supply it becomes dearer; but you do not by making it dearer make it short. That has been one of the errors over the past five or six years; at times money has been made dearer, but it has still been just as plentiful.

3601. *Professor Sayers*: Would you have the authorities not trying to act on bank advances directly at all, but making money short in some other way?——Yes.

3602. By what other methods would you like to see money made short?——Fundamentally by the Government having an overall balance on the Budget. The Government want to be in the position of squeezing our liquidity ratio; the fact that there is overspending makes that difficult to maintain.

3603. You would like to see the banks kept tight by being kept short of money market assets?——Yes.

3604. *Chairman*: But it is possible to take the view that "the good of the economy" is not aided by the present organisation of the banks, whereby they are deprived of their natural activity of competing with each other in order to provide credit on the most economic terms they can. I thought that you did not think that that was a healthy situation to go on for a good many years on end?——If we were short of money, and if there were no direct Government restrictions, then we should have to think very carefully about the manner in which we could compete with one another; we should have to eke out such money as we had. As it is now, we have ample, and would like to be lending it to more people than we are able to.

3605. *Professor Sayers*: If you were kept short of money market assets, what would you do about your advances? ——*Mr. Robarts*: We should not at the first stage do anything about our advances that we are not doing now. We should sell investments.

3606. *Professor Cairncross*: At what point would anything the Government did make you restrict advances to industry?——*Mr. Tuke*: When our advances had risen from the figure of 30 per cent., as we stand now, to the pre-war normal figure of 45 per cent. to 50 per cent.

3607. Could we assume that you would be anxious to increase the proportion of advances to deposits to about 50 per cent. if the credit squeeze was removed?——*Mr. Robarts*: I do not think we would be anxious about it. I must elaborate that; we do not go out searching for borrowers, because that would involve unsound lending. We have to be highly selective in our lendings. But I think we could with equanimity see our advance percentage increased.—*Mr. Tuke*: Certainly; but if we are realistic I think we ought to recognise that it would be much more difficult to get to 45 per cent. or 50 per cent. today than it was before the war, because a great many of the companies which were borrowing from us in the private sector before the war are now nationalised, and are being financed somewhere else in our balance sheet, either in investments or in Treasury Bills.

3608. Are you telling us that you do not think it would ever get to the point at which advances would be greater than you wanted them to be, so that Government measures would take effect in a negative direction?—— It would certainly take longer than it did before the war for that to happen; but on the other hand we do not like selling our securities at a very big loss; and if we had no more securities which were coming in during the next year, we would have to look at the price.

3609. When your advances were as large as considerations of banking with safety required, and the Government was anxious to see you restrict advances, would they not recall part of your floating debt holdings? Might that not be something which, on other grounds, was not satisfactory from your point of view? They might choose a moment to vary their floating debt which was not the moment when the needs of industry required them to move in that direction? In other words, there are some considerations governing the size of the floating debt, and other considerations governing the advances that industry needs. You are envisaging a return to the prewar situation where the liquid assets of the banks would govern their lending policy; might the banks not find themselves in a very awkward position, obliged to withhold loans from industry at a time when it was undesirable?——I feel a difficulty in answering this, because to some extent the interests of the banks are different from the interests of the Government. The Government wants to restrict Treasury Bills, but, of course, it suits us to have liquid assets. From whose point of view are you asking the question?

3610. From the point of view of the country?——The Government's ability to handle this situation is governed very much by the fact that they have borrowed so much money in past years. All this is now falling due in great lumps, sometimes two lumps in a year, so that they simply cannot handle it except by from time to time creating more Treasury Bills than they would like to do.

3611. *Professor Sayers*: Supposing the Government were now able to make life difficult for you in the sense that it managed to get down the volume of Treasury Bills very considerably so that the volume of liquid assets available to the banks was very much reduced below its present level; in the first place, you have told us, you would sell investments. But there would come a point at which you would be uncomfortable about going in that direction; what would you then do about advances?

——*Mr. Robarts*: I think all one would do would be to turn away some new advances. The last thing we should do would be to call in, in a wholesale manner, existing advances. If we did that on any big scale, it would precipitate a crisis.

3612. What would happen to the people whom you turned away? Where would they go?——Unless they could go to one of the alternative sources we have discussed they would not be able to carry out any project which they were wishing to borrow for; or they might possibly reduce their stocks, or call in their debtors somewhat more quickly.

3613. This process, which would include some liquidation of your investments, would involve some rise in interest rates. Do you think that would have any effect in depressing the demand for credit?——*Mr. Robarts*: That is a question about which I have never been able to make up my mind: how much this high interest rate has really discouraged borrowers. Wholesale sellings of gilt-edged securities by the banks would clearly depress the price of the securities and increases their yield; but the question of whether the higher interest rates would discourage borrowers is a rather separate question; the cost of bank borrowing depends, as you know as well as I do, on the Bank Rate, and, if the banks had to sell securities wholesale for their liquidity it would not necessarily mean that Bank Rate would go up.—*Mr. Tuke*: On the question of whether a higher rate discourages borrowers I would say from our experience since the war, with the level of taxation that has been built up, that up to a Bank Rate of 5 per cent. it has no effect; whether a 7 per cent. Bank Rate has an effect is, I think, in process of proof, but there is some evidence that it may.

3614. *Sir John Woods*: Do you think it is the absolute level of the Bank Rate rather than the rise in a Bank Rate that has, or can have, an effect?——Yes, if anybody wants to borrow money, and he is expecting to make 10 per cent. on the transaction in three months, it does not really matter to him whether he pays the bank 5 per cent. or 6 per cent.; but at a slightly higher level, and if he is not sure whether the price of goods is going to fall, it might make a difference.

3615. *Chairman*: Would you all separately confirm from your experience that up to 5 per cent. no effect has been observed of discouraging the borrower; it was only after it had reached 7 per cent.?——*Mr. Tuke*: Up to 5 per cent. no effect; after 7 per cent. perhaps.—*Mr. Chesterfield*: I agree with that.—*Mr. Robarts*: I agree with that.

3616. You must have some reflections from the rise to 7 per cent. in September and its effect in the subsequent months; what would you say about that?——I find it very difficult to answer. I have talked to a number of our managers on this point and got very varying answers. I have really formed no conclusion. On the question of large loans I have not found that it has made much difference.

3617. *Sir John Woods*: Does a high rate, or a rising rate, have different effects on different types of borrowers, according to their size or the type of their business?——*Mr. Robarts*: I would not think it made any difference up to 5 per cent. We have only had 7 per cent., which is effectively about 8 per cent. to the borrower, since September last, and I personally have not seen that it has discouraged at any rate the larger commercial borrowers.—*Mr. Tuke*: There has been a fall in our loans during these last two or three months.—*Mr. Chesterfield*: The executives that I meet from time to time have been surprised that it has had the deterrent effect it has had so far. Quite apart from any pressure we have exercised, there has definitely been a decrease in bank loans since September.*

3618. *Chairman*: From the impressions you have collected from executives, is that due to the interest rate, or due to a decrease of demand?——*Mr. Chesterfield*: The decrease in demand has been due to the increased rate. In other words, a lot of people had been looking at their stock position and reducing stocks; the rate had begun to hurt.—*Professor Cairncross*: Would not a fall in value mean a reduction in demand?

3619. *Sir Oliver Franks*: In 1952 there was an impression in the country that the use of interest rates had been rather more effective than people had expected. Then, when you come to 1955, what was surprising was how little effective it seemed to be. In 1956 I dare say opinions varied, but it rather looked up to the time of Suez, in the autumn of 1956, as if the measures being employed were getting the economy back under control; and now in the last four months it is not clear. In the first of those periods the general way of the world was that of recession, and so monetary measures and the total level of international activity were perhaps working together; in 1955 they were perhaps working against each other because the world was in boom; and now it looks as if the boom has given way to some recession, for example in America, and I suppose it costs less money to finance a given volume of stocks. So when one is looking at the question of the effectiveness of an interest rate it may be that one has to look not merely at the level of the interest rate but also at the environment in which it is applied. I wonder whether, if one complicated the questions we are discussing by distinguishing the present rate and its environment with the rather differing environments of the last five or six years, you wanted in any way to revise the view taken?——*Mr. Robarts*: It is very difficult to disentangle all the causes which lie behind the decreased level of advances to which Mr. Chesterfield has referred. There are many things; in fact I should say that all the factors at the moment make for a lower level of advances; for instance, the fall in commodity prices. There is also another position which affects retailers: they can get stocks of manufactured goods very much more easily and, therefore, it is less necessary to carry heavy stocks, and so forth. That has run right through the economy; and at the same time you have high interest rates. How much you can attach to high interest rates and how much you can attach to the other factors is to me just guesswork.

3620. *Chairman*: It must be guesswork really, owing to the impossibility of disentangling it; but I thought that possibly by collecting the actual views of, let us say, the branch managers as to what their customers have said to them, one might get a view; it might be the only way one could?——*Professor Sayers*: I thought that was what Mr. Chesterfield said?—*Mr. Chesterfield*: Yes, we have done that. We circularised certain selected branches in November. We supplied information to the Bank of England, and to the best of my recollection it indicated that traders and manufacturers rebelled against the high interest rate for the first time.

3621. *Mr. Woodcock*: These outside sources should be feeling a very severe draught?——*Professor Sayers*: The diversion of credit into these more expensive channels must have had some anti-inflationary effect?—*Mr. Robarts*: I do not think so, because some advances which the banks would not make owing to the Chancellor's various requests have been made by the hire purchase and kindred firms.

3622. That is to say, there has not been a serious restriction of credit, but there has been a making dearer of credit?——There has been a restriction of credit to the extent that not all the advances that the banks have refused to make have been made by the hire purchase firms.

3623. Could we go further into what from Mr. Chesterfield's experience potential borrowers have said? Is it possible to classify these people at all, and to say that people in certain directions, or people of a certain size rather than others, have been deterred by these high rates; or has it been something very generally spread? Has it been in the retail or wholesale trade, or in manufacturing, or in agriculture, or is it something that is all over the place?——*Mr. Chesterfield*: I am afraid I cannot give an accurate answer to that.—*Mr. Tuke*: If there are hundreds and thousands of people not using quite as much of their limits as they were before, the level of our loans falls; but it is impossible to identify which man and which trade.

3624. *Sir John Woods*: Do you think that it might be reasonable to say that the man who has got a business with a quick turnover, for instance, as Mr. Tuke said just now, a profitable transaction to yield 10 per cent. in three months, will not be very much deterred even by 12 per cent. for twelve months, but that another type of business, with a considerable cycle of production and needing to finance work in progress throughout, and to negotiate prices which may not be financially profitable,

* See also Qn. 3646.

would be very unwilling to pay 10 per cent?——*Mr. Robarts*: To generalise, of course, the high rate does not have the same effect when business is very good as when it is bad.—*Mr. Tuke*: With my man who is going to make 10 per cent. in three months, I think there is another consideration moving in his mind: perhaps he is not quite so sure about the 10 per cent. and for that reason he does not care to carry out the project. As soon as people begin to see the prices of goods, or raw materials (which always comes first) falling, they begin to get a bit more cautious; they do not hold so much stock.

3625. *Mr. Jones*: Are you in a position to tell us to what extent, having regard to the high interest rates, overdraft limits agreed have not been taken up in full, and to what extent they have been taken up in full?——That is quite impossible.

3626. Is there any general experience on it?——*Mr. Tuke*: It varies from day to day on every account.—*Mr. Robarts*: Borrowing limits throughout the whole of the banking system are very much greater than the amount borrowed at any one moment.

3627. *Professor Cairncross*: When you say very much greater, have you any idea of the ratio?——*Mr. Robarts*: The only figures I have seen indicated that in the bank of which I am Chairman between a half and two-thirds of borrowing limits are currently used. It is from your experience, Mr. Chesterfield, is that order?—*Mr. Chesterfield*: Yes; but I think it is a very misleading impression to get around, because so many of these loans are "seasonal". On one account we might have a limit of £100,000 which we know perfectly well is only going to be used from April to August awaiting the harvest; with the very diverse business we have the total of limits is a figure which should, I think, be disregarded.—*Mr. Robarts*: I quite agree; because it will never be reached.

3628. *Professor Cairncross*: Have you ever worked it out? I have seen figures quoted, and I wondered what the ratios were in a typical bank?——*Mr. Chesterfield*: If you took availments and limits, availments would be somewhere about 50 per cent. of limits; but the total of limits is really "phoney", because many of them do not apply at that time of year. Basically everything is "seasonal".

3629. "Phoney," but interesting. There are figures, for instance, for the Export Credit Guarantee Department, which give a certain idea of the normal ratio in respect of the credits they guarantee. They show an average of about 60 per cent.?——*Mr. Chesterfield*: I think the banks are slightly less than that.—*Mr. Tuke*: It would from a practical point of view be quite impossible for every borrower to borrow the full amount at any one time. When a man borrows money he does not just put the money on the table and look at it; he pays it to somebody else and that man's account is reduced.—*Mr. Chesterfield*: Practically everything is "seasonal".—*Mr. Robarts*: Yes; the full total of borrowing limits would never be used at any one time.*

3630. *Mr. Woodcock*: Does this mean that the figure in the second paragraph of your paper showing advances as 30·6 per cent. of deposits is "phoney"?——*Mr. Chesterfield*: No, that is an actual figure of availments and is correct.

3631. *Sir John Woods*: On the general question you seemed to get somewhere near the point of saying that the restrictions on the banks have not really had any great effect on the total supply of credit because your reductions have been made up to a very considerable extent by lending from other sources; and that seemed to be borne out by the fact that the total level of activity has not fallen very much. Am I to conclude from that that the effect has been negligible and that you might just as well not have done it, or do you think it is possible to argue that but for the requests to the banks to restrict credit there would in fact have been an increase in activity which has been checked?——*Mr. Robarts*: I think that is true; we have said in the paper that if it had not been for the credit squeeze our loans would be higher.

3632. *Chairman*: On the other hand you told us that there were a number of credit-worthy borrowers who could not get the money they wanted?——Yes.

3633. *Professor Cairncross*: Is that still true, despite the higher interest rates? You still have a number of customers coming in and asking for accommodation whom you have to refuse?——Yes. We have kept a total of everything we have refused since it started, and it is very impressive.

3634. *Professor Sayers*: Suppose that both the qualitative and quantitative restrictions were removed, and the Chancellor said: "You can go ahead and lend as much as you like". By what proportion do you think the level of bank advances would increase in, say, a couple of years?——*Mr Robarts*: That is an almost impossible question to answer; it depends, of course, on the other economic conditions, on whether we are in a boom or a slump.—*Mr. Chesterfield*: And the availability of labour and materials.

3635. I have heard it suggested that the level of advances is likely to be lower in the next half year than it is at present. That is a forecast on the basis of a guess at economic conditions. Taking those general economic conditions, but assuming the directives were not there, what demand is there for bank advances? By how much would the level of bank advances rise, if not in two years, in six months?——*Mr. Robarts*: Just at the moment, with this slow-down in trade, I cannot see any great change taking place You could say that we can lend up to 50 per cent. of our deposits, and the arithmetic of that would allow us to lend another £1,000 million; but that is an entirely theoretical thing. It pre-supposes that there is a demand for that amount of lending.

3636. *Professor Cairncross*: Does it pre-suppose that you would have to sell £1,000 million worth of Government securities?——If we were to do such a thing, presumably so. But we are going right into the realms of theory here. You have also to consider the environment of the country: at the moment we certainly could not, even if we wished, lend another £1,000 million, because there would not be the demand for it.

3637. *Chairman*: You say that you consider the restrictions on advances should be abandoned as soon as practicable. That raises two questions in my mind. The first one is this: do you consider that the conditions now ruling do make such an abandonment practicable?——I would say that we are getting towards those conditions, because trade is slowing up.

3638. Perhaps it would be easier to answer if I put it in the form of my second question: what do you think are the conditions which would make it practicable?——The simple answer is a very much stronger sterling reserve position. All this business has been brought about by these recurring crises.

3639. I understood from your paper that what you had more in mind was that you thought that the volume of Government short-term borrowing ought to be reduced by a certain amount?——We certainly think that; there is far too much short-term debt for the good of the economy. But I would say that all these things are so much tied up together. The fundamental thing is surely the size of our gold and dollar reserves.

3640. *Professor Sayers*: Suppose that the gold and dollar reserves tended to fall, but that the volume of activity in the export trades went down quite seriously, for the same sort of reasons as the fall in the reserves; would you then consider that the requests might be removed?——Provided the gold and dollar reserves were adequate (they are not at the present time, though they are slowly improving), then I should think that you could do away with them.

3641. *Chairman*: I thought your theme was rather that there was a mechanism which should he applied through the control of the money supply to regulate the banker's power to create money by advances; that that control had been lacking, in the years that we are particularly concerned with, because of the great volume of Government short-term debt which gave you an almost infallible method of recouping your cash whenever you wanted to; and that, therefore, you had had to be appealed to, rather than forced, not to make use of that position. I thought you were saying here that you thought those appeals ought to be abandoned and what I will call the regular method of keeping you under control restored; and that that involved a considerable reduction in the amount of floating debt in the banking system?——Yes.

3642. Have you in mind any kind of measure of that reduction that would make this practicable?——*Mr.*

* See Appendix to Minutes of Evidence.

Robarts: This thing has gone such a long way. There is this big volume of Treasury Bills which fall in every week, and maturities which fall in every year. Nothing can be done about the maturities falling in every year; but if a large volume of Treasury Bills was funded it would certainly have a considerable effect on us.—*Mr. Tuke*: It would have to be funding outside the banking system.

3643. *Professor Sayers*: If there was a really successful funding during the next six months, would you then say that even without any appreciable increase in the gold and dollar reserves the requests should be withdrawn?——*Mr. Tuke*: And no Budget deficit.—*Mr. Robarts*: That is important of course. A successful funding would, I think, have a big effect on us. If you go back to the autumn of 1951 that is what was done. Of course the conditions which make a funding operation possible involve adequate reserves behind sterling; that is why you cannot fund at the present time.—*Mr. Tuke*: There is another contingency: we might go into a recession and have two million unemployed and cheap money. Then the Government would be on its knees begging us to lend money.

3644. *Professor Cairncross*: Leaving these possibilities aside, would you like to see the existing arrangements continued, or have you something else you would like to propose?——We want to replace requests by coercion of the monetary system.

3645. But that pre-supposes (1) that there should be funding; (2) that there should be an improvement in the gold and dollar reserves, and (3) the possibility that there might be some change in the trend of the economic situation reducing the level of activity; supposing these conditions are not fulfilled (and certainly two of them seem unlikely to be fulfilled in the short term) in the next few months or years, what is the proposition then?—*Chairman*: Perhaps we could take this tomorrow morning; you may like to think it over and put it in order in your evidence before us then?——*Mr. Robarts*: We should like to do that.

(*Adjourned until Friday*, 24*th January*, 1958, *at* 10.30 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

SEVENTEENTH DAY

Friday, 24th January, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.

THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.

W. E. JONES, ESQ., O.B.E.

GEORGE WOODCOCK, ESQ., C.B.E.

SIR JOHN WOODS, G.C.B., M.V.O. (Questions 3646 to 3844 only)

MR. R. T. ARMSTRONG, *Secretary*

MR. G. PENRICE, *Statistical Adviser*

D. J. ROBARTS, Esq., Chairman, A. W. TUKE, Esq., and A. D. CHESTERFIELD, Esq., representing the Committee of London Clearing Bankers, called and further examined.

3646. *Chairman*: Before we go on with our questions, Mr. Robarts, was there anything you wished to come back to in yesterday's evidence?——*Mr. Robarts*: I wonder whether I might make a short statement on two matters. The first one concerns finance companies. We said yesterday that they are undoubtedly doing business which we are precluded from doing by the Chancellor's requests, and they are doing it by paying higher rates for money on deposit which they can lend at higher rates than we do. To that extent they are cutting into our business. It is arguable that the present arrangements are unfair to us in that they hamper us more than they hamper finance companies. On the other hand, I do not want to give the impression that we want protection from competition. We believe in free competition; if other people can come along and do business, they are welcome to do it. We do not want to give the impression that we require legislation which will make us monopolists of all money transactions, or anything of that kind.

The second point is this. We had some discussion as to whether the 7 per cent. Bank Rate discourages borrowers and is at any rate partly responsible for the recent decline in bank advances, and to what extent. I made it clear that at the present time it is impossible to disentangle the various causes which are making advances fall; there are so many of them. There is the 7 per cent. Bank Rate but there is also considerable uncertainty as to the future of business both in this country and in the United States, falling commodity prices and so on. It is beyond the wit of man to disentangle those factors. On the other hand, the Bank Rate was raised on 19th September, when business uncertainty was not nearly as great as it is now. I think it is sustainable that at that time 7 per cent. did have an effect on borrowings. It brought customers right up against the cost of money. I think there is very little doubt that for a month or two months it really did by itself have an effect. But I would hesitate to say that it is the dominant cause of the present fall in bank advances as so many other factors have since appeared.

I have discussed this with Mr. Tuke and Mr. Chesterfield, and I think they would be in accord with that. When we were discussing it, Mr. Tuke made a very sage remark: he said that one can discuss this sort of thing with the bank managers, but no bank manager sees the man who does not come and borrow because he thinks it is going to be expensive. That is very much to the point; it makes it impossible for us to say to what extent people who would otherwise try to borrow do not borrow.

3647. Would it be true to say that the effect of the Bank Rate as a whole depends partly on impressions? I think you stressed in your own paper that it has a traditional aspect of a warning?——Yes.

3648. Perhaps at some stage we may get a little more from you on what exactly the warning means. I do not expect you to be dogmatic for one moment; all I want is to get the impressions of people who are very much in touch with this particular aspect of the Bank Rate and its effects.—*Professor Cairncross*: I understood Mr. Chesterfield to say yesterday that his impression, based on conversations with his managers, was that there had been a reaction to the higher rate of interest, and that it was of a character that he could identify and segregate from the reaction to the business situation?——*Mr. Robarts*: I would like Mr. Chesterfield to confirm this; but I think that would apply to the first few weeks after the rise of the Bank Rate before the business uncertainty had got up steam, as it has now.—*Mr. Chesterfield*: Yes; the first two months.

3649. It was not possible to identify a particular group of clients who in your view, were being hit by the higher rate?——*Mr. Chesterfield*: No.—*Mr. Tuke*: I suppose one might say, not as a fact, but as a presumption, that the class of business man who deals in the marginal field, the broker or the merchant, is more likely to be affected than the manufacturer.

3650. *Chairman*: Because he is most interest-conscious?——No; because he is doing a big turnover for a small profit, and therefore a cut of a certain size is much higher proportionately to him than it is to the other man.

3651. *Professor Cairncross*: Interest charges are a high proportion of the cost of carrying stocks?——Yes.

3652. Are you aware of any marked effect in that direction towards a reduction in the stocks carried because rates of interest have risen?——*Mr. Robarts*: There is a tendency for stocks to run down; but it is again so difficult to disentangle the cause of that. There is the fall in commodity prices; in many people's view that fall may well continue, and it is no fun holding commodities if they are going to fall. It is so difficult to disentangle that from the effect of interest rates.

3653. Yesterday you appeared to take a rather stronger view about the consequences of raising rates up to 5 per cent.: you thought it was unlikely that any change of interest rates within that limit would have much effect. Do you still take this view or do you feel that even there it is impossible to dogmatise?——I do not think that interest rates rising up to 5 per cent. have very much effect on the demand for borrowing, no.

3654. *Sir John Woods*: Even in building the psychological effect to which the Chairman referred just now?——That is rather a different matter. I think the actual rise of the Bank Rate does help the psychological effect, even though it is within the 5 per cent. field; but I do not believe that whether a man is going to pay 3, 4 or 5 per cent. is going to have very much effect. I think you have to go higher before there is that effect.

3655. A not very large rise from a low level would merely get people prepared to do something; it does not make them do something of its own?——It is a warning.

3656. How do you reconcile there being a psychological effect but no observable effect in what people do?——In our evidence we have stressed the psychological effect: it shows that, in the view of the authorities, the machine is going too fast, or that we are losing reserves, or both.

3657. *Chairman*: You say it is a warning; could you refine on that to some extent? Do you think it is a warning that the authorities are proposing to try to reduce the volume of demand, which itself is a warning of something, whether their activities are likely to be effective or not; or is it a warning that the authorities, who are presumed to know more than others, think that the volume of demand is getting too high and is going to break?——I think you can interpret it, as it has been since the Bank Rate started to be used again after the war, as a warning that the economy was over-stretched, that inflation was proceeding and should be checked.

3658. But has not everybody known that for a long time? Take September this year: before everybody's eyes was the fact that the reserves were running out rapidly; therefore what was it a warning of when the large jump was made?——A warning that inflation was then going very fast indeed, that we were losing reserves at an intolerable rate, and that the whole economy had to be compressed as quickly as possible.

3659. *Mr. Woodcock*: Was inflation going at an alarming rate at that time?——Undoubtedly.

3660. Have you got figures?——It is so difficult to measure it. There was a general feeling everywhere of expansion and that, as Mr. Thorneycroft said yesterday, we were trying to do to much too quickly.

3661. How does inflation reveal itself?——In a rising price level.

3662. Was our price level rising higher than that of the rest of the world?——I have not got the figures, but it was certainly rising.

3663. *Professor Cairncross*: Would you not say that it was the consciousness of inflation that had changed, rather than the situation itself?——Yes, I think so. There were all sorts of indications of this: for instance, the gilt-edged market was very weak and the equity market very strong at that time; people were running away from fixed income securities to securities which they thought would protect them better against inflation.

3664. *Mr. Woodcock*: And the reserves were falling?——The reserves were falling very rapidly.

3665. What did the Bank Rate do in addition by creating an awareness of the inflationary situation?——It showed the world that we were going to tackle the inflationary situation drastically. You have seen the result of that in the gradual build up of our reserves since.

3666. Do you think that the Bank Rate did that?——I do.

3667. That was not the only thing that was done?——Not the only thing, but it was the most immediate thing; the quickest-acting thing that could be done.

3668. Do you think that that by itself would be adequate as a warning, or as powerful a warning as you suggested?——I think that all Bank Rate changes have to be accompanied by various other things. For instance, a retrenchment in Government expenditure is very important; perhaps more important than anything.

3669. Does not that considerably modify your statement about the consequences of the Bank Rate, if it has to be accompanied by these other things?——*Mr. Robarts*: I do not think so, because retrenchment of Government expenditure takes a long time to take effect, whereas the Bank Rate acts as an instant indication to the world that we have really taken our position seriously, and are going to try and put it in order.—*Mr. Tuke*: May I take this question of the warning a little further and ask you, if I may, a warning to whom? Do you mean to people like us, who are supposed at any rate to understand these things, or to the man in the street and the business men up and down the country? I do not think what we have been saying really communicates itself to the mind of the business men in Manchester or Birmingham. It is only a very limited number of people to whom that warning is effectively addressed, much fewer than is supposed.

3670. *Chairman*: I would deduce from what Mr. Robarts has been saying that its real significance is a warning to anybody concerned that the Government has a policy, which it proposes to bring into effect by a number of measures of which the Bank Rate is one; it is really a warning of future Government action rather than anything else?——Yes.

3671. To whom do you think that conveys a significant impression; are not many of the indices that call for it already available to the public? Is the significance outside this country?——*Mr. Robarts*: Undoubtedly.

3672. *Mr. Woodcock*: What significance has it to outsiders? You say in your paper that it does not have any effect on the movement of short term funds?——*Mr. Tuke*: It would draw money to this country if the foreigner had confidence that he could get it away again at the same rate in a year's time. That is the limiting factor.

3673. That is what puzzles me about the use of the Bank Rate: if it does not create confidence, what does it do? I thought you were arguing that it did?——I am saying that the effect of it on the balance of payments is limited by the fact that the foreigner thinks twice on the question of safety, rather than on the interest he is going to earn.

3674. I would like to know what you think about the use of the Bank Rate and its value. I have assumed from what you have said that the increase in interest rates does not attract money, because there is this further factor of confidence, and that people are not going to send their short term money over here simply because the rate of interest has risen with the rise in the Bank Rate?——Confidence is the salient thing. In theory a rise in Bank Rate does two things: it attracts people who have got money to put it here, and discourages people from borrowing here.

3675. Does it in fact attract money here?——No, but in present conditions it discourages borrowing here by the foreigner. It makes it more expensive to borrow here and therefore relatively less expensive in some other centres.

3676. *Professor Cairncross*: That has a short term effect, if it takes place and takes place on some considerable scale; but, looking at the longer term effect, if nothing else happened to the domestic situation, do you believe that that would really restore confidence in sterling on a permanent footing?——Not if the Government goes on over-spending. I think if the Government had been able to spend less money over the last five years there would have been no need to put the Bank Rate up to 7, or even 5, per cent.

3677. Purely on the short term effect, you are thinking, I take it, primarily of a rise in, rather than the height of, the Bank Rate as exercising an effect on confidence? You do not suppose that 7 per cent. improves the confidence of the foreigner in sterling; it is the rise from 5 to 7 per cent. which does it?——You mean that, if it had been 4 and rose to 6 per cent., it would have had the same effect?

3678. Yes; or indeed that 7 per cent. is not very encouraging if one is looking at the matter dispassionately. You are saying that a strong currency does not usually have very high rates of interest?——*Mr. Robarts*: No. Let us turn back to September: the reserves were falling very fast indeed, and the impression was gaining ground abroad that we were going to devalue. At the same time, by rather bad luck, Germany's position was improving daily, and all the floating money in the world, of which there is a great deal, was going there, and of course, across the Atlantic also. If nothing had been done I have no doubt that we should have gone on losing our reserves with very serious consequences. The Bank Rate was put up to 7 per cent., and that showed everybody that we were determined not to devalue but to take the necessary steps to prevent that happening. That, I think, is the justification for the move.

3679. Your point is that there was no other weapon in those circumstances which could have been so effective as a rise in the Bank Rate.—*Lord Harcourt*: Or effective so quickly?——*Mr. Tuke*: The measures in September would have had effect without the rise in the bank rate, but that would have effect more quickly.—*Mr. Robarts*: "More quickly" is really the point.

3680. *Professor Cairncross*: The view is that other action taken by the Government, if taken in time and taken so as to strengthen the central reserves, might have made unnecessary the rise in the Bank Rate?——*Mr. Robarts*: Yes.—*Mr. Chesterfield*: That action would have had to be taken a long time before 19th September.

3681. Much earlier. Suppose that we take a different type of situation, one that we might be faced with even in the course of this year, in which activity is slowing down and it is necessary to deal with an adverse balance of payments, but in conditions of unemployment; do you think that a movement in the Bank Rate up or down would be sufficient to put things right?——*Mr. Robarts*: Not by itself, no. It would have to be one of a series of measures, but it should be one.

3682. Which way would you move it in those circumstances?——Down.

3683. Even though there was an adverse balance of payments?——That is a difficult question to answer. I would myself still advocate a downward move, but I do not want to be dogmatic about that. You must remember the Bank Rate is not the concern of joint stock banks, but of the Bank of England and the Treasury.

3684. But you would expect it to have some effect?——*Mr. Robarts*: Yes.—*Mr. Tuke*: The difficulty is that we have not enough reserves of foreign currencies. If we had really handsome reserves we would not mind putting the Bank Rate down even though the balance of payments was against us.

3685. In the absence of these reserves we may have to think of other measures?——That becomes a very difficult problem.

3686. *Mr. Jones*: But we can have falling reserves and a substantial strength on the balance of payments?——*Mr. Tuke*: Because of speculation.—*Mr. Robarts*: Because of capital movements.—*Mr. Tuke*: Or perhaps because of over-investment.

3687. *Chairman*: There can undoubtedly be movements without speculation?——There can be investment in Central Africa or something like that, which we like to do, and which those countries expect us to do for them; or there may be speculation. In September, as I am sure you are aware, in fact the balance of payments was running in our favour, but it was against the tide of speculation.

3688. On this Bank Rate question, do I express your point of view, if I put it this way: if the action in September had merely consisted of raising the existing Bank Rate from 5 to 7 per cent. that would not have had any worthwhile effect in inducing money to come here because of the interest differential?——Agreed.

3689. Nor would it successfully have deterred borrowing from here because, assuming that the transaction was covered forward, a profit might still have been anticipated from the expected deterioration in sterling?——*Mr. Robarts*: The borrowing for genuine trade only would have been deterred, but speculation against the pound which took the form of borrowing with the intention of repaying it later in depreciated sterling would have gone on.

3690. Therefore in your view a rise in the Bank Rate under modern conditions, where a currency is under suspicion, cannot have any really remedial effect of itself, but it can be regarded at any rate outside as being a sign of other action by the authorities which may have an improving effect on confidence?——*Mr. Tuke*: "Cannot have any" might be an over-statement; but that is nearly so.—*Mr. Robarts*: I think that is just right. "Of itself", of course, is the point.

3691. *Professor Cairncross*: In the first part of your statement, Mr. Robarts, you were discussing the place of the finance houses and industrial bankers in competition with the commercial banks. Is it the position that normally the commercial banks make advances at rates of interest showing a fairly narrow spread between the lowest and highest rate quoted to customers?——Yes, it is a fairly narrow spread. The normal rate to the run of customers is 1 per cent. over Bank Rate with minimum of 5 per cent. Where there is virtually no element of risk the rate would be ½ per cent. over Bank Rate; and to the concerns having Treasury guarantee we lend at Bank Rate with a minimum of 3 per cent.

3692. That is a spread of 1 per cent.?——*Mr. Chesterfield*: That is a spread of 1 per cent. at the moment; but that is a minimum spread. When Bank Rate is at 3 per cent. or below the spread is 2 per cent.

3693. One effect of the rise in the Bank Rate has been to narrow the rates charged?——That is so.

3694. On one principle should you not all have a bigger spread in these conditions?——*Mr. Chesterfield*: I should like to.—*Mr. Robarts*: Yes, indeed.

3695. Does not this structure of rates imply that you take a view of the credit worthiness of projects put to you and decide whether to lend or not, and then look at the appropriate rate?——Yes.

3696. You do not, as some lenders might, offer one man a loan on more speculative terms at a high rate of interest, and another man a more gilt-edged loan at a much lower rate of interest, as would happen in the long term market?——The spread is not as big, certainly.

3697. Following that line of thought, would it be true that some of the industrial bankers might be catering for demands that you did not regard as credit-worthy, but which would be reasonable bank risks at much higher rates of interest than you would normally charge? Would it then be possible that some of these institutions would find a place in the British financial world even after the credit squeeze was over?——*Mr. Robarts*: To answer the last part of your question first, I think they would certainly find a permanent place in the financial system—*Mr. Tuke*: They were there before the squeeze started. —*Mr. Robarts*: As to whether they really take a view on the credit standing of different people and charge them different rates of interest, I really do not know, because I have never seen inside such an institution.

3698. Would you say that there are some clients to whom you refuse credit, but to whom you might be willing to give credit if you were charging them, let us say, twice the rate of interest which you normally charge?——That is not the way we conduct our affairs. A man is either credit-worthy or not credit-worthy; if he is credit-worthy he gets his accommodation (subject, of course, to the squeeze) on the terms I have stated.

3699. But I gathered yesterday that one banker may decide that a man is not credit-worthy, and his neighbour next door may decide not only that he is credit-worthy, but that he should take precedence over other clients at that bank. Is credit-worthiness such a chancy thing that one banker will say "yes" and another banker will not only say "no", but "no" very emphatically to the same request?——*Mr. Robarts*: I think so. When there was free competition in the lending field that was very frequently done. It is very much a matter for judgment as to what is credit-worthy. Anybody can say that big industrial companies, or a man who has a freehold house worth twice what he is going to borrow, are credit-worthy, but there are a great many marginal types of borrowing.—*Mr. Tuke*: It is a question of amount compared to the borrower's resources.

3700. You do not hedge your judgment by charging a rate of interest that may reflect your hesitations?——*Mr. Robarts*: Only within the limitations I have said, and they are pretty clearly defined.

3701. *Chairman*: I am afraid I do not know how far you expect to have completely satisfactory security for advances of this kind?——*Mr. Tuke*: Our best advances are unsecured. They depend on general credit-worthiness. If we need security that in itself implies a slight element of doubt.

3702. The floating charge is a sign of getting towards the margin?——Yes.

3703. *Professor Cairncross*: Have you any idea what proportion of your advances are secured?——*Mr. Robarts*: I do not know.

3704. Do you think it is a rising proportion or a falling proportion over the last ten years?——*Mr. Robarts*: I would say a rising proportion.—*Mr. Tuke*: When we make a bad debt, as we do sometimes, it is nearly always on an account which we thought was secured.

3705. *Chairman*: Now may we return to the point we bad reached last night? You were putting before us your view that the system of limiting advances by voluntary requests bad gone on too long and ought to be removed as soon as practicable. I raised the question of the conditions you envisaged as making it practicable to remove it, and you referred to the overall difficulty of the narrowness of our overseas reserves. Your paper itself was directed more particularly to the very large amount of Government floating debt in the banking system, which puts the banks in the position of being able to renew their liquidity when they want to. I was trying to get from you your views as to what alterations in conditions could be envisaged which could put you under coercion in regard to the amount of finance you supply, rather than leaving you subject to constant appeal. Can you take us any further on that, because it leads to the question of possible alternative techniques in control?——*Mr. Robarts*: One must go to the central point first of all: the sound conduct of Government finance. If we could be assured that the Government revenue and expenditure accounts both above and below the line would be at very least in balance and preferably show a surplus, then all these other conditions would come about. Since 1952-53 we have bad cumulative deficits on the revenue and expenditure account amounting to £1,273 million. All those deficts bave had to be financed by increasing the Government debt; there is no other way in which they can be met. If our finances had been differently run, and bad year by year shown an overall surplus, including both above and below the line, and the nationalised industries had been properly financed by long term borrowing outside the banking system, then our position would be very different. The floating debt would be much smaller; confidence in sterling would have been very much greater over the years; in my submission, our reserve position would be very much better; and the need for all these expedients like artificial compression of credit would have disappeared, or never have arisen.

3706. You would not modify your view on the increase in the national debt when so much expenditure has been made on long term investment? Is it not more a question of the nature of the public debt incurred?——I see the value of that suggestion; but unfortunately, taking it in financial terms, it does not matter very much. The money is spent, and unless that expenditure is covered by the receipt of revenue or savings or both, the effect will be inflationary. You can make a better case for building power stations than you can for spending the money on non-productive things, but the financial effect is much the same in the year.

3707. *Lord Harcourt*: If that proportion of the below-the-line deficit which represented an accretion of genuine financial assets had been wholly or partly financed by long term debt, would you think that that was satisfactory?——That would at any rate be a great deal better and, of course, could bave been done if a better balance in the national accounts had been achieved.

3708. *Professor Cairncross*: Why do you distinguish here between the practices of private industry and the practices of Government. In the case of private industry you would expect to see power stations financed by loans; why do you not expect Government power stations to be financed by loans? You are not suggesting that you would like to see private industry also financing all of its big investments out of profits and out of current revenue?——That would be extreme.

3709. That would seem to me to be implied in asking the Government to do in effect that?——I do not know that I have asked the Government to go as far as that. It is a question of the Government doing more or less what private industry does: financing part of its expenditure from retained profits and part by raising fresh long-term capital. What the Government has demonstrably done is to run at a deficit and cover that deficit by short term borrowing.

3710. *Chairman*: Your complaint is really of the volume of short term borrowing?——Which has been caused by the expenditures which have led to the inability of the Government to float a long term loan, because there is not sufficient confidence in the pound retaining its purchasing power.

3711. *Professor Cairncross*: It is not your feeling that no addition to the national debt would be proper in peace-time?——We used to think it was a very desirable thing to reduce the national debt.

3712. That was in a period when public investment was very low?——Yes; I think it would be almost an impossibility to do that now, when you bave to build capital assets to cope with new scientific processes and inventions.

3713. Would it not be true also that in the period you are thinking of the local authorities were incurring debt pretty freely for the purpose of adding to their physical assets; although the national debt might have been contracting in peace-time other forms of debt were rising quite rapidly?——*Mr. Robarts*: Certainly.—*Mr. Tuke*: Even though the Government covers this capital expenditure, which is desirable in itself, by long term loans it has to pay the interest on those loans. Some of these capital assets, such as the power stations which Professor Cairncross has quoted, earn their own keep as the expenditure of private enterprise is expected to earn its keep; but others do so only partially: for instance, housing earns about half its keep, the other half is subsidy. Where is the money going to come from? That is all promoting a considerable problem for the future from a financial point of view, unless it is covered by surplus in the Budget. Other Government expenditure does not begin to earn its keep; it may even require more money to be spent on it: take schools, hospitals, and things like that; the bigger and better they are the more you have to put in every year. You never take anything out of them.

3714. *Mr. Jones*: What would be the position if a substantial part of these deficits bad been covered by long term funded loans?——*Mr. Robarts*: It certainly would have been very much better; I have referred to the practical difficulties which have prevented that happening. The Government cannot float long term loans when there is not confidence that the purchasing power of sterling will be held.

3715. Is not a substantial part of this deficit below the line investment expenditure which is going to add substantially to the economic and industrial capacity of the country? To that extent it is well worth while incurring investment; are you taking that into account?——Very much so. But I maintain that a greater proportion of the national expenditure should have been covered by revenue and savings than has, in fact, happened.

3716. *Chairman*: Savings would be adequately represented by long term loans if they could have been floated?——Yes.

3717. The difficulty recently has been not the worthwhileness of the investment, but that of persuading people with a doubt about the purchasing power of money to invest in long term fixed interest securities?——Yes. We have seen that very recently: the latest Government loan which has just been floated matures in 1966. That is not very long.

3718. Was that not said to have been issued mainly for the benefit of the banking system?——We took some of it; I do not know bow much.

3719. *Mr. Woodcock*: Have you any estimate of what the long term rate of interest would have to be to achieve your objective?——I do not know; one simple answer is that 2½ per cent. Consols, an irredeemable security, are standing at under 50.

3720. *Chairman*: But under 50 in a market which, if I understand you, is still not enthusiastic about fixed interest investment over a long term?——No.

3721. *Professor Cairncross*: Is your solution to the problem that there should be funding somewhere or another as a substitute for the present system of controlling advances?——Not as a substitute necessarily. My opinion is this that, had the Government finances been run in such a way that they showed a balance or preferably a surplus since the war in each year, then all these artificial compressions of credit would have been unnecessary.

3722. Because the credit system would have been contracted?——Partly that; and we should have had all the things that go with a properly conducted economy: reserves would have been adequate, the Government would have been able also to fund on a longer term basis, and so on. In our submission many of our present difficulties would not then have arisen.

3723. Looking now forwards rather than backwards, your view would be that the policies to be pursued should be of this character; that the whole of the expenditure below the line should be covered by revenue?——By revenue or savings. "The whole" may be a counsel of perfection; at any rate a very much greater proportion than has been.

3724. Must not a substantial part of public investment even in the past have been covered by public revenue? The £1,273 million which you quoted looks very large, but it is less than is currently spent each year on public investment?——That is true. On the other hand, related to bank deposits of £6,000 million, for example, it is a large figure.

3725. When you say a substantial proportion of investment expenditure should be covered by revenue, how much are you thinking? Are you prepared to say 100 per cent.?——*Mr. Tuke*: I think the ideal is that in the Budget out-turn (not estimate) revenue should cover expenditure both above and below the line.

3726. *Mr. Jones*: Would that make provision for new investment?——It covers the whole of the investment which the Government is financing.

3727. And the public liquidity?——Yes.

3728. *Professor Cairncross*: Supposing this were done, how much longer do you think it would be before the banks were put into a position where they were obliged to control their advances "under coercion"?——Let us make the utopian assumption that the Government has no debt maturing in 1958 nor 1959; that takes us on to the 2 per cent. Exchequer Stock 1960, which is standing at 94 today. If the Government could squeeze us, we should not be very keen to sell stock at 94 to finance ourselves; if the object was to make us pull in our advances, I think it would have that effect. But the position is bedevilled, from the Government's point of view, that there is a constantly maturing debt every year.

3729. But do you think you are as near as that to having a look at your advances rather carefully?——One cannot envisage that happening at this moment, but if one makes all sorts of assumptions about the past we could not be sure. Our object in managing our affairs is to have securities maturing every year. We have been, up till now, safe up to 1965; we have now got the new 1966 Stock, and the next years after that are all right, so we are sitting pretty.

3730. Taking a more realistic view of what is likely to happen, would you still tend to rely on a Budget that covered outgoings both above and below the line as a means of bringing things round to the position to which you wish to get?——I think the Government would then have complete control of the situation, and if they wanted to expand or curtail credit they would know how to do it.

3731. If you assume that these securities are coming on the market for redemption, and therefore that it will be some time before you would have to think twice about making additional advances, are you prepared to look forward to a continuing freeze of bank advances?——The first requirement is that the Government should stop increasing the amount of the floating debt, by having a Budget surplus. When it has done that, confidence, I should think, would be restored both at home and abroad. At home there would be a rising market in gilt edged, and they will be able to do their funding operations through the market, not necessarily by new issues but by letting out the stuff that they have in the departments and taking cash and liquid assets off the market by that means. That would immediately give them control; greater confidence overseas would lead the foreigner to have a better view of sterling, and our gold and dollar reserves would improve.

3732. Only at the cost presumably of an increase in foreign liabilities?——Certainly.

3733. *Chairman*: You feel that some very strong measure is required in the present situation to restore confidence that may lead to funding. It would be probably too extreme that every year one should look, in the kind of expanding economy in which we live, for the Budget to cover expenditure both above and below the line; but there will be some years where you think that something like that is necessary?——In conditions of recession in trade one would expect cheaper money, and a Budget deficit would be the means of correcting it, subject always to having sufficient gold and dollar reserves to stand that.

3734. *Mr. Woodcock*: How would you achieve this balance of the Budget? Would you do it by increasing taxation?——I should hate to say "yes" to that. It might be necessary; rather than not get the balance I would say "yes"; but I want the Government to reduce their expenditure.

3735. *Sir Oliver Franks*: Suppose that the Government balances its budget above and below the line, as you were pre-supposing for the sake of argument, and suppose also that the general conditions which you have described come into force; that the reserves go up, there is more confidence abroad in sterling, and so on; I think that Professor Cairncross was saying that there was still this difficulty in his mind. As we stand at the moment the clearing banks have rather more than 30 per cent. in liquid assets, rather more than 30 per cent. in investments, rather less than 30 per cent. lent. Most or all of the clearing banks have annual maturities coming in. It might be possible for the clearing banks as a whole to keep their liquidity on or above the 30 per cent. mark and use the maturities which come in year by year to put their advances up, so that the time at which the Government would be in a position of its own decision either to relax or to restrain credit would be deferred by the length of the rope which these successive maturities give. It would appear that for a period of years the clearing banks could go on increasing their advances at the expense of their investments without loss to themselves because investments mature period by period. I think that Professor Cairncross was asking whether this argument was right and, if so, what answers should be given on the question of these artificial restrictions of credit in force?——Does not the answer depend on the success of funding operations? If they are really substantial they will take a lot of our cash away from us, which we shall have to replenish somehow, and these annual maturities of £20 million or so will not be sufficient for the purpose.

3736. *Professor Cairncross*: Can one visualise funding operations on the scale that this would require in any conceivable period of years?——Leaving aside Budget surpluses, small savings and that sort of thing, there is an immense amount of saving in the private sector: insurance payments, pension fund payments and so forth. I think I have seen a figure for that of £1,500 million in the past year. If a substantial part of the owners of that £1,500 million in one year thought that Government securities were a good thing to buy this funding could go pretty far.

3737. Do you think that Government securities are going to look like bargains in a reasonable time? From what has been said do you think this will occur?——*Mr. Tuke*: If only people had confidence, they are very cheap today.—*Mr. Robarts*: That is demonstrated by the fact that they have risen since the September crisis. As confidence has improved, they have gone up. There is one point that I should like to make on this. If the Government could fund a lot of the existing Treasury Bills into long term indebtedness, that would immediately have an effect on us. The fact that there is a maturity every year for ten years to some extent weakens that, but the maturities are not all that big; most of them are round about £500 or £600 millions, and they are not all held by the banks by any means. If a big Treasury Bill funding operation could be done, the Government would have gone quite a long way down the path to their objective. I do not know whether my colleagues would agree or disagree because it is very much a question of opinion.—*Mr. Tuke*: It would not meet the case for the banks to exchange their Treasury Bills for some longer, but not really long, loan. It must be a genuine long-term funding outside the banks. But investors are rather like sheep: they rush from one side to the other; if they once get in the mood for buying Government securities they would buy a lot in a short time.

3738. It is a very long time since the commercial banks have been in a position where they had to restrict their advances on the grounds of liquidity, and it may be difficult to visualise how the system functioned then, and whether it was quite as satisfactory as we now think it must have been. You have at present a convention

governing the relationship of your liquid assets to deposits; the convention is that that ratio should be 30 per cent.?——*Mr. Robarts*: Yes, about that.

3739. Is this a firm convention, or is this simply something that has come to be accepted because the Bank of England favours it?——It has gradually developed; I do not think that there is anything sacrosanct about it. We have to aim at a percentage, and we aim at that.

3740. Suppose you were under pressure from your customers to grant additional advances, and the granting of advances would involve your going below 30 per cent. If there were no understanding with the Bank of England, would you say simply to the Bank that you felt obliged to reduce your liquid assets?——We should sell investments.

3741. Let us assume that investments would not be sold because the investment market might be in a condition in which you would not want to sell?——*Mr. Robarts*: Yes, you can get those conditions; then I think we would feel that with a really justifiable advance which would stand any test, we could go below 30 per cent.—*Mr. Tuke*: Especially in March.—*Mr. Robarts*: Certainly; liquidity piles up in the Autumn and falls in early Spring; one has to make allowances for that.

3742. Would you state a figure, for the degree to which you would be prepared to go below?——I myself would not want to go very much below; having been brought up to this sort of idea I may be prejudiced towards it. When I got to towards 25 per cent. I should want to do something. Would you say that was fair, Mr. Chesterfield?——*Mr. Chesterfield*: Yes, I would, indeed.

3743. Would you have ideal conditions you wanted to observe in regard to investments?——*Mr. Robarts*: The investment percentage is of secondary consideration to our advance percentage. Our real business is advances, and we really invest the money that we cannot or do not want to lend.

3744. But there would be a broad limit to the proportion you would want to lend on advances?—*Chairman*: I think you have said that they could rise to 50?——*Mr. Robarts*: 50 to 55 per cent. In my early youth in banking I can remember my seniors being disturbed when their advances got towards 50 per cent.—*Mr. Tuke*: We have to have some investments. There are three lines of defence: cash is the first line, other liquid assets the second, and the third is the reinforcement of our cash which we hope we achieve automatically by these yearly maturities. We would not want to lend the whole of the 70 per cent. of non-liquid assets; therefore we must have some investments. I was brought up to the theory that ideally advances swing between 45 and 50 per cent. and investments between 25 and 20 per cent.

3745. *Mr. Woodcock*: You were brought up with that theory; do you have to accept it just as it is? Do you, as bankers, look at these conventions? Are they under constant review?——They are not practical politics today; if there were no injunctions from the Treasury I do not think we could lend 45 per cent. today.

3746. *Chairman*: How long ago is it since you were really up against this as a practical proposition?——*Mr. Robarts*: Not since we left the gold standard.—*Mr. Tuke*: Since then there was for a very long period the policy of cheap and plentiful money.

3747. *Professor Cairncross*: Your advances have been limited since the war not by these conventions, and not by the demand for advances, so much as by Government directives?——*Mr. Robarts*: That is true.—*Mr. Tuke*: Even without Government directives they would not reach 45 per cent. today, but they would be higher than they are.

3748. I am trying to see how the Government could operate on the banking system if they wanted to see advances restricted below the level they have reached. At present they operate through the imposition of a ceiling. You are putting to us that there might be some alternative arrangement, under which you were regulated by your liquidity ratio and, presumably, also by the ratio you wish to preserve between investments and advances. If we were trying to get back to that kind of situation, as you have put it to us, the Government could not necessarily count on 30 per cent. as a firm basis of operation, since if you were being guided only by your own situation you would be prepared to go below 30 per cent., possibly as low as 25 per cent.?——*Mr. Robarts*: 25 per cent. would be quite exceptional; I quoted it as the lowest figure.—*Mr. Tuke*: We could not possibly allow ourselves to be 25 per cent. on 1st January.—*Mr. Robarts*: It would only be a very temporary thing. We do temporarily go below 30 per cent. now; but only for a short time.

3749. Would you agree that it would be a necessary part of the system that you have in mind that there should be a strong convention about the liquidity ratio; one you were expected to abide by, whether it was statutory or mainly an understanding?——The 30 per cent. is so well understood in banking that we always try and keep around that. As a matter of fact we are somewhat more liquid now than usual.

3750. *Mr. Woodcock*: You say that you have not been under pressure since 1931?——Our advance ratio has not; the world has just not worked that way. Up to the war business in this country was at a lower level than it was in the late 'twenties.

3751. You made a statement that you believe in free competition; I think it is fair to see how far free competition will take you if you take Professor Cairncross's assumptions. Given those conditions, what do you think would happen to the present ratios? Are you convinced that they are for all time, that they are so implicit in the system of banking that you support and believe in that they would remain whatever the external pressures?——Our first duty is to be able to repay our deposits, so that people may have their money whenever they want it. In order to do that we have to keep a section of our assets in liquid form. I think we should always try and keep it around 30 per cent., but I would not say that 30 should be regarded as an absolutely sacrosanct figure. We must have a little elasticity.

3752. What degree of elasticity? Is the 25 per cent. very low?——That would be an extremely low level. If it got to that level we should immediately do something to bring it up again; it would only be there for a day or two.

3753. *Professor Cairncross*: If you were under pressure from your clients to lend more to them and your liquidity ratio was falling below 30 per cent., you would be inhibited from lending because, if the ratio fell below 30 per cent. the monetary authorities would put it to you that you were falling below the recognised ratio?——If you are assuming in this that we cannot sell securities, then I think we should have to curtail our lendings.

3754. You would abide by the conventional ratio?——*Mr. Robarts*. We might be a little elastic, as I say, but, by and large, it would have a restricting effect upon us. Would you agree, Mr. Tuke?—*Mr. Tuke*: Certainly. The Committee should know that, even in conditions of complete freedom from official requests and that sort of thing, we are in fairly constant touch with the Bank of England, and we listen with great care to what the Governor says to us at any time. He might give us a hint and we should not be likely to ignore it. We might even be asked to be especially liquid.

3755. *Sir Oliver Franks*: I think this is partly a matter of definition of terms; and there may be something of history in it. I imagine that, if one goes back to the era of private banking, a small private bank had a more absolute necessity to be 30 per cent. liquid than one of the joint stock banks now; there is rather more freedom for manoeuvre with these very large companies than could possibly have existed with the small ones?——Yes.

3756. From that point of view the 30 per cent. liquidity ratio becomes to some extent a convention rather than a necessity and therefore, looking at it simply from the banker's point of view, some variation above and below it is possible with safety in the present banking system. But if one is looking for a means of the Government being able to restrict credit, if it wishes to, without having to resort to the existing "artificial" measures, then I think a further question arises: whether from that point of view you have to have certain rules of the game within which the banks operate, and whether then there is a case for the 30 per cent. ratio taking on a stricter aspect than it would if it were simply being regarded from the point of view of prudent banking in terms of the modern joint stock banks. If a large variation below the 30 per

cent. was compatible with banking practice, and if the Government was trying to restrict credit by classical means, the existence of a large margin could mean that quite a lot of time would elapse before its policy paid; it might be unable to restrain advances as quickly as it wished. I think that these are the thoughts in Professor Cairncross's mind when he is trying to distinguish between the elements of necessity and convention in the 30 per cent. ratio as we observe it today?——*Mr. Tuke*: There is certainly a great element of convention. The difficulty about having any firm arrangement, either by law or by custom, about the 30 per cent., is that you would have always to have over 30 per cent. of liquidity; you could never do otherwise. It is much better to have a general understanding such as we have today; and it is, in fact, observed.

3757. *Professor Cairncross*: Do you receive communications from the Government from time to time, saying that they do not think 30 per cent. enough in present circumstances, but that it should be a higher ratio, since in that way they can exercise a restraining influence on credit?——Unless they give us very long notice to correct the position, we can only sell securities.

3758. *Chairman*: If the Government introduced a regular rule to correct the situation, that you must from now onwards be 40 per cent. liquid, and liquidity was defined, you would have to take action; there would be no room for play. The action you would have to take in those circumstances would be to sell the securities required to correct the position, as you say in your memorandum in your answer to Question 4 (e)?——That is correct. If we had to correct the position quickly through calling in advances, we should push people into bankruptcy. We do make the point that, if the Government wanted to alter the liquidity ratio from 30 per cent. to something else, it would be very difficult to do; it would only be done gradually. We should want a year's notice; and the authorities would want to do it much quicker.

3759. The possible alternative of calling in some of your loans would, you say, produce a major embarrassment to the people relying on the credit; the other alternative is to turn to investments. That means that you have to sell those on a fairly large scale on the gilt edged market. The result would be that you would flood the market, and the long term rate of interest would go up a long way; perhaps they would become unsaleable?——Yes.

3760. *Professor Cairncross*: You are visualising as a method of control of bank advances a system under which the Government seeks to reduce bank holdings of liquid assets of one kind or another. Possibly the action the Government takes may lead you to try to sell investments, which is a way of maintaining your advances. But the Government can only be successful in its action if it succeeds in reducing the liquid assets held by the banks. That would seem to me to be, in present circumstances, a rather circuitous technique; one that might not be very effective if the Government's own short-term borrowing requirements did not respond at the same time. Might it not be necessary to think of some other more direct method of operating on liquid assets?——If the Government carries out successful funding operations, that reduces our deposits. We lose 100 per cent. cash, and our liquidity is affected very intensively.

3761. Are not there serious difficulties about funding in the short term?——*Mr. Tuke*: I think if the Government would only have a Budget surplus, confidence would be restored, and, their securities at present prices being very cheap, people would buy them and go on buying them.——*Mr. Robarts*: That would make funding very much easier; you would have a rising market to do it on. There is one thing to remember when talking about bank advances: we cannot cause bank advances to rise to suit ourselves; we have got to have demands from creditworthy borrowers. Whether or not those demands come about depends on the whole of the economic climate of the day.

3762. The situation we were discussing was one where you were being asked to refuse more demands for accommodation, not one in which you were being asked to reduce your standards of creditworthiness, or seek to find new lines of business or attract additional borrowers; and the issue is, in part, whether the Government can, at the existing ratios, look forward to a situation in which you would of your own volition be disinclined to grant advances?——I think Mr. Tuke hit the nail on the head: if the Government had a substantial and successful funding operation outside the banking system, they would have the situation you want.

3763. That would be necessary every time the Government wanted to restrict advances?——If they could fund short term debt, and did not go on increasing it through Government deficits, they would remain in that position, and open market operations, by which I mean purchases and sales of bonds and Bills through the Bank of England, would have a very direct and quick effect on us.

3764. Only if you got somebody else to hold the Bills. If the supply of Treasury Bills is inelastic, somebody has to hold them?——*Mr. Tuke*: In the last resort the Bank of England takes them. We call upon the bill brokers, and the bill brokers have the right to take them to the Bank of England.

3765. Open market operations are unsuccessful unless these Bills are issued to somebody else?—*Chairman*: I was not sure whether you were accepting the assumption that the supply of short-term Bills was inelastic?——*Mr. Tuke*: There is such a number of factors which influence the supply of Treasury Bills; for instance, the rise and fall of gold and dollar reserves; in these recent months when we were losing gold and dollars, that reduced the amount of Treasury Bills. It is difficult to say that one particular state of affairs is decisive.—*Mr. Robarts*: The one thing quite certain to increase it is a deficit on the national accounts.

3766. *Professor Cairncross*: You do not feel that anything should be devised now, that would be of a temporary character, to replace the present method of restricting bank advances. You would rather continue as we are, moving towards an arrangement in which the Government would operate by "coercion" on the liquid assets ratio?——*Mr. Robarts*: The answer to that question is definitely yes.—*Mr. Chesterfield*: I believe it is much more possible than this discussion has indicated. If the Government were to have an overall balance on its Budget accounts and fund a large part of its Treasury Bill issue outside the banks, that would reduce our deposits, and reduce our ability to make advances. In point of fact, in the last fortnight or so there has been a very noticeable buying of long-dated Government securities, and I would think that the conditions are much more favourable in that respect than the discussions this morning would have led an outsider to believe.—*Mr. Roberts*: It is, I think, a perfectly practicable conclusion.

3767. *Chairman*: That the Government should in its next Budget cover the deficit below the line?——*Mr. Chesterfield*: I think it must do, in the absence of genuine savings.—*Mr. Tuke*: If it did so these other things would flow from it; an overall Budget balance is the first condition.

3768. *Sir John Woods*: You think a funding operation of Treasury Bills outside the banking system would then become a feasible operation?——A gradual funding through the market; not a particular issue on a particular day.

3769. *Chairman*: Does that mean that, given the Budget you envisage, there is enough long-term stock in the Issue Department of the Bank of England today to be successfully got rid of during the next year in exchange for short-term debt and thereby to reduce the existing floating debt?——They generally seem to have quite a lot, but they can always replace it.

3770. You are envisaging a large scale issue of a ten or fifteen year stock?——*Mr. Tuke*: Yes, or longer; the Government themselves could take the bulk of it on the day of issue and then peddle it out; I think in modern times that is the way this funding happens.—*Mr. Chesterfield*: I believe that has happened in recent weeks in what is known as the "Eternity" $3\frac{1}{2}$ per cent. Funding Stock; it is very much more difficult to acquire than it was. The Government has been "peddling" it out, and there have been very substantial buyers in the market.

3771. What kind of investor would take these?——*Mr. Chesterfield*: The insurance companies, which, of course, represent genuine savings of people in life policies and the

like; provident funds, and all these people who generally think that, given a Budget with a surplus, the conditions for long-term gilt-edged securities are better than they have been for some years past. There are a lot of those people about today.—*Mr. Robarts*: If you have a rising market in anything it is much more easy to operate. It is not difficult to get a rising market from the present low levels; and if you can get a market where you are getting a rise of one point regularly (which is what has been happening lately) you can begin to sell stock or float a loan.

3772. *Mr. Woodcock*: What would be the effect on the level of total investment of this situation which you envisage?——*Mr. Tuke*: New savings would be going into Government securities instead of into industrials. There would perhaps be less money available for industrial investment.

3773. How much less?——It is impossible to say; it would be less by the extra amount that went into Government securities. Going back to this, I think, rather unreal figure of £1,500 million personal savings in the year, if £500 million of that went into Government securities in 1958, that would be quite a substantial amount.

3774. Would that ease your position?——No, it would ease the country's position. It would make ours more difficult, but we say it ought to be done.

3775. What contribution would it make to the problem of your position?——It would make it easier for the Government to get their hands round our throat.

3776. How much easier?——*Mr. Chesterfield*: By that amount; it would be a cumulative thing.

3777. Is it not all coming back to the question put by Professor Cairncross: that would have to be done, and at the same time the Government would have to maintain these restrictions?——For a time; we do not deny that.

3778. *Professor Cairncross*: You have laid a lot of stress on increasing the volume of the reserves. I take it you would be willing to see a substantial investment in these reserves. Would not that investment almost inevitably be financed by the issue of Treasury Bills, and would not that increase the degree of liquidity of the market again? When you are talking of funding, have you taken this into account?——*Mr. Robarts*: It would operate in that direction; but funding operations, if big enough, could take care of that and a lot of existing Treasury Bills too.

3779. The operation would have to be pretty big?——Yes, it would, because there are a lot of Treasury Bills. But, after all, a funding operation of £2,000 million was done when 5 per cent. War Loan was converted; and money then was very much more valuable than it is now. I should have thought a very big funding operation could be undertaken, given the right background conditions.

3780. You are thinking much more of the conversion of short into long than a reduction in Treasury Bills?——That is what I am thinking of.

3781. *Chairman*: In your answer to Question 4 (*e*) in the memorandum you speak of the possibility of compulsory control of liquidity ratios. There could be a great many alternative forms of possible compulsory control directed at the private sector as represented by the banks. We have covered a good deal on this particular one; another one you had in war-time was the Treasury Deposit Receipt. How would you compare that in its advantages and disadvantages with your compulsory liquidity ratio?——The real drawback to Treasury Deposit Receipts was that they were unmarketable. Of course they were rediscountable at the Bank of England; but I understand that was only done on one occasion, and was not encouraged at all. I think all our assets, other than our loans, ought to be in readily marketable form.

3782. *Professor Cairncross*: Would not that destroy the whole point of the operation? The aim of the Treasury Deposit Receipt system would be to freeze some of your liquid assets?——*Mr. Robarts*: Our assets should be in marketable form; that is my main objection, although there are others, to Treasury Deposit Receipts.—*Mr. Tuke*: We want to be able to turn them into cash to meet demands from our depositors.

3783. Supposing the Government takes the view that you are too liquid in relation to the outstanding level of deposits or bank advances, and seeks to operate on your liquidity position; is not this an effective way of doing so?——*Mr. Robarts*: It would certainly have that effect, as it did during the war, because Treasury Deposit Receipts were not counted as liquid assets.

3784. You would rather have your bank deposits lower than have this form of control?——*Mr. Robarts*: Provided the present circumstances can genuinely be regarded as temporary, and provided we see our way out of it on the lines which we have been discussing, I myself would rather go on as we are.—*Mr. Tuke*: Yes; and if I had to choose between the liquidity ratio being put up to 35 per cent., or having to have 5 per cent. in T.D.R., I would sooner have the 35 per cent. liquidity ratio, because what I held for the extra 5 per cent. I could turn into cash if I had to.—*Mr. Chesterfield*: We dislike Treasury Deposit Receipts very much, because we do not think it right that our customers' money should be put into something over which we have virtually no control at all. Might I ask a question: why should the authorities think we were "excessively" liquid? The only fear could be that we should rush off and make a lot of advances which would destroy the economy; but that has not been the case. Our relations with the Treasury through the Bank of England have been such that, though we have continued to be "excessively" liquid for a long time, we have not rushed off and made countless advances, and advances we should not make.

3785. *Chairman*: That may take us a little in a circle. At the moment it is thought to be necessary that you should be restrained in making advances by a number of requests which are expected to have effect. This discussion is only on the basis on which you have made your case, that this is not a good system; and the question is whether something, more palatable possibly, directed towards the same end could be substituted for it?——I would put Treasury Deposit Receipts last in the queue. We all dislike them.

3786. *Mr. Jones*: You are saying that the banking system is being made excessively liquid in consequence of the tremendous volume of Treasury Bills that are available at this time; is there any reason why some proportion of those Treasury Bills should not be converted into Treasury Deposit Receipts?——Except, as we have said, we do not like Treasury Deposit Receipts, because they are a means of putting our customers' money into non-liquid assets, virtually outside our control.

3787. *Professor Cairncross*: Would you see the same objection to a system such as exists in Australia, under which you were obliged from time to time to make deposits, say, at the Bank of England?——*Mr. Robarts*: It is the same thing in a way. In Australia, as I understand it, they have what they call special accounts into which certain sums can be put by the banks, and those special accounts do not count as liquid assets; and if a bank has to have money it can borrow at a penal rate against those accounts. I would say that that is just yet another expedient, that all these expedients are undesirable, and that if Government finance is properly conducted they are unnecessary.

3788. *Mr. Jones*: Are you saying that the operation of a system like this in the present financial circumstances would militate substantially against the interests of the depositors of the banks, and that there should be no controls in this particular field? Are you saying that this would be exercising an unfair control upon the depositors of the banks?——Rather upon the banks; and the wrong sort of control. I would agree with Mr. Tuke in preferring the higher liquidity ratio to Treasury Deposit Receipts.

3789 *Mr. Jones*: Would not the outcome of that be that, if you called in some of your advances, you would give an impetus to recession in industry?——*Mr. Robarts*: In practice we should first sell securities to restore our liquidity ratios. It is very rare to find a time when one cannot sell any gilt-edged securities at all; it has happened, but not for very long, and very rarely. Next, after we had sold all we thought we should, we should restrict new advances; and after that we should try and get reductions in existing advances, but only reductions; we should not say to a customer "You owe us so many

thousand pounds, and you must pay it all off tomorrow". We have the legal right to do so, but we would not do that in practice.

3790. *Sir John Woods*: May I go back to the idea of the special deposit account? As I understand it, it seemed different in one important respect from the Treasury Deposit Receipt. That used to work regularly week by week; as I understood the other device it would be an intermittent device which would only be brought into operation at a time when the authorities thought there was excess liquidity in the system which needed correcting. So it would be different from the T.D.R., and in a sense different from the present system of an absolute ceiling on advances which operated the whole time. Is not that a material difference?——*Mr. Tuke*: T.D.R.s need not operate continuously if they are not needed. They did during the war, because there was Government borrowing to conduct the war; it was meant to mop up our excess liquidity, and as long as the war continued that state of affairs continued.

3791. This other device could be brought into effect at a particular time when it appeared to be necessary. I wondered whether you might regard it as an acceptable alternative to the present system?——*Mr. Tuke*: I do not know whether, if there was a special account at the Bank of England, we should be allowed to draw the whole of it out on one day without notice. Treasury Deposit Receipts were fixed for six months; there was something coming in every week, but they were at six months' maturity.—*Mr. Chesterfield*: With the right to discount only under penalty.—*Mr. Tuke*: Yes, but in the ordinary course they would take six months to run off.

3792. *Chairman*: I do not think the assumption of those who have considered the special account is that you could call the account on short notice or at your own will?——I do not think we could call it; but if the Government suddenly thought we ought to have this money, they could give it to us at one time. The economy does not change its character overnight, and that would not be likely to happen. I suppose they would peddle it out gradually over a period of six months, and in practice it would be just like bringing T.D.R.s to an end. But I have never had experience of it.

3793. Do I understand that under the Australian system the depositing bank can call on its account, but subject to paying a penalty?——*Mr. Robarts*: It can borrow against it, but I am afraid I do not know enough about it to know exactly what the controls on borrowing against it are. There is a penal rate, but whether the bank can borrow the whole amount on deposit I do not know. It would easily be verifiable.

3794. *Sir John Woods*: Have the clearing banks ever been called in to consultation either by the Bank of England or the Treasury as to their views about possible alternatives to the existing system of controlling the banks?——*Mr. Tuke*: Not as far as I know.

3795. *Professor Cairncross*: May we ask what your relations are with the monetary authorities? It would be useful to us if you could tell us on what occasions and for what purposes you see the Governor of the Bank of England, or any other member of the Court of Governors of the Bank?——*Mr. Robarts*: What happens is this. The Governor of the Bank of England and the Chairman and Deputy Chairman of the Committee of London Clearing Banks of the day are in very close and continual touch. When the Governor has anything he wishes to impart to the banking system, he asks the Chairman or Deputy Chairman of the Committee of London Clearing Banks to go and see him; the Deputy Governor may or may not also be present. We have an absolutely frank talk about whatever it is and discuss it, as we did freely and frequently before the intensification of the credit squeeze in September. We are not, of course, consulted about a change in the Bank Rate; that is not our affair; but we are consulted very closely about any such scheme as was announced by Mr. Thorneycroft in September. We have to see whether what we are asked to do is feasible from our point of view. If it is not, we have to make representations accordingly; we arrive at an arrangement which we feel we can carry out, and then we undertake to do so.

3796. *Mr. Woodcock*: That was the request to you to limit your advances to the level of the previous twelve months. Did your discussions cover the other matters dealt with by Mr. Thorneycroft in September, apart from the Bank Rate?——Not that I can recall. They centred round the various formulae which were being considered for restricting bank advances: what the formula should be and whether we could conscientiously say that we could carry it out.

3797. Did you discuss the decision to limit Government expenditure?——That was certainly told us by the Chancellor when we saw him about a week before the rise in the Bank Rate. I cannot remember whether, or in what detail, I discussed that with the Governor. I am quite sure I said it was vitally important that something on those lines should be done, because just a holding of bank advances without any assistance on the Government side would not take us very far.

3798. Did you discuss the decision to limit the borrowing of the nationalised industries?——I do not think we did. In times gone by we have had many discussions on the borrowing of the nationalised industries. I cannot remember discussing it in September. On a previous occasion when it was decided to change the whole system of borrowings for the nationalised industries, so that instead of borrowing from us they were to be financed by the Government and were just to borrow from us what you might call working capital, that was all fully discussed.

3799. *Chairman*: So the discussion at these meetings arises primarily out of something the Governor wants the banks as an institution to do; in that case out of the proposal that you should limit your advances to the same average level as in the previous twelve months?——*Mr. Tuke*: It is the manner of carrying out what they want done, and not whether it should be done or not.—*Mr. Robarts*: It is a limited form of consultation on the practicable means of putting through Government policy. There were other ideas; for instance, a fixed limit to advances at their then existing figure. That of course would be very inelastic. Those were the sort of discussions.

3800. *Professor Cairncross*: They were exclusively with the Chairman and Deputy Chairman of the Committee?——Yes, but I would not go very far without calling a meeting of the clearing bankers and telling them how we were getting on.

3801. There was no direct contact with the rest of the Committee?——We were all asked to come and see the Chancellor; he explained what he was trying to do, and we had a large number of meetings with the Governor and the Chancellor as to how we should do it.—*Mr. Tuke*: I was not there so I can only give hearsay evidence. I was told that the Chancellor said: "I am going to do this and that, and I want you to do so-and-so"; and the discussions centred around how that so-and-so should be done, and not as to whether it was right to do this or that in the national interest. That was already decided, and we were not permitted to comment on it. We might have said that it was not enough.

3802. *Mr. Woodcock*: You did discuss these with the Chancellor as well?——*Mr. Robarts*: On this occasion we did.

3803. *Professor Cairncross*: Is there any contact between the officials of the clearing banks and the officials of the Treasury or the Bank of England?——*Mr. Robarts*: With the Bank of England continually. I would like Mr. Chesterfield to enlarge on that, as the Chairman of the Committee of Chief Executive Officers of the Clearing Banks.—*Mr. Chesterfield*: There is a very close contact with the Bank of England. Following on the conversations which the Chairman and Deputy Chairman have with the Governor, there would be a lot of executive decisions to be taken as to bow the decision of the Chancellor was to be put into effect. Those would be decided between the Chief Executive Officers of the banks meeting together, and then I would go to see the Chief Cashier.

3804. These are all on operational matters?——Yes, except that there is a regular contact between the Chief Executive Officers of the banks individually and the Executive Directors of the Bank of England, for example, in regard to our monthly published figures. They will ask us to go and explain variations in the figures to them.

3805. In that case the business discussed is exclusively the affair of the commercial bank itself; there is no comparison of notes on the general economic situation of the

country?——Periodic reports are made by each of the Chief Executive Officers of the banks to the Chief Cashier, as a result of inquiries sent out to branches, covering different areas of the country.

3806. Reports involving a visit to the Bank of England, or in the form of a document?——Normally in the form of a document, though I have known it that we have been called over afterwards to discuss certain aspects of it.

3807. The personal contacts are limited, and confined to operational matters?——Yes, Sir, and as to the result of the efforts we are making, or not making, as they think, to comply with Government policy.

3808. How often do you set foot in the Bank of England, Mr. Chesterfield; frequently?——Yes. I would say over the last ten years once a month perhaps. But there are frequent telephone calls as well on all sorts of matters: the fiduciary issue, whether we are holding too many notes, and all kinds of things.

3809. Would you have any contact with the Treasury?——I do have informal meetings with members of the Treasury, but normally there is not direct contact from the Treasury to the banks; it is normally always through the medium of the Bank of England.

3810. *Chairman*: Is that the same for you Mr. Robarts?——*Mr. Robarts*: Yes; contact is normally through the Bank of England. I know a number of Treasury officials and we discuss matters, but I would only very rarely pay a formal visit to the Treasury, and then at the request, probably, of the Chancellor of the Exchequer of the day.

3811. *Mr. Woodcock*: What is a formal visit?——When I go there by appointment to see the Chancellor and he wants to discuss some special matter, as, for example, the matters last September.

3812. What is an informal occasion?——If I were to meet socially, as I sometimes do, some of the higher officials of the Treasury, they might very well discuss the economic situation of the day, just as a matter of interest.

3813. That would not get from you to your colleagues, except by similar accidental meetings?——No, such casual meetings would be of no importance.

3814. *Chairman*: There is no system of contact under which the monetary authorities in Whitehall draw upon the bankers for their experience, or consult with them about the economic situation?——That is done through the Governor of the Bank of England. The Governor has frequently asked me to go and see him, and has asked me, for example, how I think the credit squeeze is getting on, and whether it is having the desired effect on the industry of the country.

3815. *Mr. Woodcock*: Are you satisfied that you can properly do the things you are expected to do simply by contact or knowledge such as is actually given to you through the Bank of England?——I am completely satisfied with the system; I think it is the best possible. Our relations with the Bank of England are such that when the Governor asks us to do something, all we do, having agreed that we can do it, is to think of the best way in which we can do it, and adopt a certain machinery to see that we then use our best endeavours to carry that through; as can be seen from the operation of the credit squeeze.

3816. Are you satisfied that the Treasury know the views that you have expressed this morning about the directions that are given, and the general policy of the directions?——I do not think there is any doubt that the Governor passes on our views with complete accuracy to the Treasury, and vice versa from the Treasury to us.

3817. *Chairman*: We are not asking about personalities in this, of course, Mr. Robarts.——I appreciate that. We do make it our business, of course, to know the Governor and the Deputy Governor, because it makes business so much easier.

3818. *Mr. Woodcock*: In the same way, any representations you have to make about these things would have to go through the Bank of England, and would not go direct to the Chancellor.——That normally is so. The only time it would go directly from us to the Chancellor is if the Chancellor sent for us to a formal meeting at the Treasury; then we would give him our formal views. In that case the Governor would certainly be there.

3819. *Chairman*: Regarding this as an institutional arrangement, and trying to see the advantages and the disadvantages, I am not clear why this idea of using the Governor as a vehicle both ways, from the monetary authorities to you, and from you to the monetary authorities, is regarded as the best way?——*Mr. Robarts*: Owing to his position the Governor of the day knows the two sides: he knows the Treasury side of the business and he knows the City side. I think it is very important that there should be someone who can interpret the Treasury's views to the City, on the basis on which we can really follow them, and see what we are supposed to do, and vice versa. He has that peculiar and unique position which we do not have. We know very little about what goes on in the Treasury.—*Mr. Tuke*: This applies not only to the banks, but to all sorts of other organisations in the City.

3820. It seems clear that the Government regard the clearing banks as of special importance?——*Mr. Robarts*: I should think so, yes.

3821. You know very little about what goes on in the Treasury. Having regard to the importance of your position, would there not be an advantage in a more regular contact on a wider scale?——When I say we know very little of what goes on in the Treasury, I would say that it is not our business to understand the workings of the Treasury, and I do not think that any great advantage would be achieved by making visits to the Treasury. I think it is really better that the Governor should, as I say, interpret to us what he is told.

3822. *Professor Cairncross*: The views you have expressed today are all, in large measure, about fiscal policy rather than monetary policy; and that is a matter for the Treasury?——Fiscal policy is a matter for the Treasury; but of course we can comment upon it.

3823. *Mr. Woodcock*: Where can you comment upon it?——*Mr. Robarts*: In our Chairman's speeches, if we wish to do so; or we can go to the Governor of the Bank of England, if we wish to do so. Not that I think our views would get us very far; quite clearly the Government makes up its own mind.—*Mr. Tuke*: I do not think it would be of any particular advantage to us to be more closely informed or consulted about Treasury affairs. Those things are their business, and our business is our business. Whether it would be any advantage to the Treasury is for them to judge.—*Mr. Robarts*: I think that that is a very fair way of putting it.

3824. You are not interested in what makes the Treasury's mind up?——Of course we are interested; but we would not presume to try and thrust our policy upon them, or thrust any policy upon them.

3825. *Chairman*: I am not sure that I have got what is in your mind; is it that, with all your other duties and responsibilities it would be difficult for you to get much advantage from increased contact with the Treasury?——I would say so. I personally should think that the more and closer the contacts we have with the Bank of England the better. That is very important indeed; and we do have them: I am quite satisfied with that. Having arrived at that position, I do not think we want to go and discuss very much the same problems with the Treasury.

3826. Would it also be in your mind that if you had frequent and direct contact with the Treasury it might create a triangular relation: Treasury—commercial banks—Bank of England, which might be rather confusing?——*Mr. Robarts*: I think that might arise, and I think it would be undesirable. I am very firmly of the opinion, and this paper contains the view, that our right contact is through the Bank of England.—*Mr. Tuke*: We do depend on our views being faithfully conveyed to the Treasury when the Treasury want to hear them, and I am perfectly sure that they are.—*Mr. Robarts*: It certainly depends on that, and I am very sure that they are; and we can, and do, go and see the Governor any time we want to.

3827. *Professor Cairncross*: You would have no objection if called into consultation by the Treasury on matters of interest to them?——No, we put ourselves at their service on particular points.

3828. There might be problems where you would express one view in isolation from that of a person who was deciding policy, because there were other considera-

tions affecting the policy which you did not know about?——When we knew more about it we might change our minds.

3829. If you were looking at it from a monetary standpoint you might have one view, and you might have another view from a different standpoint?——That is quite possible yes.

3830. *Mr. Jones*: You are pretty dogmatic, as a Committee of Clearing Bankers, about fiscal policy; do you channel those views regularly through the Bank of England to the Treasury?——Sometimes we do; but I am not presumptuous enough to say that I think they have any effect on the decisions taken.

3831. *Mr. Woodcock*: One question has been in my mind; I do not know if it is going to sound very rude, but I assure you it is not intended to be rude. I have an inescapable impression that most of what you said yesterday afternoon and this morning would represent the views of a banker, as such?——I am a banker; yes, I would agree.

3832. Again I apologise for my way of putting this; but it does not seem to me to show, on the face of it, as much awareness as I would have expected of the objectives of monetary policy as distinct from a banker's obligations to his customers. One can have all the things a banker wants as a banker, a stable currency, confidence in sterling, ability to meet all liabilities instantly, freedom to make decisions about where he puts his money, dictated solely by bankers' considerations; and there can be the management of all these affairs with another objective in mind, if you like, maintaining full employment, expanding the ecoomy. Those are the two sides, surely; do you think that is a weakness in your position or not?——That second aspect is really not in our field. What we have to do is, first of all to run our businesses so that they are conducted with safety to our customers, and secondly, as far as we can, to follow the monetary and fiscal policy of the day, whatever the colour of the Government, as described to us by, as a rule, the Governor of the Bank of England, and on occasions by the Chancellor. I hope that answer meets the point you have in mind.

3833. You do look at it as bankers?——*Mr. Robarts*: Yes, I must agree; because we are bankers, and not statesmen.—*Mr. Tuke*: There is our duty to our depositors; if we lose their confidence everything is lost.

3834. Perhaps I put it too much as a matter of black and white?——*Mr. Chesterfield*: I do not think, having regard to our international position, that our duty to our depositors can be overemphasised.—*Mr. Robarts*: If you would cast your mind back to what occurred in America in the early thirties, there the banks made far more mistakes, and with few exceptions they closed their doors because they could not meet their obligations. That was one of the greatest causes of the disasters of the early thirties, and the subsequent horrors which took place. I am thankful to say that that did not occur here; and, providing we look after our businesses properly, there is no reason why it ever should.

3835. There was an example of the kind of thing I am thinking of in the discussions this morning: so far as you as bankers are concerned, there is no reason at all why you should not vary, at your own discretion as bankers, your liquidity ratio; but there may be good reasons why you should be controlled in that ratio. You say that you believe in free competition: one does not want to go into all the implications of free competition, but it may be that the people who are restricting you control you towards objectives which are worth while, which are not the things you would do as bankers?——*Mr. Chesterfield*: We have accepted that, and the reasons for it.

3836. *Professor Cairncross*: You do accept that the economic climate is a matter of very great importance to banking operations? Even in 1933, when the American banks shut down, that particular catastrophe could not be entirely laid at the doors of the banks, however many mistakes they made. And the same kind of thing can arise in other countries: banks may be conducted very satisfactorily by their own standards, but the economic policy of the country may have effects on the banks that are not happy, or vice versa?——*Mr. Robarts*: Yes, that is so. Of course, as I say, we are here to discuss with you the banking view; but I do not want the impression to get around that we pay no attention to the economic necessities of the day. We pay the greatest attention to them, and when it is explained to us, from whatever channel, that a certain policy is necessary in order to correct some strain in the economy we then do our best to do it. I do not want to give the impression that we are just cold fish who pay no attention to anything except the interests of our own business; far from it.

3837. *Chairman*: But you are content to accept the situation, from the wider point of view, in accordance with the Government's wishes or desires as conveyed to you, and you provide the best banking service you can within the limit provided by these requests or directives?——Exactly; and we do recognise the economic forces which lie behind them.

3838. We have been talking earlier about the effects of the credit squeeze. We get from a number of sources the suggestion that the credit squeeze has struck harder at the small firm than it has at the bigger business. Can you give us any light upon that?——It is implicit in the way that larger businesses can be conducted that that is apt to happen. The large businesses are nearly always public companies, and they can, subject to the sanction of the Capital Issues Committee, raise money from the public. They are not forced to depend on the banks to the same extent as smaller businesses which, by and large, are not public companies.

3839. It is a question, you think, of alternative resources? The large business, if it is cut down as far as its bank accommodation goes, has alternative means at its disposal (one of which is, I agree, the raising of capital, although it is not the only one), but you think the small firm is more in a vice if it cannot get a bank advance?——*Mr. Robarts*: I think it must be from the nature of things.—*Mr. Tuke*: I would say the smaller business is not so much directly squeezed by the bank as squeezed by the people above it in its line of trade. Its wholesaler is being squeezed, and he says: "I can only give you one month's credit instead of three". The little man has no-one to turn to; he is already doing a cash trade.

3840. It is the weakest link that suffers most; not necessarily, though very often, the retailer?——It pushes down eventually to the retailer.

3841. *Lord Harcourt*: Cannot it also push the other way? Can the retailer not refuse to carry such big stocks and throw them back on the wholesaler, who in turn may throw them back on to the manufacturer, so that you may get pressure coming up from the small man to try to force the manufacturer of the goods to hold greater and greater stocks?——The small man suffers from being so small, and his voice is not very loud.

3842. *Professor Cairncross*: You would accept it as a fact that the small man has suffered more from the credit squeeze than firms of a larger size?—*Chairman*: He cannot, possibly, tap other alternative sources of finance that the man in a bigger way can get to hear of?——*Mr. Robarts*: I am not quite sure what alternative sources you are referring to.

3843. I am thinking of finance companies?——The finance companies have certainly done a lot of business for the small man.

3844. *Mr. Woodcock*: In operating the credit squeeze you would not discriminate against firms of small size; this would be incidental?——*Mr. Robarts*. No. We certainly do not discriminate against the small man in operating the credit squeeze. His difficulties arise simply from the nature of life; it is nothing to do with how we conduct our business.—*Mr. Tuke*: It takes just as long to get 10 per cent. out of a little man as a big man; from that point of view it is more worth while to look at the big one.—*Mr. Robarts*: The small man is, after all, the basis of our business, and we do everything we can to cultivate him.

Chairman: I think, if it is convenient to you, we will break now and go on after lunch.

(Adjourned until 2.15 p.m.)

Mr. D. J. Robarts, Mr. A. W. Tuke, and Mr. A. D. Chesterfield further examined.

3845. *Chairman*: Was there anything in this morning's discussion to which you wished to return?——*Mr. Robarts*: We spent a lot of the morning discussing liquidity ratios, but we did miss one point, about the cash ratio, that is the amount of cash which we keep in our tills and our balance at the Bank of England. That is, as distinct from the liquidity ratio, an absolutely fixed thing: a minimum of 8 per cent. of our deposits. It is adjusted from day to day. We regard that, and so do the authorities, as an essential ratio; and we strictly observe it.

3846. That means that by the end of the day you must have achieved 8 per cent. on the day?——Yes. There is one other point with regard to the liquidity ratio. I said that we might possibly go down to 25 per cent. [Q. 3742 and 3748]; but I also made it clear that would be for a very short space of time and would be immediately corrected. I want to emphasise that point. 25 per cent. must be regarded as being a very exceptional minimum; it would only occur at our lowest point; I do not know if it has occurred since the war. I must emphasise that we would take energetic steps to raise it at once.

3847. *Mr. Woodcock*: The point that interested me, and I think Professor Cairncross, is whether that is something you would do because you were told to do it, or whether it is something which you ought to do, as bankers, under certain circumstances?——*Mr. Robarts*: It is a thing which, as bankers, we think is desirable.—*Mr. Tuke*: But we are told to maintain the 8 per cent.—*Mr. Robarts*: We should get fairly strong representations quickly if we did not do that.

3848. If you had not this check by the Bank of England, would you be as meticulous about this 8 per cent? Is it a banker's requirement?——Yes; it is in order that we should be able to meet the cheques drawn on us.

3849. I have heard it suggested that on different days in the week you are in a different position, so that on some days you might let your 8 per cent. run down. For example, on Friday there would be a lot of cash drawings, when people are drawing money for wages and so on; you might not worry if you fell below your 8 per cent. then?——*Mr. Robarts*: Oh yes, we would call to make up this amount.—*Mr. Tuke*: It used to be 10 per cent. with elasticity; now it is 8 per cent. without.*

3850. *Chairman*: We have covered a great deal of the general ground, but I think it would be as well if we went now question by question through your memorandum, and see what additional questions emerge from the Committee as we go along.—*Mr. Woodcock*: In your introductory paragraphs you mention investments. Are all the investments Government stock?——*Mr. Robarts*: Practically all. We have all of us what I would call trade investments; there are a few subsidiary banks.

3851. *Mr. Jones*: "Bills discounted" have relation to the money that you advance to the discount market and your holding of Treasury Bills?——They are in the main bills that we buy from the discount market and therefore in the main, but not entirely, they are Treasury Bills; we also discount bills for our customers. The "money at call and short notice" is what we lend to the discount market, as distinct from the bills we buy.

3852. *Chairman*: Does "investments" include all holdings of bonds, however near towards maturity?——Yes. We do not put any bonds in our bills.

3853. So, although they appear there as the less liquid element, there is some, to me unknown, part of this 31·4 per cent. which is verging towards complete liquidity?——Yes. Supposing that we have the arrangement that investments should be all redeemable within, let us say, ten years, we would obviously try to get about a tenth of them to mature each year.

3854. But there is an element of liquidity in these "non-liquid" assets?——Yes, in so far as investments mature every year.

3855. *Professor Cairncross*: You never publish details of the maturity of your investments. Do you feel that some information on this point might be released? Would the banks have any objection to the publishing of an aggregate figure of their holdings of Government investments due to mature within the next five years?——I should like to have notice of that question. It is not one of the questions which have recently been put to us.

3856. *Mr. Jones*: As I understand the position, the banks' investments are generally in short term bonds. How would you divide this 31·4 per cent. in investments on the basis of maturity? What proportion of this would be for ten years or under; and what proportion of that would be over five years; and then would the remaining proportion be all under five years?——I only know about the investments of the bank of which I am Chairman; by far the greater proportion of those mature within ten years, and practically all of them within twelve.

3857. Would the greater proportion of them mature in less than five years?——I think the only answer of value to you would be an answer on behalf of all the clearing banks, and before I gave any answer I would want to discuss it with my colleagues.

3858. *Chairman*: We may have to take this as a general question, as to what statistics it would be wise to make available for publication in the public interest; but can you tell us what kind of objections you would have to that information being published, supposing that it was of general interest?——The only real argument that I could produce against it is that, if a bank decided, for good reasons of its own, to change its investment policy, it might well attract uninformed comment in the Press; you cannot make an informed comment unless you know all the circumstances surrounding the position, some of which we might well not wish to give.

3859. *Professor Cairncross*: Would this argument apply if you were considering the aggregate only and not considering it in relation to any particular bank? Would you see any objection to the disclosure of this information to the Bank of England?——I would have no objection about telling the Bank of England in confidence what was going on.

3860. *Mr. Jones*: Would a reply to this question have any harmful effects at all on the monetary system?——I would like notice of this. For instance, one of the reasons that make one go shorter in investments is if there is a general malaise about the way the economy of the country is going. If things are going rather badly, the shorter your investments are the better, because in the event of a crisis it is better to have short-term investments.

3861. We are looking at the monetary system in the economy of the country and I, at any rate, have formed the opinion that it is essential to adjust the economy to the resources that we have available for running the country. To the extent that the reply to this question would be harmful to that end, then I can understand the disposition not to give us a reply; but in dealing with this matter we shall want, in my view, a good deal of this information on the banks' holdings of short-term investments, and I would think that it is in the best interests of our doing our work that we should have this information?——Could we prepare a figure and give it to you in confidence?

3862. *Chairman*: I do not think that is the real burden of the question that you are being asked. We have always two things to consider: what we need for our own study, and what we think the public interest requires as part of the background for studying monetary policy and the economy of the country for the future. They are not quite the same thing. It is suggested that the aggregate figure of the distribution of the clearing banks' investments may be an important thing from the point of view of an informed study by the public. The question is: could that have any adverse effect upon the interests of the banks, as banks?——*Mr. Robarts*: I should like to consult Mr. Tuke on this point.—*Mr. Tuke*: I have been brought up in an atmosphere of not disclosing our affairs or, so far as possible, any of these things; and (though perhaps I have no right to say this) I should want to be convinced that it really was in the interests of the country that these things should be disclosed. If I was told that there was, a sufficient reason, other than what I would call curiosity to know about these things, then it might outweigh our disinclination to disclose figures. But we have this natural disinclination.

* See Appendix to Minutes of Evidence.

3863. My question was a little sharper than that; I wanted your views about this. One would have to weigh against public advantage any actual disadvantage to the banking activities concerned. Could it be a detriment to the banking activity?——I cannot cite any precise fundamental objection, in the way that I could if you were asking about disclosure of our inner reserves, for instance. I do not think it would be anything like as bad as that. Without trying to think it out, I am afraid I fall back upon my natural disinclination; but I realise that that is perhaps not very convincing to anyone but myself!

3864. *Professor Cairncross*: A great deal of our discussion this morning bad to do with the liquidity of the banks. Would you not agree that in that connection it was of interest to know something about this?——Mr. Robarts has told you the sort of way in which we try to divide these investments up in pretty well equal tenths. I would support that. That is our policy, always, in practice, with a bias at the lower end; there is more under five years than over.

3865. Would there be any more significance in knowing the proportion of your investments under five years than in knowing the money at call and short notice, which you do disclose? One wants to see the whole picture of liquidity in the banking system, and this is a material factor?——If we give you the figure of stocks under five years, someone will come along and ask for more information; they will want to know the figure for stocks under two years.

3866. Not necessarily; though you seem to attach considerable importance in some of your references to two years as being a critical period?——*Mr. Robarts*: The chief damage that I can see is that, supposing one saw some movement from the longer-dated end to the shorter-dated end, that would indicate a general malaise about the future of the gilt-edged market.

3867. It would indicate much more than that surely; it would indicate that there was an additional mass of manoeuvre in semi-liquid assets to supplement what was held in the form of bonds, which could be interposed against the normal methods of control?——*Mr. Tuke*: The Bank of England know what we have got. They can simply call for it from their registers.

3868. The Bank of England can find out; but the public, who want to determine an independent view, cannot?——*Mr. Robarts*: No, the public cannot find out.

3869. And, if I can just pursue it a little further, does the Treasury have any access to this information?——I really do not know. The Bank of England does; I do not know if the Treasury ask them.

3870. *Chairman*: We have in mind that the Bank of England could, by calling from you, get the information they needed; but public comment on the situation cannot help the Bank of England, and the monetary authorities generally, to form views from time to time, unless is is informed on these matters; so I think it is little wider than that?——*Mr. Robarts*: What does Mr. Chesterfield say on this very difficult question?——*Mr. Chesterfield*: It is a very difficult question. I cannot think there would be any great disadvantage, apart from the one Mr. Tuke has mentioned. I remember within the last few months a statement made by one of the large banks, saying that all their investments mature within ten years and the majority within five. If any other bank were to publish their figures and they did not appear to be quite so liquid as that, it could have a bad effect on that bank; that would be a matter for some thought.

3871. *Mr. Woodcock*: But we suggested an aggregate figure, and not individual figures?——*Mr. Chesterfield*: If I may express a personal view, I do not think that an aggregate figure would have any adverse effect.—*Mr. Tuke*: If we are thinking in terms of dividing our investments into two parts, five years is the point at which to do it.

3872. *Chairman*: Is it your point that bonds with less than five years' maturity are freely discountable at the Bank of England?——*Mr. Tuke*: Not by us; but they are considered suitable by the money market.—*Mr. Robarts*: There is no arrangement existing between the Bank of England and the money market, or between us and the money market, whereby the Bank of England is an automatic buyer of bonds.

3873. *Professor Cairncross*: These bonds could be sold to the discount market and so turned into call money in your accounts, and they could discount the bonds at the Bank of England?——No, there is no arrangement existing between the Bank of England and the discount market whereby the discount market can take their short bonds to the Bank and discount them, as they can with first-class bills.

3874. It is a question of advancing rather than re-discounting?——*Mr. Robarts*: Yes. In my experience the only assistance of this kind which has been given to the market has been in very exceptional cases when the Bank of England has agreed to buy from them some holdings of short bonds.*—*Mr. Tuke*: There is no right to discount them at the Bank of England.

3875. *Chairman*: We have been given a more concrete impression of that than you are now putting forward.——You may have a more correct one, but that is what I have always understood.

3876. *Mr. Jones*: As I read the last paragraph in your answer to Question 1 (*d*), I would reach the conclusion that the banks would never, or seldom, subscribe to the funding or the purchase of a new British Government security of a length of period that went into ten, fifteen or twenty years, but would buy Government securities nearer the period of maturity than the date upon which the subscription list was opened to the market?——*Mr. Robarts*: That does not follow. We certainly would not willingly buy very long-dated issues, because we have to have things which are reasonably proof against depreciation. But we certainly subscribe to issues, and, in fact, some of us have done so recently.

3877. To new issues?——Yes, to new issues. For instance, we (and I have no doubt my colleagues also) made a quite heavy subscription to the new 5½ per cent. Exchequer Stock 1966. That is an eight-year issue, and so is all right for us. Had it been a twenty-five year issue I should not have recommended a subscription, merely because our money is not our own; it is our depositors' money, and if we put it in bonds that depreciate, that is highly inconvenient.

3878. So any twenty-five year security in your portfolio would be there in consequence of your buying it some time well on in its life?——Yes, that is so; probably when it becomes ten years or less.

3879. *Mr. Woodcock*: I do not see what is, from your point of view, the difference between a ten year bond and a twenty-five year bond, as long as they are both negotiable and can be sold; in neither case can you see that far ahead?——If you buy a twenty-five year bond, and then money gets dearer, the price of that bond will fall. A ten year bond will not fall so much, because all Government bonds are repayable at 100 when they mature.

3880. But is not ten years ahead far enough to make the par price irrelevant?——*Mr Robarts*: The price can fall, of course; but securities are bought and sold on the basis of yield, and when a ten year bond starts to depreciate its yield to redemption rises. That is also true of the twenty-five year bond, but the rise in the redemption yield for each fall of one point is greater in the case of a ten year bond than in the case of a twenty-five year bond.—*Mr. Tuke*: It is not a question of the running yield, but of the redemption yield.

3881. *Mr. Jones*: On this question of the movement of values in investments, is not a bank in a pretty strong position to hold its wind? Can it not retain those securities, having regard to all the circumstances which enable them to evade losses?——*Mr. Robarts*: It may or may not. Supposing we did get heavy depreciations, which have, in fact occurred, and then supposing that some of our deposits were withdrawn, and we still wanted to keep ourselves round about 30 per cent. liquid, we might be forced into selling some of those securities, and might incur a very serious loss in the process.

3882. *Professor Cairncross*: Would that not depend on the maturity distribution of your portfolio?——Yes; that is why we like to keep short, to provide against that contingency.

3883. Are you not a good deal shorter now than you were before the war; at that time would you not have been willing to accept them longer even than twelve years?——Yes, I think we would have been more inclined

* See Appendix to Minutes of Evidence.

to than we are now. But most of us always had the bulk of our investments fairly short.

3884. But you would not have laid the same emphasis in those years as you do today on holding investments under five years?——*Mr. Tuke*: I think it is probably true that, with the shocks we have had in the last five or six years, we have tended to let the natural shortening of our book take its effect, without counteracting it by pushing it out again. But we always did have, as Mr. Robarts has said, a considerable proportion within five years; we always had the idea in our minds that any additional liquidity which we wanted in any year should be provided, if possible, by something that was falling in naturally. We never want to have to sell any security for the sake of liquidity. But before the war there was not this regularity of maturities, which there is today; there was not so much Government stock about, and we did not have a maturity every year to help us out.

3885. *Chairman*: But given a high short-term yield, in relation to the long-term yield, you have no motive to be anything but short? It is only if you have to pay for being liquid, by taking a lower yield for short-term bonds, that you are tempted to go longer?——*Mr. Robarts*: That is true.—*Mr. Tuke*: Except that there is the motive today, with yields so attractive in themselves, to ensure that we enjoy them for as long as possible.

3886. On question 1 (b), when you are asked to restrict advances what exactly is the action taken within the banks to keep advances within their limits or to reduce them? How does it operate when it comes down to an individual office?——*Mr. Robarts*: By refusing certain new advances and by pressing customers to make reductions in their existing advances; that is, of course, what we have been doing under the credit squeeze for all this time.

3887. What kind of instructions are issued to the individual bank manager that enable him to decide what to do?——We have all from time to time, and even as recently as last September, circularised our bank managers. We do not agree on the wording of the circulars; each bank does it differently. Some will quote what the Chancellor or some authoritative person has said in the statement when he makes his request for reduction, and the branch managers will be instructed to pay attention to this.

3888. *Professor Cairncross*: How do they decide which request to refuse? Do they in fact decide?——If it is within their discretionary power, yes; above that, the question goes to head office. Every branch manager has discretionary power.—*Mr. Chesterfield*: Which varies from branch to branch and from bank to bank. In some banks, no branch manager can refuse any accommodation without referring it to headquarters.—*Mr. Robarts*: Is that so? It is not so with us.

3889. That I understood to be the general position, at least in the 1930's?——There is a discretion given to branch managers to grant advances throughout the country in nearly all the banks.

3890. What form does the discretion permitted to the branch manager take, in those banks where there is a discretionary power? Is it a fixed sum?——Yes, they have discretion up to a fixed limit.

3891. Are there differences between the banks?——*Mr. Tuke*: It differs from branch to branch; an inexperienced manager in a small branch has a smaller discretion than an experienced manager in a large one.

3892. There is no universal procedure in any one bank?——*Mr. Tuke*: No.—*Mr. Robarts*: The larger the branch and therefore, presumably the more experienced the manager the bigger is his discretionary power.

3893. Have any changes in organisation been necessary, because of the introduction of a ceiling, in order to achieve parity of treatment for different requests?——No changes of organisation. We have circularised our branch managers; they are very well aware of the policy, and they carry it out.

3894. There seem to be some cases in some clearing banks where they have, in the past, enjoyed great discretion. There has been no change?——We have not done anything in that respect. In fact we have raised the discretionary powers; given the value of money as it is at present the manager who used to have discretionary powers up to £500 ought now to have up to £1,500; I do not know if we have actually gone quite as far as that.

3895. You are not aware of the credit squeeze having affected different banks differently in this regard?——*Mr. Robarts*: Not so far as I know.—*Mr. Chesterfield*: Only in so far as their businesses themselves differ, there are some banks who have a much more commercial business, whereas another bank may have a preponderance of industrial accounts.

3896. Is it the view of all the banks represented here that when an advance is refused it is likely to require a head office decision?——*Mr. Chesterfield*: In our bank it is certainly so.—*Mr. Tuke*: We have no rule that no advance must be refused without reference to head office.—*Mr. Robarts*: We have a return of what has been refused.

3897. And a right of review, of course?——*Mr. Robarts*: Yes.—*Mr. Tuke*: There is a pre-disposition on the part of the manager to say "Yes" and not "No", because he wants to do business; so we do not have to chase the managers for refusing advances in the ordinary way.

3898. I am wondering what the ordinary manager does, faced with the general policy of restriction and a large number of clients, all of whom want advances. He has to refuse some; is he left to make his decision in some banks and not in others? How is the balance struck?——I think that is an unreal question. They do not all line up on one day, these customers.

3899. But if you have to cut advances by 10 per cent., somebody has to go without and somebody else has to decide who shall go without. Who decides and why?——We have given the clearest possible instructions about the kinds of advances which should be restricted; and there have been one or two cases where a definite cut has had to be made. For instance, we were asked by the authorities to make a percentage cut in hire purchase advances; we thereupon did it and then that actual figure was passed to the branches concerned. Otherwise, circulars have been sent out to explain the various categories that could be permitted and those that should be discouraged and, with the enormous mass and number of borrowings that there are in the banks, that has worked in practice very well.

3900. That means relying heavily on the bank manager to carry out instructions?——Yes. As regards this power of discretion, in the case of Barclays Bank doubtful decisions go to head office and are dealt with according to size; a large amount would be dealt with by a higher official and smaller amounts by lower officials. But all the people who are dealing with these matters are acting in accordance with the Chancellor's request, whatever it may be.

3901. I was not implying that there was anything underhand in it; but is it not difficult in a large organisation like a bank to ensure that each branch is following a common line?——Of course, all these things depend on personalities to some extent, but I think that, as nearly as one can get an organisation to pursue a common line, that is done. One must remember there is a big turnover in advances: some are being paid off every day, and if you restrict new ones the total will fall. I think it happens to some extent like that.

3902. *Mr. Woodcock*: Do you have meetings with your branch managers?——*Mr. Chesterfield*: Yes.

3903. What puzzles me is that on the one hand in some banks, I gather, the refusal is left to the head office and not to the branch manager, while at the same time I gather that the branch manager plays a very large role in holding the line, as it were, and in telling clients exactly what the policy is and, if necessary, getting them to reduce their outstanding overdraft. How can he be the agency through which the application is refused in a bank where the head office takes the decisions?——*Mr. Tuke*: In the case of existing advances which have to be reviewed and come up for periodical reconsideration once a year, the manager has his general guidance, and he sees the customer, as he naturally would, when the customer brings in his balance sheet, and says: "I hope you are going to be able to do with a hit less next year for your seasonal overdraft; what can we arrange?"

Perhaps he gets 25 per cent. out of one, and 10 per cent. out of another, and nothing out of another. Then he puts up the application to head office for renewal at a lower figure, and everyone is satisfied.

3904. This is a reversal of his normal function and instinct? He is out to reduce business and not to increase it?——*Mr. Tuke*: Bank advances ought to be repaid in due course and reduced in the meantime, so it is merely applying rather strictly a principle which ought to be applied anyhow.—*Mr. Chesterfield*: Where a manager has a lot of discretion he has to make at least half-yearly returns to head office; so there is no laxity.

3905. *Professor Cairncross*: I was not thinking of laxity; I was thinking of the possibility of different practices in different banks?——*Mr. Chesterfield*: They would iron themselves out.—*Mr. Robarts*: I do not think there is any fundamental difference in what we do; by and large the principle is the same. There might be some slight differences of detail.

3906. *Chairman*: In the answer to question 1 (*a*) you say that the bankers' deposit rate is automatically adjusted in accordance with the movement of the Bank Rate. What, in your view, makes it necessary or desirable that the rate should regularly be altered in that way?——It has not always been tied exactly to two per cent. under the Bank Rate; there have been occasions when it has differed. But tying it to Bank Rate seems to work well. We must have some rate which we will pay on deposit, and that rate must control our lending rate, because, with overheads as they are, we have to have a given margin. It is related to the Bank Rate because, I suppose, the Bank Rate is the fundamental rate of the country.

3907. The Bank Rate is a re-discount rate?——Yes.

3908. And you have this automatic regulator by this practice?——That is so, yes.

3909. Is it because there is some competition for deposit money which you are meeting by this adjustment?——*Mr. Tuke*: We first of all put up our loan rate. Our loan rate depends on Bank Rate; when that goes up we can afford to pay more; and if the loan rate and the Bank Rate go down, we must pay less.

3910. What governs the movement of what you pay for money is what you can do with that money yourself?——*Mr. Robarts*: Yes, I think that is the best way of putting it.

3911. *Professor Cairncross*: You are not afraid of competition from other possible borrowers who might take your deposits away from you?——We have explained in our answer to question 1 (*e*) that in the state of the money market at the moment it would not pay us to push up the rate for deposits.

3912. *Chairman*: That is a condition of the present situation; is not this practice of adjusting the deposit rate to the movement of Bank Rate much older than that?——Yes. Of course, we have had all kinds of arrangements in the past; the history of it could be produced quite easily. But since the war our ability to lend has been restricted, and therefore the desire to get extra deposits by paying high rates for them is very much less. Having got them, all we can do is to buy securities with them.

3913. That is merely a result of what you can make on your loan rate; and the loan rate, so far as your use of money is concerned, is directly related to the Bank Rate itself?—Yes, and the rate at which we lend to the discount market again depends upon the Bank Rate.

3914. *Mr. Woodcock*: Do you find that money flows into you on deposit when the rate goes up?——I do not know that we get more total money in the banking system. When the rate is high, people are more inclined to transfer money from current account to deposit account because they do not get any interest on current accounts as they do on deposit accounts. There is more inducement to make the transfer when the rate is high.

3915. You do not find people switching, say, from National Savings Certificates to bank deposits?——*Mr. Robarts*: I do not think so. People are rather more inclined to hold money on deposit than they are to invest it at the present time, because they can get 5 per cent. on deposit, which is pretty good today; it is completely safe and it cannot depreciate.—*Mr. Tuke*: The great majority of people are rather lethargic about their investments; once they have bought them, they do not do a great deal of switching. The professional investor does, of course, but the great mass of people do not.

3916. *Chairman*: Is the Treasury Bill to some extent a competitor for your deposits?——At these rates, certainly.

3917. *Professor Cairncross*: So long as your assets remain constant your deposits remain constant. If someone withdraws money from you to buy a bond, somebody else has to provide money to buy the bond, and the transaction simply registers as a change in the ownership of deposits or in the ownership of bonds, whichever way you look at it?——Unless the Government is the seller of the bonds; in that case the money goes into the Government and is not seen again in the banking system.

3918. Which is equivalent to a funding operation?——Yes.

3919. I have something on question 1 (*b*) which is related to question 1 (*f*); perhaps I could take the two parts together. Question 1 (*b*) was intended to invite you to comment on the possibility of undertaking entirely new lines of business if you were completely free to lend; not just lending more to the existing range of customers, but perhaps entering fields of lending that you had previously refrained from entering.——*Mr. Robarts*: I am afraid we read it differently, as meaning new businesses starting up.

3920. I wonder if you would like to comment on this rather different formulation of the question? Do you feel you might like to take on different types of business, such as are undertaken by bankers in other countries (including hire purchase, for instance), which you are now deterred from entering because you have not the money to lend?——*Mr. Robarts*: What other types of business have you in mind besides hire purchase?—*Mr. Tuke*: Do you mean what we call "German" banking; investment in industry?—*Mr. Robarts*: We could do that, but I could advance many arguments against it.

3921. There are questions about term loans?——*Mr. Robarts*: To deal with hire purchase first, I have always felt that we do better to participate in hire purchase business by lending to the hire purchase companies as we do, and allowing them to exercise their expertise in conducting their business. We have quite enough to do in looking after our own banking business and in going into hire purchase through the recognised methods of banking, that is, by lending to the people who know how to do it. We might make more money if we went into it directly, as the Americans do, or we might not; but it is a different business from our own business, and I think that we should stick to our own line. But there is room for many opinions on this, and I should like Mr. Tuke and Mr. Chesterfield to state their views quite independently of mine.—*Mr. Tuke*: I think my views are very much the same as Mr. Robarts's. It is all in accordance with the modern tradition of retail trade to have general stores: the grocer starts selling boots, and that sort of thing; but it is against my inclination. I think that a grocer should sell groceries, and a bootmaker should sell boots, and would probably do the job better than the grocer. My inclination is for us to stick to what is called deposit banking, and let other people who are expert in other fields have the money to develop their expertise and do it better than we should.—*Mr. Chesterfield*: I would agree generally with that. On the other hand I have been to America and Canada and I have seen the undoubted attractions from both the banks' and the customer's point of view of hire purchase business being done by the banks; I do not mean, for instance, taking a charge on a washing machine or a refrigerator, but on the personal loan basis.

3922. *Chairman*: The "personal loan basis" meaning an advance to an individual avowedly for a definite purpose, without taking a security?——Very often, in the case of America and Canada, after having checked up that the man has a reasonably safe job; the bank might take a life policy as cover against his sudden demise to protect his widow, and so on. That is a very remunerative and attractive business, and I think on the whole it enables the customer to get his credit at a cheaper rate than if it is done through the normal channels of hire purchase.

3923. Are differential rates made for this type of business?——Yes, but they are not so expensive as financing a hire purchase transaction through hire purchase finance companies would normally be.

3924. That brings the banks then directly into competition with the hire purchase companies in America and Canada?——Yes.

3925. *Mr. Woodcock*: What is the length of those personal loans in America?——Some of them are six months; the maximum is eighteen months to two years.

3926. *Professor Cairncross*: The views you have expressed now I am sure you would have held before the war; I wonder whether you will hold them in ten years time?——Very likely not!

3927. Your advances are at present roughly 30 per cent. of your deposits, and you would be quite prepared to see them rise to 55 per cent. Do you seriously expect to see them go up that high at any time in the future, even if Government controls are removed? Do you see other types of advances to fill in this difference between 30 per cent. and 55 per cent., in entirely new lines of business or along traditional lines? Do you really feel that you are going to have the kind of business you used to have on a scale which will absorb deposits?——*Mr. Robarts*: I see no reason why we should not.—*Mr. Tuke*: If we had a 20 per cent. reduction in our deposits, the advances percentage would go up proportionately.

3928. You are not looking forward to that in the next ten years?——*Mr. Tuke*: It is a question of funding and the Government getting control of the situation; I do not think so to any extent, no.—*Mr. Robarts*: If we had a period of very active industrial conditions and there were no controls, our loans would definitely rise; but I doubt if they would just at the moment.

3929. You do not feel there has been a secular change in the traditional reliance on the banks; that firms no longer want the same accommodation from them and rely much more on their own resources?——*Mr. Robarts*: I do not think so. I do not know whether the proportion of profits now retained by businesses is higher than it was before the war, but that and issues of capital are the only other ways.—*Mr. Tuke*: This large business in personal loans did not exist before the war anywhere, so they are an addition. It is not a question of who was lending that money before the war: nobody was; or perhaps hire purchase was just beginning to start up.—*Mr. Robarts*: I do not see any fundamental change in the economy which would mean that never again would we lend heavily.

3930. The issue is not that you will never again lend heavily. Your advances at the moment are a little more than half the proportion you would like to see; if all control over bank advances was removed, and one was looking to the process of inflation coming to an end and normal relationships, being established, say, over the next ten years, is it your expectation that without entering new fields of business you would have the old proportion of advances to deposit?——The nationalised industries are quite a factor; the great majority of that business has gone from us. The level of our advances in those conditions must depend on the state of industrial activity in the country; if we had a state of very high industrial activity I see no reason at all why we should not run in the direction we have been talking about.

3931. Do you not think that business, which has been growing rapidly, has become virtually independent of bank advances as a means of finance?——If you mean that, if there are a lot of companies in a group, one company lends money to another, it may tend towards that; but I do not know how big a force that would be.

3932. Would it be within your knowledge that about half the public companies in this country have no bank overdraft?——I have never seen the figure you mention and I do not know. Do you know where that figure has been extracted from?

3933. From balance sheets——It does not follow that they do not have it some time during the year.

3934. That is true. Perhaps we should now turn to some of the other possible lines of extension. You refer to advances against export credit guarantees; is this a type of business which you would like to see expand?——The difficulty of that type of business is that it is for a considerable period. The advances are for years and not for months, or for one year, or anything like that. As we have pointed out, we can only use a certain amount of our deposits on these relatively long-term loans, for the simple reason that our deposits are callable.

3935. But you lend to the Government for ten years?——Yes, but all those securities are marketable.

3936. If the advances you were making against the export credit guarantees could be reduced to a negotiable instrument that was marketable, would you feel the same hesitation about advancing the money?——We could go up higher then; and we have indeed made that suggestion in the part of our document that deals with this question.

3937. *Chairman*: But once they become negotiable in the ordinary sense you are taking something for which there is already a market available, and you are out of the wood?——*Mr. Robarts*: Yes, the thing entirely changes.—*Mr. Tuke*: Is it not a little difficult to envisage putting in an eight or nine years maturity, as a three months bill? Can it be done by some means with an agreement for renewal?—*Mr. Robarts*: No; I think that sort of thing would have to be placed with long-term lenders, like insurance companies and people of that kind. There are certain technical difficulties in doing it at the moment.

3938. It emerged yesterday that the actual length of credit given by the instrument is not so important if it is during the course of its life freely negotiable?——That is perfectly true; that of course obtains with a short-term bond.

3939. So the problem is how to get a system going in which such instruments are freely negotiable; that means a ready market to take them at any time?——There are great difficulties in this. There are certain transactions which carry the E.C.G.D. guarantee, which could, subject of course to the agreement of the Bank of England, be made available to the discount market; that is one course. It is possible that one might get some instrument, or some bond, guaranteed by the E.C.G.D., which would be acceptable to the insurance companies; but, of course, not at the present time with this structure of interest rates. It could only be done when interest rates were lower.

3940. Would you explain that?——*Mr. Robarts*: The insurance companies at the moment will only buy relatively long-dated securities. The interest rate is high, and they take the view that it will come down; therefore they want to buy securities on the basis of a 7 per cent. Bank Rate and to have them run as long as possible, and a security of, say, eight or ten years' duration is not attractive to them.—*Mr. Tuke*: How much of this we can do as things are at present depends on whether we are 30, 40 or 50 per cent. lent. We can do more in our present state than if we had what we used to regard as a more normal proportion of lending.—*Mr. Robarts*: We have done a certain amount of this business, for the reason that it is highly desirable from the national point of view. It is always represented to us that, unless we can give credit to customers overseas comparable in length to the credit they can get from other countries, they will not buy from us; so it is a direct help to export.

3941. There is nothing new, is there, about this demand for medium-term credit for a number of kinds of exports?——*Mr. Tuke*: It used to be done quite differently, by way of a loan to the Government of the country concerned for a longer period. These medium-term export credit guarantee transactions are, from the point of view of the buyer of the goods, not nearly long enough. If they are buying a power station, or something like that, they want more than five or six years to pay for the thing; but they take what they can get, and what will happen at the end we do not know. In the old days it would probably have been a twenty-year loan to the Government of the country.

3942. When there was a freer capital market it could be a loan to the Government or the institution concerned in the other country; it had the money and paid the manufacturer without difficulty. But that has not been a regular pattern for a very long time, has it?——Foreign

loans, generally speaking, are not acceptable on this market.

3943. This demand for medium-term credit on the actual machinery or installation is not a very new phenomenon surely?——*Mr. Tuke*: We never saw it before the war.—*Mr. Roberts*: A perfect example is the Argentine credit which is taking place in London. That is primarily to enable Argentina to equip her railways, which I believe are in a deplorable condition. That has been done by an E.C.G.D. guaranteed loan in which banks and kindred institutions participated. That would have been done years ago by the flotation of an Argentine Government loan.

3944. *Professor Cairncross*: You say you are doing quite a bit of business of this kind now; is it possible to say how much?——It varies enormously from bank to bank, partly due to the policies of the banks and partly on the chance of what customers happen to bank with them. A bank which happens to have customers engaged in, say, the engineering business with a big foreign clientele will do more of it than those who have not got such customers.

3945. If it is going to be an expanding business would it not be useful to have separate figures for this kind of business (an aggregate for all the banks, not for individual banks), so that it would be possible to see how rapidly it was rising?——*Mr. Tuke*: I think the Export Credits Guarantee Department would have them, though I do not know whether they publish them.—*Mr. Robarts*: They must have them, yes. They will no doubt have to be produced in confidence by us to the Bank of England, because these transactions are outside the scope of the present credit squeeze.

3946. *Chairman*: What do you find mainly lacking in the E.C.G.D. provisions today?——I am told by the people who in our organization have to deal with the E.C.G.D. that there are a lot of very small clauses always written into these guarantees, always slightly adverse to the lender. I would like Mr. Chesterfield to enlarge on that; he is closer to it than I am, although I do not think he does it now.

3947. More clauses than you find in a normal insurance policy?——*Mr. Chesterfield*: About the same. The underlying documents are a bit of a trial, but the basic objection, having regard to the long term nature of the transactions involved, is the non-negotiability of such documents as may be supported by the guarantee of the E.C.G.D.—*Mr. Robarts*: We have said in our answer to question 5 in the paper that in any event a more simple form of direct guarantee or export credit is desirable, and I am told by the people dealing with this that that is a very real point.

3948. *Lord Harcourt*: Is there a very great difference between the medium-term credit for exports and the ordinary term loan from the bank's point of view?——I am never certain what is meant by a term loan. It is an American expression, if I may say so with respect.

3949. I am thinking of the American practice of lending to industry for 2, 3, 4 and frequently up to 5 years (I do not think most of them go beyond 5 years). They make fixed loans with fixed maturities, perhaps a proportion repayable annually, sometimes the whole thing repayable at the final date. It struck me that there was not very much difference between those and between the medium-term loan for export; but I think British banks have never made fixed term loans?——I will just qualify that in a moment if I may; but as a generalisation that is right.

3950. Is there any reason why they should not?——There is no reason why we should not make a few; but we are limited, as we have explained in our evidence, in the proportion of our deposits which we can tie up in that way simply because our deposits are callable; everything we have is repayable at seven days' notice.

3951. But you surely have a large number of loans which, though ostensibly repayable on demand, have been running for years and years because you have never wanted to call them, and would not be repayable if you did call them. Could you in fact call in a very large industrial loan?——I suppose we could; but we have got to act as reasonable people. It would be quite unreasonable to say to a man who has had a loan for some time, or indeed for any time: "You have to pay this back at once; that is your legal obligation". We always give him time to turn round. You referred to large industrial loans; providing a business is in good condition, it could, for instance, mortgage its plant, and so on.

3952. *Professor Cairncross*: At the very moment at which you are likely to want to realise the loan, the market would surely be more frozen?——Of course we do not operate it in that way. We have loyalty to our customers in that kind of thing.

3953. For that reason, as Lord Harcourt says: you are not really counting on calling in those loans on a very large scale?——No, we are not.

3954. *Lord Harcourt*: Would it not in many circumstances be more advantageous both to yourselves and the company to make a fixed loan?——We do in certain circumstances: for instance, loans were made last year for financing the building of tankers. That was an exceptional transaction. There is no hard and fast bar against them, but, as I say, we can only use a certain proportion of our deposits in that direction.

3955. *Chairman*: It becomes a question of degree then?——*Mr. Robarts*: Yes; and I think it is for the individual bank to decide what it should do. We vary very much in these matters.—*Mr. Tuke*: Lord Harcourt is quite right in saying that in practice loans to certain customers go on for a very long time.—*Mr. Chesterfield*: Longer than if it were for a fixed period, and we really meant what we said: we fix limits for reconsideration in, say, twelve months. They may be repayable on demand if required, but they can be renewed. There is probably an overdraft limit, the advance fluctuating all the time.

3956. *Lord Harcourt*: They can take advantage of periodic cash which they have, instead of taking a fixed advance and having to pay the interest on the full amount whatever other cash they have?——*Mr. Tuke*: Our system of the overdraft is quite different from the American term loan system, and far more advantageous to the customer. Every cheque he pays in reduces the amount outstanding.

3957. *Professor Cairncross*: Unless he knows he needs money for five years, in which case he is interested in getting money but not in the prospects of repaying it?——Yes; if he feels that the security of knowing that he has it for five years makes it worth paying a bit more interest, then it is an advantage.

3958. *Lord Harcourt*: Might it not be of interest to some of your customers to have a proportion of their overdraft on fixed loan so that they know exactly where they are, and keep the overdraft for the marginal borrowing that might fluctuate?——*Mr. Tuke*: Yes.—*Mr. Robarts*: We would have to look very carefully at the proportion of our deposits which we used in that way, as we do for these E.C.G.D. guaranteed loans.

3959. *Professor Cairncross*: That leaves the last issue of long-term investment in industry; investments that bring you into such an association with industry that you want a seat on the board. As I understand the matter, British banks have never relished the prospect of being obliged to send a representative to take a seat on the board of an industrial company. Is that still the general attitude?——Yes. We do not like doing that. We want to remain creditors of our customers; we do not want to become partners with them. That is the fundamental difference between British banking and the sort of *banque d'affaires* they have abroad.

3960. If you think of what has happened to the capital market with the disappearance of the wealthy patron, do you not think a small firm may have difficulty in raising capital, and want to get the capital from the financial institution with which it is in most intimate contact, namely, its bank?——That is the "Macmillan gap," which the Industrial and Commercial Finance Corporation was created to fill.

3961. I am thinking of something smaller than that. The "Macmillan gap" referred to firms with a capital of £200,000, which would be something like £600,000 at current values?——Yes; but they are still dealing with loans of the order of £5,000 to £200,000.

3962. *Chairman*: You make a point in your answer to question 1 (g) that you have been asked to supply F.C.I. and I.C.F.C. with funds, and that:—

"the banks have responded, in spite of the fact that they are thereby doing indirectly business which they would not normally do directly".

You make the suggestion that the Corporations ought in that situation to get their resources from elsewhere and not from you. Where do you contemplate them getting their resources from?——When times are suitable they could issue debenture or loan stock to the public quite easily. It would be well secured. I would not urge them to do it at the moment, because it would be so expensive, but it will not always be like that.

3963. You think that they really ought to resort to the capital market?——Yes. The other source from which they can repay us is by floating off some of the businesses which they have been financing, and issue their shares to the public. They have not done that lately because things are so difficult, but they have done it from time to time.

3964. This is not the type of business to which you are attracted, or think you ought to undertake in the public interest, the financing of small companies who may have difficulty in issuing stock?——No, I do not think that is the sort of business we really ought to go in for in a large way; though we have done it from time to time. There are many businesses that owe their existence to having had their first finance from a bank. But it has always been on the basis of a creditor; we have never taken shares in the business.

3965. *Chairman*: There are businesses which say that their present position is due to their bankers, that they were nursed in their early stages by their bankers; surely something more than a creditor relationship must have been involved?——No; strictly a debtor-creditor relationship.

3966. I do not mean you took shares, but you must in fact have exercised a benevolent financing activity in regard to them?——We know a lot about them, if we are going into a thing like that; but we would not go beyond lending money, and we would not take a share of the equity.

3967. *Professor Cairncross*: Nor take an interest in promoting a company, or finding the man capital somewhere else?——We would advise him where to go: to an issuing house or to I.C.F.C., for instance, and we frequently do.

3968. That would be a man of some size. I was thinking more of the very small man whose capital might not be more than £10,000?——*Mr. Chesterfield*: I.C.F.C. would deal with that.

3969. Provided he could show a seven year profit record?——No, not necessarily.

3970. Are you sure of that?——I do not know the internal workings of I.C.F.C.; but a large part of I.C.F.C.'s business comes from the joint stock banks. Wherever we think there is a company who could do with finance of that size, between £5,000 to £250,000, we introduce them to the I.C.F.C.

3971. In the case of the small man you have an intimate acquaintance with his affairs, because he is indebted to you; if he had to pay for the cost of an inquiry into his affairs, it would cost him a substantial sum, even in the case of I.C.F.C. Is that not a material item?——*Mr. Robarts*: I do not think any of us are familiar with the internal workings of the I.C.F.C. We own the shares, admittedly, and it is very well managed.

3972. *Chairman*: I do not want you to under-estimate the amount you have done and can do in this field. Surely the branch manager in many cases has been something like an institutional patron to small and beginning businesses which he thinks well of?——I would agree entirely. He helps with advice, and he is very much relied on in the community where he works just for that.

3973. Apart from sending them to I.C.F.C., which is perhaps rather an impressive thing, can he help them to find alternative backers, apart from what the bank can do in lending money?——*Mr. Robarts*: I would think it very likely but I cannot call to mind any concrete instance. —*Mr. Chesterfield*: Does the Chairman mean that he might introduce them to another customer of the bank?

3974. I was thinking of that primarily?——*Mr. Robarts*: I think the answer must be, no, because he would at that point take some responsibility for seeing the thing went right, and he would look very silly if it did not.—*Mr. Tuke*: In normal times we all of us do lend such people £1,000 or £2,000; that is really the way we have helped them with the banks' money, even more in the past than in the present. The old private banks did that a great deal; it is a question to what extent the joint stock bank with its managers can still maintain that, but we all hope we are doing that.—*Mr. Robarts*: It is particularly true, of course, in the case of farmers, but it is very difficult to get any charge over the assets of a tenant farmer; there are certain things you can do, but your money really depends on your judgment of his farming capacity. That is a very important function of a bank manager in an agricultural area. He is always backing his judgment in the farmers.

3975. *Lord Harcourt*: I imagine that the joint stock banks have carried on to some large extent the tradition of financing the small man through the local manager and through local committees?——*Mr. Tuke*: Very much so; with the proviso that in these days it is much more difficult for the small man to get on his feet through careful living and saving because of the level of taxation. It takes him much longer to develop; it is not such an attractive proposition either to him or to the bank.

3976. *Mr. Jones*: In the answer to question 1 (c) we are told:—

> "The position of its liquid assets is bound to affect a bank's decisions about lending, but rather than call in advances to adjust its liquidity, a bank would first consider reducing its investments. Decisions of this kind are taken without concerted action or discussion between the banks. It may happen that different banks will take different views about an industry, and so a restricted policy by one bank may well be counteracted by a more liberal policy in another."

Is this really a problem? Surely, no bank can have a monopoly of one industry or trade?——*Mr. Robarts*: No; no bank has, of course. We are trying to say that in the normal way there is free competition. I might take a pessimistic view about, let us say, the cotton industry and might not be prepared to lend money to it; Mr. Tuke might take the exactly opposite view; and if he was right he would take the business from me with success. That is what was in our minds.

3977. *Professor Cairncross*: I have a question on the answer to question 1 (e). I believe it to be true in other countries that there are different rates for different periods for which money is deposited. You make a distinction between current account and deposit account; have you considered the introduction of a spread of interest rates for different periods of loan?——*Mr. Robarts*: We used to do it years ago.

3978. You have not thought of reviving it?——As we say in the paper:—

> "The Clearing Banks do not offer special rates for varying terms of deposit and have not done so since 1945. Since that date the great majority of the banks have been well supplied with deposits and are underlent as compared with the pre-war period, and have therefore not felt it desirable to pay special rates for long-term deposits which might well entail raising the rates charged to borrowing customers. It is necessary to preserve a balance between the rates paid for deposits and those charged for advances."

As I have said before, there is not much object in bidding up for deposits at the present time.

3979. Have you thought of reviving the policy, given that you had an incentive to obtain additional deposits, which you have not at present?——*Mr. Robarts*: It is possible that that may come back again. If it has happened in the past it can happen again; but in present conditions we would not wish to do that.—*Mr. Tuke*: We treat all our money alike; it goes into the common pot, and the fact that we had some fixed for a longer term at a higher rate would not influence us in any way. Therefore it would not do us any good. I would frankly think that in the past, when we took money for a longer term, for three months, six months or that sort of thing, and gave a higher rate on it, we wanted to give a higher rate in order to get the money, and the longer term was in part an excuse for paying a higher rate for it. It was not that there was any particular advantage in having that money for three months; we did not put that particular money into a three months Treasury Bill, or anything

like that. I can perhaps contribute something from our overseas experience: our overseas branches take time deposits for various reasons, and their experience is that those are the most volatile of all their deposits. Their deposits on seven days remain in the mass unchanged, but these big deposits for fixed terms go up and down, and are a thorough nuisance.

3980. *Mr. Jones*: The services of banking are very useful to your current account customer, so that he is content not to derive any interest upon any margins that be is able to leave with the bank. If his current account is substantially built up, that is to the advantage of the bank. I am not quite sure what the position would be in relation to the use by the bank of resources on current accounts; do you have, with a higher Bank Rate, a substantially greater increment from your current account banking than otherwise would be the case?——*Mr. Robarts*: Dealing with your first point first, the remedy is completely in the hands of the customer. All he has to do is to instruct his bank to put so much of the balance on deposit, and provided he leaves it for a minimum of seven days he will receive interest on it at a rate, at present, of 5 per cent.

3981. *Mr. Woodcock*: Is that what you expect him to do?——They do it freely; anybody who has money which is surplus to his requirements, and does not take advantage of that, is not so very well advised. As for current account balances, when the Bank Rate is high we can clearly use that money at a higher rate of interest than when the Bank Rate is low.

3982. There is a movement from current account to deposit account in these circumstances?——Very much so. We have noticed it very much since the Bank Rate went up in September.

3983. *Mr. Woodcock*: Are these tanker loans paid back gradually?——In equal yearly instalments.

3984. Not like an overdraft? They cannot pay you back as they want to?——No, they are much more like the term loans, to which Lord Harcourt has already referred.

3985. What is the rate of interest here?——It was based on the current level of Bank Rate.

3986. Does it move with the Bank Rate?——*Mr. Robarts*: Yes; speaking from memory, as each section of the loan is taken, the rate for that section is fixed in accordance with the Bank Rate at the time it is taken.

3987. The rate once fixed does not vary?——Not on those particular loans; but on nearly all our other loans it does. The tanker loans were special loans in a different category from almost everything else we had.

3988. That formula is only applied to each separate borrowing; it is not retrospective? The actual loans you made before the Bank Rate went up still remain at the rate of interest fixed before the Bank Rate went up?——*Mr. Robarts*: Yes.—*Mr. Tuke*: Within the total of any particular series of tanker loans, we lend it in chunks as a particular tanker is launched.—*Mr. Robarts*: Perhaps I had better describe this arrangement rather more fully. The loans are for companies engaged in building tankers, the tankers being chartered to the oil company which will use them for periods of about twenty years, which is roughly the useful life of a tanker. Finance has got to be produced as the tankers are built; hence the various tranches of the loan. I have already explained that insurance companies want only to lend for fairly long periods at these high money rates, so these loans were divided into branches, the longer tranches being taken by insurance companies, pension funds and kindred institutions and the shorter tranches, which have an average life of eight years, by the banks.

3989. *Chairman*: And this is an arrangement, from the bank's point of view, for medium term financing, which did not produce a negotiable instrument?——It did not produce a negotiable instrument.

3990. *Mr. Woodcock*: You would not want to do much of that?——*Mr. Robarts*: We could not do much of that. It was, of course, represented, and no doubt rightly, that it was very much in the national interest at the time.—*Mr. Tuke*: It was at the time of the Suez crisis; we wanted fast tankers to circumvent Suez.—*Mr. Woodcock*: The argument about the national interest would apply to power stations too.

3991. *Chairman*: In your answer to question 4 you make the comment, in dealing with the authoritative exposition of policy changes:—

"When Bank Rate was reduced in February, 1957, despite official warnings that the reduction did not imply a reversal of the restrictive financial policy, the public interpreted the reduction as a sign of a reversal of policy.

Fuller explanations to the public of these moves would have been useful."

What more do you think could have been said to impress the public with the significance, or lack of significance, of what was being done?——I suppose what was really wanted was that the public should believe what they heard, and they did not.

3992. That is rather a different point; you make the point here that fuller explanations ought to have been offered. I wondered what more could have been said; the right things were said?——*Mr. Tuke*: The Government would naturally think in terms of making an announcement in Parliament, but the trouble about that is that only some fragment of it appears in the Press. It may be played up or played down, and it does not get home.—*Mr. Robarts*: It is difficult to achieve it, but I feel that a fuller, more comprehensive explanation in the Press would have been of help. A full and comprehensive explanation was given by the Governor of the Bank of England to the City, and they understood the significance.

3993. So it was your customers who did not?——Yes; people up and down the country. These things are not of very great public interest; they are rather technical, and it is difficult to get the papers to explain them thoroughly. A reason for this reduction was the technical one that the Bill rate had fallen; but that is not the sort of thing which goes very easily into headlines.

3994. It would not have been understood, unless it had been fully explained?——Exactly. It is not an easy one; and I am quite certain that the man in the street thought "This is fine; things are looking up."

3995. *Mr. Woodcock*: Is not that what you would expect? If a rise in the Bank Rate is to be taken as a warning, what is a reduction to be taken as?—*Chairman*: If you stress the psychological importance of increasing Bank Rate, you must expect the consequence of reducing it?——*Mr. Robarts*: That is perfectly logical; but the reasons which may cause a reduction in the Bank Rate are various and many. This was caused by a purely technical position. I agree with you that is a very difficult thing to explain.—*Mr. Tuke*: Any explanation offered had to stand up against the impression among business men, which had been confirmed over ten years past, that they could not do wrong to get hold of as much stocks as they could get hold of. That has been going on all the time. There was just one moment, after the Korean war, when prices fell a bit, but otherwise they have been right to get hold of all these stocks. It was the general inflationary mentality of the country. They probably went on buying equities too. In the last few months, and beginning even before the 19th September, there has been a move the other way.

3996. *Professor Cairncross*: There are a number of questions on statistics, which we should like to put to you. I doubt whether we can put all of the questions to you today, but it may be useful to you if we give you an indication of the kind of matters which are of interest to us. Clearly the information which you need for your purposes, or which your shareholders need for theirs, is not the information which would show what was happening to the banks as a group, which is what is of importance for monetary policy. The kind of information we are concerned with, both for our own purposes and for publication, relates to the totals in the banking system. I think you would agree that some of the information which is at present released is not satisfactory, because it is not comprehensive: for instance, although there are figures for the clearing banks, there is no single figure of deposit liabilities of the British banks as a group; nor is there any comparable figure for other items, aggregating together the Scottish banks, the English banks and other banks. I think you would agree that it would be useful to have those aggregates, for the purpose of seeing what was happening to the money supply as a whole. There is no

figure, so far as I am aware, of the money supply in this country?——*Mr. Robarts*: If you mean the deposits of the banks which operate in this country, does not the British Bankers Association publish such a figure?

3997. They publish figures for advances, but not for deposits.——*Mr. Robarts*: I am very surprised. I should have thought that that was easily obtainable.—*Professor Cairncross*: It is not.—*Mr. Tuke*: I take it that you are really concerned with the upwards and downwards movements, rather than the basic figures. The clearing banks form an immense proportion of the whole, and the "Big Five" are 86 per cent. or so of the clearing banks. So if you look at the "Big Five" you have a fair indication of trend.

3998. You have a fair indication of trend; but it seems a little odd that the one figure which would appear to be crucial is not available. It may be an indication; but the Scottish banks do not always move in the same direction, or to the same extent, as the clearing banks.——But these other banks outside the clearing house keep a lot of their money with us, so you would get a lot of the money appearing twice over.

3999. You may equally keep some money with other banks here, and there may be other forms of overlapping; but the total which is of interest is the deposits held by commercial banks, as far as possible purged of any duplication of this kind. If there is duplication ought we not to know about it? If the Scottish banks have deposits with you, that too would be of some interest, because otherwise we might be looking at the wrong sets of figures. There are other items where I think the general public, if it is going to form a view on monetary policy, might like more precise and fuller information.——*Mr. Robarts*: A lot of the banks which you are referring to are operating overseas.

4000. Is it not apparent that there is a distinction between deposits by British citizens resident here and deposits by citizens resident somewhere else? I do not want to go into this in this discussion; I am merely making the observation to you that, as far as I am aware, the data are not altogether satisfactory; we lack even such a division as would allow us to arrive at sensible conclusions about the money supply in this country.—*Chairman*: Could we, first of all, draw up and send you a list of the various sets of figures, about which we would like information for the purposes of our own report, and about which we would also like to know whether there is any reason why they should not regularly be made available? There is no urgency about this, but perhaps in due course you would be able to give us an answer, and then we could have a meeting after due notice to discuss what emerges from question and answer. Do you think that would be the best way to deal with it?——I think it will short-circuit a lot of discussion; and I shall have to consult other people; a lot of this is not our business, and we must get their agreement.

Chairman: We will get the letter out as soon as we can. I think that brings us to the end, apart from this matter which may mean another meeting. We are very much obliged to you, gentlemen, for the time and help you have given us.——*Mr. Robarts*: Thank you very much, Sir. I hope that we have answered your questions clearly. We are at your service at any time.

(Adjourned until Tuesday, 4th February, 1958 at 11.00 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

EIGHTEENTH DAY

Tuesday, 4th February, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

THE HON. P. M. SAMUEL M.C., T.D., Chairman, H. J. S. FRENCH, Esq., O.B.E., Deputy Chairman, and A. H. CARNWATH, Esq., representing the Issuing Houses Association, called and examined.

4001. *Chairman*: Would you begin by telling us a little about the composition of the Issuing Houses Association, and how it is recruited?——*Mr. Samuel*: It was originally started after the war. Every issuing house was written to at the time, and pretty well all the issuing houses joined at the time. Since then, people have been able to apply to become members of the Issuing Houses Association; the Executive Committee examines any applications, sees that those applying have done issues and are responsible bodies, and, if so, they are elected.

4002. Was there any organisation before the war?——There was no Issuing Houses Association before the war.

4003. What brought it into existence after the war? Was it a suggestion of the Bank of England?——No, I think it was a suggestion of Mr. Bertram Abel Smith, who was a partner in my bank. He thought that it would probably be a good thing to centralise the problems of the issuing houses, and discussed that with various people. That is how it came into being.

4004. What is the main purpose of the Association? Is there a series of rules of conduct, or understandings, which members are expected to observe?——No, there are no rules of conduct. It is really an advisory body, which deals with any problems which arise in the course of the business of issuing houses. It may cover a great number of technical things which crop up, from the issuing of coupons on bonds to the S.E.C. rules in America. Sometimes we are written to by one of the members; sometimes somebody who is not a member writes from one of the other bodies, say the Stock Exchange, or the Investment Trusts Association, and says: "I think this is a problem which you will be interested in."

4005. So it is generally for the discussion of matters which are of common interest to those engaged in the work of issuing?——Yes. We do not control how people manage their own businesses, but we like to think that the fact that we are there means that members of the Association would not do things which would not be directly in accordance with what one would think would be the right practice.

4006. When it was formed, everybody who had been concerned before the war in the business of issuing was invited to become a member?——*Mr. Samuel*: I am afraid I cannot answer that; I do not know whether anybody else can.—*Mr. French*: I think the Issuing Houses Association came out of the Accepting Houses Committee, because problems arose there after the war which that Committee did not think were within their province, for instance about foreign bonds that had defaulted, and that sort of thing. There are only about seventeen accepting houses, and there are a great many more people who are concerned with issues.

4007. The accepting houses had a body before the war?——*Mr. Samuel*: Yes, the Accepting Houses Committee has been going much longer.

4008. Have you had any applications to join your Association since it was originally constituted?——*Mr. Samuel*: Yes; periodically people apply. Only a month ago somebody applied, who actually had done issues, but was not a member.—*Mr. French*: I happened to meet the man in question at dinner on the day he had done an issue, so I asked him why he was not a member of the Association; he said that it was not worth it, but he applied to join the next day.

4009. He came in?——Yes.

4010. Has anybody who applied been refused?——We would only admit a firm. On one occasion there was an applicant who was a sole trader; he did not qualify under our rules, but he later joined up with a firm, and came in. We do not allow a sole partner. It is very rare to have a sole partner making issues.

4011. Is the point in requiring that you should not have a sole partner the solidity of the house?——*Mr. Samuel*: Yes; one does not know with an individual or sole partner what is his position. There is no means of knowing enough about him.

4012. Has anybody applied and not been accepted, since the Association was formed?——*Mr. French*: There was that one, but he was accepted later when he joined a firm. —*Mr. Samuel*: I do not recollect any other, certainly not since I have been on the Executive Committee, which is about five years.

4013. *Professor Cairncross*: Why then are there so many issues that are made not through the Issuing Houses Association, but in other ways?——Most of those are made by brokers without an issuing house, which is a practice which has arisen in the course of years.

4014. Should we be right in taking the figures which you give in paragraph 7* as indicating that about 40 per cent. of the issues of public companies are handled by brokers?——59 per cent. was raised by us; the other was raised by brokers.

4015. Chairman: Would that be mainly placings?——No.

4016. Issues with prospectus?——The brokers do business in exactly the same way as an issuing house.

4017. *Professor Cairncross*: Would these be mainly in London, or would a substantial portion be out of London?——*Mr. Samuel*: I expect most of it is in London, but it does take place out of London at other Stock Exchanges, like Birmingham and Glasgow.—*Mr. French*: I.C.I.'s recent issue regrettably had no issuing house. There are these big firms of brokers which specialise, and are really like issuing houses; but an issuing house really acts as principals in the matter, and brokers are agents when they are broking.

4018. *Chairman*: A broker who did a very big issue of that kind would not be a member of your Association?——Brokers are not members. We have to have brokers when we make issues, as well as an issuing house.

4019. *Professor Cairncross*: Is the broker still merely the agent for the public company?——I think he does it very much the same way as we do.

* Memoranda of Evidence Part VI No. 12.

4020. *Professor Sayers*: What is the distinction, then, between a broker and an issuing house, for this purpose?——*Mr. Samuel*: The distinction is one which we particularly like to think is a very good one. If you are an issuing house you have to use a broker, because the shares have to be quoted on the Stock Exchange, and you have to go through all the business with the Stock Exchange. But we think that issuing houses are the best bodies to do that, because their resources are greater, and their general knowledge of business is greater, than the broker's, who should really be confining his business to stocks and shares as such. I have no doubt they do not agree with us, but that is our view.

4021. *Chairman*: Does the broker arrange the underwriting in these cases?——Yes.

4022. He takes them himself, and does what he can by sub-underwriting just like you do?——Yes.

4023. *Mr. Jones*: What would be the "greater resources" of the issuing houses, as compared with those of a firm of brokers?——A lot of the issuing houses are private companies, and you cannot tell what their issued capital is; but a lot of them are very large ones, and you know what their issued capital is, and you know, even if you do not see their figures, by the business they do, that they have large resources, in many cases running into millions of pounds.

4024. *Professor Cairncross*: You are referring to their capital; not to deposits or anything of that kind?——No.

4025. *Professor Sayers*: How are the resources brought to bear on an issue? What responsibilities do issuing houses take, which a broker does not take when he acts without an issuing house?——No different responsibilities; in other words, in those cases it is a question of underwriting. With most issues there has probably been some sub-underwriting with institutions and bodies like that; in either case the ultimate responsibility is with the underwriter. If his sub-underwriters let him down, the underwriter is the person who takes the ultimate responsibility.

4026. Then what are the advantages, from the public point of view, of these greater resources that the issuing houses are bringing into the business? They take no further responsibility?——If anything went wrong, it would be incumbent upon the person making the issue to find the money; naturally, if I want some money for my business, I want to be certain that I shall get it.

4027. *Professor Cairncross*: The advisory service, which you referred to in the memorandum, would perhaps be more expensive in the case of an issuing house, than in the case of a broker?——I think generally speaking that would be so.

4028. Would you sub-underwrite 100 per cent. of each issue, or do you retain part of the underwriting in your own hands?——It varies very much according to the size and nature of the issue. I would say that most issuing houses kept a certain amount in their own hands, but not proportionately more than they thought was generally good business. On the whole I should say that probably the great majority of an issue would be sub-underwritten.

4029. Which, in your view, are the main sub-underwriters? Do the insurance companies take the bulk, or are there any other groups of sub-underwriters?——The insurance companies take most of it; and there are investment trusts, pensions funds, and various charitable funds, as well.

4030. Do you think the insurance companies would take half, as they claim to do?——*Mr. Samuel*: I should think that is about right.—*Mr. French*: If they do not take half we have a job to underwrite it.

4031. To see charitable funds venturing into this is rather odd. What brings people into the sub-underwriting business?—*Sir Oliver Franks*: I know of one or two which do; they pay tax on their profits if they make them, because it is a trading transaction; but their funds are not precluded from being used in this way?——*Mr. Samuel*: It varies; some do and some do not. On the question as to how people become sub-underwriters: when one wants to underwrite or sub-underwrite an issue, particularly a large issue, one obviously wants to tap as many sources as possible. As new sources come into being (pension funds and things like that) we know that there are other sources which we can use, and naturally we approach them. Also, of course, on the whole they like to have the underwriting. In many cases, if it is a rights issue, contact is established as shareholders get their rights. It is just part of the general mechanism of the City; people are brought in as sub-underwriters as they become established bodies.

4032. *Mr. Jones*: Are the arrangements for underwriting always direct between the issuing house and the insurance company or whatever it is, or are there occasions when brokers come in between the issuing house and the underwriter?——In most cases I should say the broker does not come in between as regards responsibility. The broker acts as an agent who goes round and places the sub-underwriting on behalf of the issuing house. He does not, when he is acting in that way, take the responsibility for it.

4033. You would never have an arrangement, say with a superannuation trust or an insurance company, for underwriting a certain amount of the issues for which you were responsible as issuing houses? Would it always be done through the brokers?——*Mr. Samuel*: If it was a small amount one wanted to underwrite, it might not. In some cases we do not underwrite it, we just place it direct, in which case the issuing house may go direct to an insurance company. We may find that one of the big insurance companies, if it is a very small amount, will take the whole lot. It varies according to the size and complexity of the issue; on big ones a broker is usually used, but even on those the issuing house may place some of it itself and not give it all to the brokers. Usually the issuing house discusses the matter first with its client, the firm that wishes to raise the money. Then the issuing house approaches one or two of the big insurance companies to sound out what they feel about it, and to get an idea of what their reaction would be. Then we call in a broker, and there is a tripartite discussion with the client and the broker; maybe accountants and solicitors will come into it by that time. As far as the issuing house is concerned, the price must have the agreement of his client, in discussion, possibly, with the broker. Then the issue is underwritten, which consists of an underwriting agreement between the issuing house and its client, and more or less simultaneous sub-underwriting agreements with a great number of sub-underwriters.

4034. Is that underwriting in all cases in the hands of brokers?——*Mr. Samuel*: Some underwriting may be done by the issuing house, itself; as regards the remaining part, which is in the hands of the brokers, one will have a pretty good idea before they go round as to what may happen.—*Mr. Carnwath*: When the broker does this for the issuing house, he is acting as an agent for the issuing house. The issuing house has put its name to the issue and the sub-underwriters will be considering the reputation of the issuing house whose name is on it. So they are really doing it with the backing of the issuing house, and the broker is purely an agent.

4035. To what extent do issuing houses themselves underwrite issues that they are responsible for without sub-underwriting them?——*Mr. Samuel*: Very seldom.

4036. *Professor Cairncross*: Do you assume a financial commitment for the issue, before you have arranged the sub-underwriting?——That varies. Sometimes one does but on the whole, if it is a big issue, one does not.

4037. There must be times when the financial climate changes abruptly, when the Bank Rate goes up sharply, for instance; if you were then in the position of being committed to making certain issues, and had not arranged the underwriting, you might be in some difficulty?——*Mr. Carnwath*: Yes, it does arise, occasionally on large issues; the issue may have to be put off, or the terms altered.

4038. *Professor Sayers*: For how long a period do you feel committed to an issue before you have it safe in the hands of the underwriters?——*Mr. Samuel*: Committed on doing it: possibly for quite a long time; committed on prices: usually not for long.

4039. We have had for a long time something approaching a convention that the Bank Rate, on the whole, moves up by 1 per cent. and down by one-half. If that were to give way to a convention that the Bank Rate normally

went up by 2 per cent. and down by 1, would that make difficulties for you?——*Mr. Samuel*: I think it would merely mean that we should have to give a great deal more consideration to this particular issue. The whole terms of an issue depend on the Bank Rate and gilt-edged prices, and if we thought there were likely to be very wide or large fluctuations in the Bank Rate we should just have to be more careful.—*Mr. French*: The rates of commission might go up.

4040. *Professor Cairncross*: But is it not part of your contention that you would like to see the rate of interest used more freely as an economic regulator, and does that not imply rather more violent and frequent movements of the rate?——*Mr. Carnwath*: I would not quarrel with that at all.—*Mr. Samuel*: But one might quarrel with that being the normal way of using the Bank Rate when there were no particular economic pressures which were unduly violent at the time. Our whole thesis has been that when it was necessary it has not been used violently enough.

4041. *Professor Sayers*: On that basis it might be more normal in future for the Bank Rate to move both up and down by bigger jumps than has been customary in the past. There is another point on the mechanics of Bank Rate movement: it is sometimes suggested that it is unfortunate that Bank Rate movements are thought to be properly confined to about 12 o'clock on a Thursday. Suppose that it became normal for them to happen at any time in the week, as technically they can now; would that also make your work more difficult, and also more expensive for the public?——I do not know in either case that it makes it more expensive to the public.

4042. If it made it more difficult for you, it would seem to follow that it would become more expensive to the public?——I do not think that does follow.

4043. *Chairman*: I thought one of the answers we had just now was that, if there were steeper movements of Bank Rate, with consequent movements of gilt-edged rate, in which you are primarily interested, it would tend to raise the commission which the underwriter would have to take. Did you not say that?——*Mr. French*: I said that, but I may be wrong.—*Mr. Samuel*: It is awfully difficult to judge how much difference it would make, until it is in force, and one sees how frequently it is used on economic arguments. If it is really going to be altered very frequently, once a month or something like that, then I suppose it would make a difference, but I was not really thinking of it being altered quite so often.

4044. *Professor Cairncross*: Suppose that it is altered by 2 per cent. upwards, whenever an upward movement is necessary; is not that going to create a jam in the new issue market, from time to time, which would be really awkward from your point of view?——*Mr. Carnwath*: Surely we are not going to contemplate a completely irresponsible movement of Bank Rate. If Bank Rate is going to move, it is going to move in a certain economic climate. Presumably it is part of the job of the issuing house, advising their clients, to consider that economic climate, and they would be considering their assessment, in the light of that and of the possibility of a movement in the Bank Rate. Whether it moves 2 or 1 per cent. I think you can only consider it in the light of the circumstances at the time.

4045. You point out in your memorandum that there are quite long stretches of the year when the new issue market is not functioning, on seasonal grounds. Have increases of the Bank Rate normally been followed by a similar interval in which issues were extremely difficult? ——*Mr. Samuel*: No. I do not say it makes issues difficult to raise. It causes a delay, because there is a re-adjustment of sights to the new basis of Stock Exchange prices; and I suppose in certain cases a drastic raising of Bank Rate in the sort of climate which happened last year might cause a shock which might make issues difficult to do, because people might suddenly think that the situation is worse than they thought. But, generally speaking, I would think that the actual mechanical fact of raising the Bank Rate merely means a mechanical adjustment of rates. It might in certain cases make borrowing too expensive; and some people might say that they would not go ahead.

4046. Is this just a matter of prices? I have always understood there were times when the new issue market was in effect closed to issues, because it would be technically impossible to make an issue. This was not just a matter of whether your client would be prepared to accept another price, but really that it would be impossible to arrange underwriting and subsequent disposal of stock. Is this not so?——*Mr. Samuel*: I should think it would be true for a week or two after a really big adjustment of rates, because it means a big adjustment all round. I think that would be the right way of putting it.—*Mr. Carnwath*: The last movement of the Bank Rate, which was a particularly large one, had surprisingly little effect on the long-term rate, with which we are mostly concerned. As you will remember, a large issue was being underwritten in the City at the time, and the terms of that were not really all that different from those at which you can underwrite a similar issue today.

4047. *Chairman*: You say "surprisingly little". Were you all in fact surprised by the smallness of the movement in the gilt-edged market which resulted?——*Mr. Carnwath*: I do not think I was myself, no; perhaps "surprisingly" was not the right word.—*Mr. Samuel*: I think a lot of the movement had been discounted in advance.

4048. *Professor Sayers*: May we come back now, in the light of what we have just been saying, to my question about the timing of Bank Rate changes? Now the chances are very heavily against its moving between one Thursday and the next; on the whole that does not happen. Suppose that it became usual for it to happen on any day of the week, say at the opening of business on any day of the week; would you be much discomforted?——Speaking purely as an issuing house, I think it must be easier to know on which day a fluctuation in the rate may take place.

4049. *Sir Oliver Franks*: Is that saying that freedom is only real under rules? If there is a rule about the Bank Rate, then, as issuing houses, you think freedom means rather less after modification in the rules about the Bank Rate, i.e., it becomes more difficult?——Yes.

4050. *Professor Sayers*: How substantial is this point? Would you raise a serious argument against greater freedom in the timing of the Bank Rate changes?——*Mr. Samuel*: No.—*Mr. Carnwath*: It is just one of the things one has got to deal with.

4051. *Professor Cairncross*: Have you seen any indication, since the last increase in Bank Rate, that the queue of applicants for new issues is diminishing? Is there any marked change?——*Mr. Samuel*: No, I do not think it has, on the whole. I think there have been just as many. —*Mr. Carnwath*: It is difficult, because people's experience varies.—*Mr. Samuel*: There have been some very big issues.

4052. There were large numbers of big issues pending. If you take the more immediate evidence in the last two months, is there any indication of any marked falling off? —*Mr. Carnwath*: I would say there was some indication. —*Mr. French*: Yes. I think the smaller ones have probably sheered off a bit.

4053. The C.I.C. is finding rather fewer applications, and I wondered if this had come through to the market? ——*Mr. Carnwath*: Whether it was so much the actual long-term interest rate which has kept them off, or being rather frightened to go to the C.I.C., because of its tougher attitude, I do not know.

4054. *Chairman*: Would not the fact that these very large issues have taken place and are still hanging over the market tend in itself to keep the small issues back?—*Mr. French*: Yes.

4055. *Sir Oliver Franks*: Does permission have to be obtained from the authorities for the timing of all issues above a certain size, or for all issues?——All above £1 million have to go to the Bank of England; all below £1 million have to go to the Council of the Stock Exchange.

4056. When you are dealing with the Bank of England, are you not dealing with something which forms and manipulates a queue? Is that the case with lesser issues with the Stock Exchange, or is that a straight formality? ——The Stock Exchange are merely acting as the agent

of the Bank of England, but they have been given discretion at a lower level. Where there is a small amount it does not really affect the market very much, so it can be allowed to go ahead.

4057. But if the Bank of England wished to hold the way clear for a particular issue of some sort, it could make its wishes effective not merely with its own decisions for issues of £1 million and up, but through the Stock Exchange for the little ones, if they thought it necessary?——I am not quite sure how it works, but I imagine so.

4058 *Chairman*: What happens with this marshalling of issues by the Bank of England? Does the issuing house take up the question of the timing of the issue with the Bank of England?——When it is over £1 million, we have to go through the Government broker; the issuing house can do it direct with him if it wants to keep it secret, or, if it has a broker acting, he will normally go to the Government broker.

4059 The Government broker is the means of access?——Yes.

4060. Do you have arguments about what place you should have in the queue, or is it all accepted without demur?——*Mr Samuel*: There is not always an active queue, but if there is one we probably put our claim in for the date we want, and we may have to alter it later.—*Mr Carnwath*: One is told in the first instance by the Capital Issues Committee, when one gets Treasury consent, whether or not one has to make application for timing; and then, of course, depending on how far advanced one is with the issue, one tries to get one's place in the queue as quickly as possible.

4061. You go to the Government broker and ask for a date?——Yes. We say: "This is what I would like to do. Is this all right?" In the great majority of cases, it usually is all right; there is not usually much difficulty, unless there is a really big issue which is likely to fill the market during that time. Then you are probably warned that it would be wiser to put your programme on a week, or bring it back a week, if you can.

4062. Are you told the reason for the date you want not being acceptable?——No.

4063. *Professor Sayers*: Do you accept the change of date as being probably in your own commercial interests anyway?——*Mr. Carnwath*: I think so, really. I was trying to see if I could remember one when we actually did not get the date we wanted. It usually seems to fit in fairly well.—*Mr. Samuel*: Of course the very big ones have to be very much put in at the right moment.

4064. *Sir Oliver Franks*: But is there not anything outside your field in the market? There is a certain amount of marshalling, or inclusion and exclusion, in the whole field; surely local authorities think that they are either held back or allowed to go forward in relation to everything else that is going on in the issuing field?——*Mr. Samuel*: Yes, local authorities and Commonwealth projects, too.—*Mr. Carnwath*: There is probably a different queue for local authorities, which are in a different class from industrial debentures. That is the impression one gets.

4065. *Professor Sayers*: For how long has this marshalling been going on? Is it purely post-1939, or does it go further back?——I was surprised, on reading the life of Lord Norman, that there was an unofficial arrangement, even after the first World War, in regard to foreign issues; but I think it has only been official in any way since the Capital Issues Committee.

4066. We should not really find that within living memory a system was operated without any marshalling at all?——I should think that is probably right.

4067. *Chairman*: You spoke just now as if the variations that were brought about were really a week forward or a week backward. Are they not larger than that?——I am only talking of my own experience; in practice that is so.

4068. *Sir Oliver Franks*: Has it not been the case (I am not speaking from knowledge at all, but from impression which may be mistaken) that with some really large issues it was not clear, within even a couple of months, when the actual time would be?——*Mr. Samuel*: That is the case; that has actually happened in the course of the last few months. There have been two exceptionally big issues, the BP and Shell issues; when they get to that size they are controlled not in weeks but in months.

4069. *Professor Cairncross*: Do rights issues take their place in the queue?——If they were big enough, they would. They all go through the C.I.C.

4070. *Sir Oliver Franks*: Decisions about placing in the queue, the size of the queue and the co-ordination of the different queues, presuppose certain judgments about the amount of money which can be raised, and the amount of capital investment in the private sector which is possible or desirable. Are these general considerations, which presumably govern the action of the authorities in the way that they space things out and arrange them, communicated? Do you, as issuing houses, know how much capital investment is likely to be made in six months or twelve months, or is that not said?——We are given no information on it, no.

4071. *Chairman*: What, according to your understanding, are the absolute priorities which affect this order? There are the Government's own issues for which the way is cleared, I gather?——Yes, I think that is considered to be so.

4072. Apart from that, what would you understand had a priority over any ordinary issue you were wanting to bring up?——It depends very much on the industry, and the Government's opinion of what is important in the national economy. There is no question, as things go at the moment, that industries which have a lot to do with the exports field would have a high priority.

4073. This is apart from the C.I.C.'s operations; I am assuming that you have got through the C.I.C., and it has given you consent, subject to timing being arranged by the Bank of England?——*Mr. Samuel*: I think the only consideration is what would appear to the Treasury to be the things which are most needed at the time, according to their size. The aim is also very much not to congest the market, and that depends on the size of the issue. I think that side of the timing is almost the most important part of it. But we are not told.—*Mr. Carnwath*: We can make guesses like everybody else, but, on the whole, we have not had much trouble with it, except on the very big issues.

4074. *Professor Cairncross*: Could you tell us what you regard as a small issue? How low do you go?——*Mr. French*: Lower than £1 million might be regarded as a small issue.

4075. What would be the lowest limit that you handle?——*Mr. Samuel*: We would probably go down to £50,000.

4076. Would that not be infrequent, and very expensive?——If somebody wants £50,000 we just go to an insurance company, or two or three insurance companies, and place it straight away. Because of the way it is done it would probably be the cheapest form. That is, of course, subject to all the other difficulties there are with very small issues.

4077. *Chairman*: Ought we to regard a £50,000 placing as being exceptional, or something that you are engaged in year in year out on quite a scale?——In the issuing houses as a whole a great deal of business of that size is going on.

4078. *Professor Cairncross*: When the Macmillan Committee looked at this issue they regarded £200,000, in terms of 1930 money values, as about the lower level. That would be equivalent today to certainly well over half a million pounds. At the same time they said that issuing houses were not particularly interested in home issues. Now you are putting it to us that nearly all your business is in home issues (so that there has been a complete changeover) and that you are prepared to go down to £50,000 and to do a fair amount of business in issues of that size. Would it, however, be a fair assumption that most issues of that size are made through individual brokers, rather than through issuing houses?——*Mr. Samuel*: No. I would think that it is possibly more the other way with the small ones; but there are so many bodies, not all issuing houses, which deal with that sort of thing.—*Mr. French*: We do not often raise £50,000 for any concern whose shares are quoted on the Stock Exchange already; that is possibly rather exceptional, but there is a lot of business with private companies and quite small companies wanting that sort of amount of money, or more or less than that.

4079. *Sir Oliver Franks*: And taking £50,000 as the lower limit, and going up to £250,000, would it be true that all, or practically all, of the issuing houses do some of that business?——*Mr. Samuel*: Yes.

4080. It is quite generally spread?——Yes.

4081. *Chairman*: Could you, through your Association, give us figures which would show the order of magnitude of this business? Could you take issues of up to £250,000, taking £50,000 as the lower limit and £250,000 as the upper limit, and give us an idea of what those who are members of the Association have done in issues within those figures in a series of years?——*Mr. Samuel*: I have not got those figures. I am told that the Midland Bank already produce them.—*Mr. French*: Whether they would deal with these small ones, I do not know, but every month they produce statistics about new issues.

4082. *Sir Oliver Franks*: The interest of the Committee is in the number and the general volume of capital received at the different steps of size. If you go back to the problems of the Macmillan gap, the things which you are telling us now are directly relevant to whether there is or is not a gap at the present time?——We say in this paper that there are specialist organisations to provide for the requirements of smaller companies.

4083. *Professor Sayers*: It is your part in the business that we want. It is the number of transactions and the total amount of money involved, taking all the members of your Association together.——*Chairman*: I think you would make an interesting point for us, if you could give us these figures.—*Mr. Samuel*: We will certainly see what we can do.*

4084. *Professor Sayers*: You said that in some of these small transactions the obvious thing to do is to go directly to an insurance company, and see if you can place it with them. Why does the borrower not do that himself? Does he come to you because you know the sort of places where the securities might find a home?——Yes; the average borrower of that kind is not acquainted with the City, or the people in it. He also comes to the issuing house for advice on what he can do and how he can do it, and as to the form of security, and so on.

4085. So that, even though the operation might prove a very simple one from your point of view, you can seriously claim that you do perform a service?——We most certainly would claim that very strongly. The financial advice given to people of that sort is of very great help.

4086. *Professor Cairncross*: Where the issue is placed in this way, there is presumably no quotation because there will be no dealings?——No; they would not be quoted and there would be no dealings at all.

4087. So in most of the small issues you are speaking of there would be no subsequent quotation?——For the ones that are placed that way there would be no dealings; that happens quite a lot in larger amounts.

4088. I wondered if there were any small issues you were thinking of that involved an issue to the general public without a placing and were accompanied by an application for a quotation and permission to deal.——It is done occasionally; you do see prospectuses coming out for companies of £100,000 capital, where the proprietors are only getting rid of 25 per cent. of their capital, and are getting a quotation of their shares, often to get a valuation for estate duty purposes; but it is not very easy. Market dealings are so small and, as far as getting a market for the shares is concerned, sales are not easily made.

4089. What is the approximate cost of making a small issue compared with making a large issue? Let us compare the cost of placing £100,000 firmly with an issue of at least £1 million. The cost would presumably be very different?——*Mr. French*: There are a lot of different elements in this; it depends on the capital to start with; and, if they have to pay stamp duty, the cost goes up straight away. But I should have thought 2½ per cent. on a placing of £100,000 was about right.

4090. *Professor Sayers*: And what on £1 million?——*Mr. French*: Still 2½ per cent.—*Mr. Carnwath*: It depends on what you are talking about: a debenture issue, a share issue, issues by public prospectus, issues to shareholders. For example, an issue by full prospectus in accordance with the Companies Act procedure is obviously very much more expensive than if you issue it to the shareholders on a circular letter.

4091. *Professor Cairncross*: I was excluding in my own mind debentures and rights issues, which are quite different, and taking an issue of shares that would be placed, and not necessarily accompanied by a prospectus?——*Mr. French*: The percentage tends to be higher on the smaller issue, because there is probably almost the same amount of work involved in raising £100,000 for one company as £1 million for another; but I should have thought it was roughly 2½ per cent. in this country.—*Mr. Carnwath*: 2½ to 3 per cent.—*Mr. Samuel*: The overheads—the solicitor's fee, the accountant's fee, and whatever the issuing house fee is, depending on how much work it does—would not vary very much, but that is not the biggest percentage of the expense.

4092. You are not suggesting the total cost to the proprietor of the business is measured by 2½ per cent. of the capital?——*Mr. French*: £2,500 on £100,000.

4093. No more, including all the fees?——I was thinking of it being done privately. If it is done publicly, with a document with people's names on it, it would probably be a bit more; but done privately you keep the fees down.

4094. You are aware that the published literature on this indicates figures very much higher; but the literature relates much more to public issues with prospectuses?——The issuing house does not get more than 1 per cent., I think.

4095. *Chairman*: I gather from what you said that there are great variations in the conditions which you have to assume if you are going to try to make out what the percentage cost is in the operation?——*Mr. Samuel*: Yes.

4096. By and large the least expensive would be a direct appeal to an insurance company to take an issue of shares firm?——Yes.

4097. And the most expensive would be the full issue to the public on a prospectus, without any complications like combining an offer for sale with a rights issue to shareholders, which involves a prospectus too, I think?——*Mr. Samuel*: Rights issues are done on a circular.—*Mr. French*: That washes out advertising; if you have to advertise in two leading London papers, that is £2,000 straight away, which is equal to the whole of the rest of the cost of a £100,000 issue: therefore you do not advertise.

4098. If you do not advertise that takes you off the full public issue?——*Mr. Samuel*: Yes, to have a quotation you have to advertise.—*Mr. French*: That is very expensive.

4099. *Professor Cairncross*: On the figures you have given us about issues, it appears that most issues for public companies on foreign account are not done through members of the Issuing Houses Association. You indicate in paragraph 8 of your memorandum that only £52 million was raised for foreign companies through members of the Issuing House Association, and £87 million was raised in other ways for companies registered abroad. Is that correct? What would these foreign companies be?——*Mr. Samuel*: I do not think I can answer that. Would you like to have the answer?

4100. If there is a simple answer it might be useful to us?——I should think the answer is very likely mining and finance companies; but we will look at that and let you know.†

4101. Is not the comparison which you make in that paragraph later on a little misleading? It appears to imply that the amount raised through the market for joint stock companies represented quite a small proportion of the investment carried out; but if you deduct depreciation, tax payments and all kinds of other elements from the profits of the U.K. companies, I think you would find that the proportion raised through the market was a very much higher quantity than this?——Yes. Our figure does include depreciation.

4102. The figures I have seen suggest that something like a third of net new investment would be financed by new issues, which is not at all proportionate with this paragraph?——*Mr. Samuel*: If you subtract depreciation, you would get quite a different relationship.

* See Appendix to Minutes of Evidence.

† See Appendix to Minutes of Evidence.

4103. *Professor Sayers*: That is to say you are much more important than this paragraph would seem to indicate? Going on now to the paragraphs in your memorandum about the adequacy of monetary measures, and looking at the comparison of circumstances with what we have had before, one of the difficulties that has been put before us more than once has been that the Government seems to have chronic difficulty in floating a large block of long-term bonds on the public. This looks a little odd when one thinks of the growth of various investing bodies in the last twenty or thirty years. Does your experience give you any ideas about why the Government has this chronic difficulty in floating its long-term bonds?——I would have thought that up to now it had been a question of inflation, with people not wanting to invest in long-term gilt-edged securities more than is actually needed by the traditional bodies, like the insurance companies and banks, which have to have a certain amount.

4104. Suppose that the fears of inflation were substantially modified; would you expect the Government to be able to float a very large block of long-term bonds, or two or three very large blocks, so that it could raise appreciably the proportion of the national debt that was in that form?——*Mr. Samuel*: I would have thought that it needs at the moment a long-term assurance to the people that inflation is not just going to be stopped for a short term. I am not saying whether this is practicable; but the need is to get away from the feeling that, even if it stops for two or three years, the same thing starts all over again, and therefore, as has happened over many years, the value of fixed interest securities continues to go down. This is only a personal opinion, but I would have thought that at the moment people have rather lost their faith in the course of the last five years. It has been pointed out so often what the value of their investments in fixed interest securities would be compared with what it was twenty or thirty years ago that the general feeling is that they do not want to invest in fixed interest Government securities unless they have an assurance that the money will not go the same way in ten years.——*Mr. Carnwath*: I think it is really a question of confidence in the will and ability to stop the depreciation of money. This is possibly slightly borne out since the last movement in Bank Rate: there has possibly been a slightly greater readiness of people to take fixed interest securities. —*Mr. Samuel*: Whether that is long-term, or whether it is because people feel the next move in the Bank Rate will be down and that it is therefore a good time to buy gilt-edged securities, but not necessarily as a long-term investment, I do not know.

4105. *Professor Sayers*: They have been able to get 5¼ to 5½ per cent. on long-term bonds, and at the same time, if they kept their money in short-term form, they have been able to get 5½ to 6 per cent. gross. If those figures had been different in relation to each other, if, for instance, one had a 5-5½ per cent. yield on long-term bonds and the short-term rates down in the region of, say, 4-4½ per cent., would people be more willing to go into longs?——No; investment of large sums of money must really be affected by people's long-term views rather than by comparison with short-term rates at the moment. I would have thought it was a question of confidence, not a question of comparing the rates as between long-term and the short-term.

4106. *Professor Cairncross*: If it is a matter of confidence, do you feel you could look forward to big fluctuations in long-term rates of interest as a means of regulating the economy? Do you think it is practicable to make the long-term rate fluctuate a great deal without destroying the confidence you were referring to?——*Professor Sayers*: That is the kind of policy you are envisaging in your memorandum?——That is a long-term policy. The basis of that long-term policy is Government spending itself. There you come on to very tricky economic and political ground; speaking just practically on how we restore confidence in the value of money, I would say we have to cut our coat according to our cloth. I think perhaps that has been proved a little since this memorandum was written; the Bank Rate has gone up and a very tight monetary policy has been adopted by the Government. The combination of both high rates of money and the difficulty of making profits quite so easily, and therefore the inability to pass on wage claims and that sort of thing, does seem to have been doing what one imagined it would do.

4107. *Professor Cairncross*: Supposing the situation were to turn right round, and we found we wanted to encourage long-term investment rather than discourage it, do you think it would be easy to get the long term rate down again?——No, I do not think it would be.

4108. Does this not make it rather difficult to use long-term rates as a regulator? Are not the practical difficulties against it?——*Mr. Samuel*: I think the practical difficulties are very great.—*Mr. Carnwath*: So much depends on Government policy towards spending, the use of the printing press and all that sort of thing.

4109. That is rather a different point: you are saying that savings through the Budget, for instance, might be made to correspond with the pressure on investment, rather than letting the price of savings do the trick?——*Chairman*: In your paragraph 22 you come to the conclusion:—

> "It follows that reliance must be placed in the main on the use of interest rates as a means of rationing credit."

You are no doubt thinking of interest rates as a restraining element and not, in other circumstances, as a stimulating element?——Yes, as a restraining element. When you say "stimulating", do you mean that low interest rates might have a stimulating effect or perhaps encourage people?

4110. When you are going to think of the possible uses of the long-term rate of interest with regard to the rate of investment, you may think of possibly wishing to achieve a low long-term rate of interest at a time when you wish to stimulate the economy?——*Mr. Samuel*: If there is enough capital to go round, then you would obviously have a low interest rate as well, or if Government spending were not so very great.—*Professor Cairncross*: You would *like* to have a low interest rate.

4111. *Mr. Jones*: Are you not saying in paragraphs 21 and 22 that you would give precedence to the use of interest rates as a means of rationing credit? As I read the first complete sentence of paragraph 22 you seem to be making an entirely negative approach to this question: you are setting aside everything else, and putting right at the centre of things the question of a high interest rate as a means of controlling credit?——The important point about the high interest rate, as we have stressed, is that by itself it is not effective: it can only be effective with the control of budgetary policy and the spending of the Government. In fact, as we have actually said, interest rates otherwise have not stopped inflation.

4112. *Professor Sayers*: So that if the country wants to go in for much more capital investment you would say that it must run a much bigger Budget surplus, and that the job cannot be done by regulating interest rates?——Not entirely by itself; not unless the monetary policy fits in with it.

4113. You would look to the Budget to secure the main increase in saving?——I think that is the way it would have to work.

4114. *Professor Cairncross*: But you would also want to see the rate of interest move in the right direction?——Yes. I think according to how the economy is at the time interest rates must be moved accordingly. I do not think a high interest rate by itself is necessary or vital; we have not said that. We have said that there should be a high interest rate as long as budgetary policy fits in.

4115. *Chairman*: How do you envisage the long-term rate of interest being moved? Simply by the play of supply and demand or by some process of control?——*Mr. Carnwath*: I think by supply and demand.

4116. *Professor Sayers*: But you think the supply and demand equation should be well doctored by the operation of the Budget surplus?——Yes.

4117. You do not in fact expect the rate of interest to do anything very useful itself, but it should be made to fit what is being planned in general?——I think it should be allowed to affect the demand for capital. I do not think it has done so at any time since the war; I do not think that any company considering investment has given serious consideration to the rate of interest at all because it has

not, at any stage, practically, since the war, been a real rate of interest at all, owing to high taxation and the rate of inflation.

4118. And when you say that the Budget arrangements have not fitted the situation hitherto, you mean that there has not been a Budget surplus to cover a sufficient amount of the country's capital investment?——Yes.

4119. You think that our Chancellors should have planned our country's capital programme much more deliberately?——*Mr. Samuel*: We are coming down to very general questions now. We would say that we cannot, as a country, afford to spend so much. When it comes down to the question of where to get it from, we can see at this moment that Governments are faced with this kind of problem, whether to cut the health service or this, that and the other, or whether that action in itself is inflationary because it is passed on in wages. Our point is that, so long as there is a shortage of capital in the country, so long as we are not saving enough, the Government must cut down on something, though I do not think we can say what, and that, if the Government is over-spending, high interest rates cannot work entirely by themselves.

4120. *Mr. Jones*: In paragraph 27 reference is made to the situation of capital investment in Germany. Has there not been a tremendous amount of self-financing in Germany?——Yes. There has been a great shortage of capital there, and that is why the cost of borrowing has been very high. But she has, in spite of that high rate, invested a large amount of her gross national product.

4121. But has there not been a higher rate of self-investment in Germany?——No, it comes out about the same. The actual figures for 1956 are that she invested 23 per cent. of her gross national product, and here we invested 22 per cent. That is gross investment as a proportion of gross national product. One figure is taken from the National Income Blue Book and the other from the Deutsche Bank Economic Review.

4122. *Professor Cairncross*: The big distinction was in the size of the Budget surplus that was being run in Germany when they had no defence expenditure, rather than in the degree to which individual companies were ploughing back profits?——Our only point there was that high interest rates by themselves do not necessarily stop capital investment.

4123. *Sir Oliver Franks*: May I ask one more question on the rate of interest on long-term gilt-edged bonds? I think you said, first of all, that you think that rate is really regulated by supply and demand; secondly, that it bad not been accompanied by what you think should have gone with it in a time of heavy demand for capital investment, namely large budget surpluses; and thirdly, that if one allows for inflation perhaps the rate of interest obtainable has been even negative rather than positive. Why, if that is so, over the past few years has the rate of interest been so low? If supply and demand does determine the situation and all these other things are true, why do you think we have not in fact seen here the sort of rate of interest that they have enjoyed in Germany?——*Mr. Carnwath*: I wonder whether one of the reasons is that some of the main suppliers of money have been companies like insurance companies whose own contracts with other people have been in money terms and who have therefore been able to pass on the depreciation; they have not therefore been so much interested in the depreciation of money, and the law of supply and demand has not worked, possibly, quite as freely as it should have done.

4124. *Professor Sayers*: You mean that they have got their money very cheaply and therefore have lent too cheaply?——Yes; and I think also (again I am only speculating) that people have not been used to inflation in this country; they still think, or have until recently still thought, that a pound was worth a pound, and the habit of saving and putting their money back dies very hard. I think there has been a time lag over that.

4125. *Chairman*: Do you think there can be a premium in interest rates which will compensate for a loss of confidence?——It is getting to that point now, possibly. I think that supply and demand have been slow to take effect for that reason possibly over the years, but I think the lesson is now well and truly rubbed in.

4126. *Professor Sayers*: If over the next five years the demand for capital remained basically very high, do you think that it could be moderated by resort to interest rates appreciably higher than we have seen over the average of the last five years?——*Mr. Samuel*: So long as inflation is kept in check at the same time. Obviously if inflation went on at 5 per cent., every year people would be prepared and are prepared to pay more and more for their money as long as they can pass it on. I suppose that you could put on a penal rate.

4127. I am trying to find out what you mean when you say the rate is determined by supply and demand. Is the demand capable of being squeezed at all?——Surely the answer to that is yes; by a rate at which industry cannot use money; because it could not profitably use that money it would do without it. That must be so.

4128. On the supply side do you think an altogether higher range of interest rates would increase the supply much?——*Mr. Samuel*: No, I think it would check demand rather than stimulate supply.—*Mr. Carnwath*: The interest rate is not expected to do anything; it is supposed to equate. It is the rate that will emerge as a result of the balance of supply and demand.—*Mr. Samuel*: Surely the fact that there is a high interest rate cannot give you more capital; it will merely make it uninteresting for some people to use the supply of capital available, so that there might be more for other people.

4129. So that when you favour greater freedom of interest rates to move, you are looking to it to ration demand rather than to stimulate supply?——Yes, I think that is so.

4130. But you have not much faith in it as a rationer of demand?——This goes very much hand in hand with the policy of the Government. By itself we have said it is not effective; it has not proved to be effective.

4131. But when I asked what else you wanted done you indicated that you wanted the supply of capital increased by a Budget surplus; that is to say, you wanted the supply of capital to be increased by other means than by raising the rate of interest. If that is the position, what has been the use of letting the rate of interest rise?——If we followed that policy probably it would not rise.

4132. You would say that, if there is an adequate Budget surplus to take care of an abnormally high demand for capital, then interest rates can be held stable?——Yes, I think that is certainly so.

4133. *Mr. Jones*: In paragraph 28 (*c*) you say:—

"since a high rate of interest is not necessarily incompatible with a high rate of investment, interest rates should be allowed to move to whatever level is necessary to equate the demand for resources . . ."—

in other words to regulate the available credit for investment. Is that not an argument for full accommodation for profitable concerns? What about industries that are less profitable, who are making provision for strengthening the economy in terms of exports or the elimination of imports? Have you not got to make some provision for that in dealing with the working of the monetary system?——The interest rate is something which, as we have said, is an economic thing; it may vary with supply and demand and with Government policy. Are you suggesting that there might be a different rate of interest for some bodies than for others, or are you just saying a high rate of interest is bad because certain firms cannot afford it although they may be doing a good job?

4134. Do you regard the working of the monetary system in the economy as one that must not take account of the necessity for the economy to have high exports and as low as possible imports? The impression I get is that it is a "free-for all", provided only that there are the resources in the industry concerned for new investment?——I do not think it is necessarily that some companies are able to afford investment rather than others. Whether they are doing exports or are high priority companies or not, they can still borrow their money whatever the rate is. If there is a company making a loss, whatever is done about the rate, it is going

out of business. You cannot legislate for a company that is badly run.

4135. But surely the development of exports and of alternatives to imports within the country are the pillar upon which we are able to deal with our balance of payments?——I do not think anybody denies the importance of exports and imports; and I do not think that this could possibly have meant that it does not have regard for that. Everybody must feel that that is paramount. But you cannot differentiate between one business and another in the rate of interest. You can differentiate, and they are differentiating at the moment, by means of the Capital Issues Committee. But, as far as the rate at which they raise their money is concerned, that is a matter of supply and demand and Government policy. You cannot differentiate between a lot of very large firms which can afford to pay the money and firms which cannot afford the money because they are small, or because they do not run their businesses as well. I do not see how you can say that high interest rates themselves are "anti-export".

4136. As I see it this makes provision for selecting investment on the basis of the capacity of the industry to provide high interest rates. What about selecting investment on the basis of making its provision for the economy's fundamental requirements? Or do you not accept my interpretation of this paragraph?——No, I do not. I can see what you mean, but I do not accept it.

4137. *Chairman*: You have said before that a process of controlling the demand for capital resources for investment by selection in itself is a good system, or socially acceptable?——Yes.

4138. You are advocating here that the test that regulates the demand for resources for capital investment should be the rate of interest; but with regard to the selective control by the Capital Issues Committee, you say it is a disagreeable necessity for the time-being, and within those limitations you have certain proposals to make about improving it?——That is correct. We do not want people to think that the Capital Issues Committee is something we should like always to have, if there were an abundance of capital to go round; we think it is a control which is not necessary in those circumstances. But since the economy is in the situation it is we should like it to be in the most efficient form we can imagine.

4139. Within those terms I think there is something in the point Mr. Jones is making. Really you are saying that the proper control is the rate of interest and not individual *ad hoc* selections by some body?——Yes, under normal circumstances.

4140. That brings us to your points about the Capital Issues Committee. You say in paragraph 36 that in your view "there is an overwhelming case" for certain amendments which are to produce "greater effectiveness and despatch". So your criticisms really come to this (I do not say they are small ones): first, that it does not work quickly enough to aid in the efficient conduct of issuing capital, and second that it does not work effectively enough. I follow the points about quickness, but I am not quite clear what you mean when you say there is an overwhelming case for greater effectiveness. Do you mean that it should have greater impact on the total process of making issues of capital?——No, I do not mean effectiveness in that way, but effectiveness in regard to executive functions. I do not think we were looking at it in the larger context. Perhaps it is negative in its effectiveness in that it has to do so very much more work than perhaps it should, as is borne out by the small amount of business which gets turned down.

4141. Your general line of criticism is that it should be more independent with more power to act on its own?——It is difficult to know what one wants to set up, when one tries to set up a different body that is better than the body that is there. We feel the Capital Issues Committee works on very wide directives at the moment, that it has in itself only a very small secretariat and therefore all the work has to be done by voluntary people, and that it is not sufficiently in touch with the various departments in the Treasury and the Board of Trade and so on from which its functions stem. The result is that when one puts up a demand for a capital issue to them they cannot act of their own accord; they have to send it round to all these various bodies, particularly if it is one of importance to find out their views: to find out whether that particular industry is in favour at the moment, and what the various effects might be in various ways. We think that if it were in closer contact with Board of Trade and Treasury officials on exactly what they wanted, it could say, for instance, that a certain industry would automatically have top priority and certain other industries have no priority at all. That might vary in the course of a year. The Capital Issues Committee would then be able to say, in case of a proposal for money to be raised for, say, the iron and steel industry, if that was top priority, that they did not need to ask very many more questions, once they had been told what the money was wanted for; the Government would have told them that this was something that it was very much prepared to back every time it came up, so that they could deal with it themselves. We feel that it would work very much better, and we feel a great deal of time would be saved, if it were to make decisions instead of sending it round to various bodies.

4142. So really it ought to have in its own possession a general brief from each department concerned, to be kept up to date; and you think it could then act on its own without further reference?——*Mr. Samuel*: Yes.—*Mr. Carnwath*: Any issuing house in the City that knows its job generally knows what the answer is going to be before it puts the application in. It seems to me that, if that is so, the body that is in much closer contact with the Government should not take three, four or five weeks to give the answer when it knows the answer in the beginning.

4143. Do you know because you have visited the department concerned and had a talk first?——One knows by experience; one frequently advises a client that it is no good to put in an application because it is unlikely to be granted. If it is possible for somebody who is in the market to give that sort of answer, it seems to me that the body given control ought to be able to exercise it much more quickly than it does at present.

4144. *Professor Sayers*: Are you bewildered by the answers you get from the Capital Issues Committee? If you reckon in general to know what the answer would be, it would seem to follow from that you are only very rarely bewildered?——Sometimes on capitalisation of reserves; not much bewildered on questions of raising new money, at least in my experience.

4145. Supposing the Committee gave reasons for its answers as a matter of course to the parties immediately concerned, would you feel you were any wiser than you are now?——*Mr. Carnwath*: No.—*Mr. French*: It would take longer to give its reasons, too.

4146. You see no advantage from your point of view?——*Mr. Samuel*: No. If it is unusual, one can probably find out; but I think normally one knows. On the matter of capitalisation of reserves, which we have said we do not think should be under control at all, those are the ones which have caused more curiosity because they do not seem to have formed any pattern at all.

4147. *Chairman*: Can you give practical instances of cases where you have made applications for capitalisation of reserves and have found the results bewildering or inconsistent with previous issues?——Only last year Great Universal Stores applied to capitalise a large amount of their reserves; it was turned down and no reason was given for it. There did not seem any reason why they should be turned down; their reserves were there.

4148. But that would only be odd if other cases which seemed to be comparable had been passed?——That is exactly the position; suddenly there was one which was not passed, and no one quite knew why. It is bewildering. There seems to be a frequency rule, though I do not know if it is a rule in the sense that it is written down in black and white: if you wish to capitalise every year a certain amount of your reserves, say, £50,000 every year for five years, you suddenly find, after you have done three, that you are not allowed to do the others because of the frequency rule, whereas if you capitalise the whole of the £250,000 in one year you probably get away with it. That does not seem to make sense. Others are bewildering because suddenly one is turned down which does not appear to be any different from others.

4149. *Professor Cairncross*: Except perhaps that it is bigger?——This was certainly big, but I do not believe

that as a pattern that would be so. There are a lot of the small ones that we do not know about.

4150. *Professor Sayers*: Did you try to find out why it was turned down?——*Mr. Samuel*: I do not think we were concerned with it.——*Mr. Carnwath*: I think also there is a suspicion that the Inland Revenue is possibly using the capital issues control to get over certain tax matters in regard to capitalisation: for instance, capitalisation in the form of redeemable preference shares.

4151. *Chairman*: If you had reasons given, would you not at any rate have some light upon why the thing was done?——*Mr. Carnwath*: If we are speaking about capitalisations of reserves, we do not think these should go to the Capital Issues Committee at all. It is not a question of raising new money, and therefore not a proper subject for capital issue control at all.

4152. *Professor Cairncross*: Have you found that the delays have been any longer since the limit was lowered from £50,000 to £10,000?——No, I do not think so.

4153. You would not expect any relief from an increase in the limit back to the old figure?——A great relief to a lot of hard-working people. I think it would also possibly enable the Committee to devote more attention to things that matter.

4154. *Chairman*: I should also like to hear instances of the kind of thing on which you comment in paragraph 41:—

" . . . having in mind that the Committee's terms of reference were to ensure that priority of capital issues should be determined according to their relative importance in the national interest, it has at times seemed as if consent has been given in cases which it would be difficult to justify on these grounds."

What kind of cases have you got in mind?——*Mr. Samuel*: Mostly new building.

4155. *Professor Cairncross*: Office and commercial buildings?——*Mr. Samuel*: Yes, offices and commercial buildings that did not seem in all cases to be a very high priority compared with others.——*Professor Cairncross*: You have perhaps noticed that they have been given high priority in other countries?——*Mr. Samuel*: Yes.

4156. *Chairman*: You can only form a judgment about their relative contribution to the national interest by comparing things which appear to have been passed with things which appear to have been refused?——It is a matter of opinion in those cases, I agree, as to what is a priority and what is not. We have seen consent given in cases which would be difficult to justify. But I think perhaps over-emphasis may have been put on that; I do not think it has happened a great deal.

4157. *Professor Sayers*: You do not even know for what reasons the Committee has turned down some of these and passed others? You are only guessing when you impute certain reasons to them?——That is true; one has to make an intelligent guess on that.

4158. *Chairman*: What other kind of applications would your companies discourage on the grounds that they would have no chance?——*Mr. Samuel*: Certainly anybody wanting to raise money for a hire purchase project; and probably commercial building.——*Mr. Carnwath*: I should say a brewery company, unless he can show certain special features, such as a substantial overdraft position.

4159. Hire purchase is covered by the instructions to the Capital Issues Committee; what other things in your own judgment?——*Mr. Samuel*: Somebody manufacturing luxury goods for the home market we would advise not to go to the Capital Issues Committee; and then there are all sorts of borderline consumer goods that are not quite luxury; with them one does not quite know. One's mind would vary according to what the actual thing being made was.——*Mr. Carnwath*: And I think according to the particular company's position. If it had a large overdraft, and was in danger of running down altogether because of lack of capital resources, it might have a case for the Capital Issues Committee even though there was low priority otherwise. But I am only guessing.

4160. *Professor Sayers*: You think the Capital Issues Committee feels it has a duty to make life easier for the banks in squeezing overdrafts?——*Mr. Samuel*: That is a nice point; it rather depends on how the financing arose originally, I think. If somebody obviously in a non-priority category has managed to squeeze £50,000 or £100,000 out of his bank to enlarge a business which should not have been enlarged at that time, he might very well fall down at the Capital Issues Committee; but I would like to think that banks would not do that. If there is a long history of bank overdraft with a growing company, and there was danger of the company going out of business, and unemployment being caused and that sort of thing, I suppose the Capital Issues Committee might take a different view. But I do not think one could say that the fact that the Capital Issues Committee did take that view would encourage the bank to give its advance on a wrong basis.

4161. *Mr. Jones*: As I read paragraph 39, you tell us that it is your experience that to a surprising extent consents applied for have been granted. What does that mean in relation to the whole volume of applications?——I think we have qualified that later and said why that may be: first of all, the greatest influence on the Capital Issues Committee is its mere existence; in other words we do not put up to Capital Issues Committee at all things that are likely to be turned down; secondly, boards of directors tend to raise money for proper purposes; and thirdly most of their applications are valid. We are drawing attention really to the point that a lot of work has to be done, by the Capital Issues Committee particularly, in order to pass virtually everything (not everything but a large percentage of it), and suggesting therefore that their work should be made easier on the lines we have discussed.

4162. Have consents been made "to a surprising extent" that do not seem to fall within the general common denominator?——I do not think that is so, but one cannot tell oneself what other applications are put in by other people: solicitors, accountants and so on.

4163. *Professor Cairncross*: From your own experience what proportion of the cases coming before you do you not proceed with on the grounds that you do not expect to get a consent?——*Mr. Samuel*: Very few, as far as we are concerned. I think it is fairly widely known by accountants too what the situation is.——*Mr. French*: I would say very few.——*Mr. Carnwath*: I would qualify it slightly, in that we have rather a large number of brewery clients; on the whole we warn them that, if they want money, they have to put up a pretty strong case.

4164. May we then know what happens when a client is told he has a poor chance? Does he seek to find his money in some other way, out of profits, or by getting in touch with another firm, or does he drop it completely?——*Mr. Samuel*: I would have thought that it is usually dropped or put aside.——*Mr. Carnwath*: Our brewery clients would certainly scale down their capital programmes in the light of the credit squeeze.

4165. *Professor Sayers*: Their actual programme for building?——They have enormous arrears of maintenance to catch up on public houses all over the country. With the removal of building restrictions they suddenly found themselves free to go ahead, and they were under great pressure from local authorities seeking to provide these facilities. Now the credit squeeze has shut down on them again, and they are having to resist very strongly.

4166. *Professor Cairncross*: Those are cases where there is a limitation on the scale of capital expenditure. If it were a case of entirely new flotation, would the scheme be dropped?——That would depend very much on how strongly they wanted it. There are methods of finding fresh capital which do not entail going through the Capital Issues Committee.

4167. But you have no cases you can think of?——We personally have not.

Chairman: Mr. Samuel, I think that that finishes our questions. We are very much obliged to you and your colleagues for the help you have given us.

(*The witnesses withdrew.*)

(*Adjourned until 2.15 p.m.*)

SIR FREDERICK LEITH-ROSS, G.C.M.G., K.C.B., called and examined.

4168. *Chairman*: Sir Frederick, we are very much obliged to you for the memorandum* and booklet† that you sent in to us. We have all read them with great care. Your memorandum, I think, is on the basis of putting down a number of headings which you thought of major importance for us in setting out on our survey. We should like to follow up some of the pointers you have given us under these various heads. I take it the burden of your first note, on the working of the Bank Rate, is that for a number of reasons, to which you draw attention, the movements of Bank Rate in the recent period have failed to produce what I might call the classic responses that might have been expected of them according to standing theory?——Exactly.

4169. You say in your second paragraph that the increases in the Bank Rate certainly had a marked effect on the gilt-edged market. Can you elaborate that view to us, because we have heard a great deal of the way in which the movement of Bank Rate relates itself to the rate of interest obtainable in the gilt-edged market?——It works through the discount rates on Treasury Bills. If the Bank Rate goes up, the Treasury Bill rate will go up to about the same differential to the new rate as the Treasury Bill rate in the previous week had to the old Bank Rate. The reason for that is that the discount houses may at any time be forced into the Bank to borrow at Bank Rate, which is a penal rate, and therefore they are not prepared to tender for Bills at much below that rate. From the rate of discounting of Bills, it tends to spread through the rest of the market. Of course there are variations; normally I would have expected long-term rates to be considerably more and short-term rates to be considerably less. There has been very little difference between them recently.

4170. It was the gilt-edged market I was principally interested in. Is it simply by arbitrage that the changes spread out into medium and long-term?——Yes; it spreads from Bills to short-term bonds very quickly; and after all the shorter bonds tend to run for at least five years, and some for eight years: so you get to what you can call the middle-term spread then.

4171. Bills and short-term bonds you can regard as being directly money market assets; then it spreads outwards by imperceptible degrees?——Yes; and the increase in the Bank Rate may affect the liquidity of the clearing banks; they may be sellers of the long-term or middle-term. In fact they undoubtedly were a year or two ago.

4172. It would be true, though, that it is hard to establish any correlation between the movement of Bank Rate and movements in the gilt-edged market?——I have never examined it in detail, but I should have thought there must be some correlation, perhaps not absolute but relative.

4173. *Professor Cairncross*: There were quite large changes in the gilt-edged market before 1951, while the Bank Rate was held constant; so the gilt-edged market might move without any change in interest rates, and vice versa?——That is possible, certainly; but in the long periods when the Bank Rate has been stationary other considerations have been much more important.

4174. *Chairman*: We have an interesting phenomenon today, in that gilt-edged prices are virtually back to where they were before the alteration of Bank Rate in September?——That is because most people have at least a hope that the Bank Rate will not remain long so high.

4175. In (*c*) of the fourth paragraph you refer to the level of taxation, and then you say: "At the most the increase of Bank Rate may act as a red light on business sentiment causing a certain caution in the preparation of expansion plans." This is a point we have come up against a great deal in what we have already heard. Do you attribute as much importance to the "red light" aspect of the increase in Bank Rate as it used to have attributed to it?——I think it has been relatively more important than it used to be. In the old days when the Bank Rate went up high, money was tight, and it was therefore very difficult to get it. Nowadays money can be got at a price; but there is this sentimental or psychological effect, particularly on the smaller businesses, I gather; I do not know if the larger businesses would worry much about it.

4176. Could one be exact about what it is a signal of: that money is going to be tight, or that business demand is going to recede, or that the Government is going to try to do what it can to make it recede?——I think it is all those things.

4177. It cannot be closely analysed?——No.

4178. *Professor Sayers*: You used the phrase "relatively more important", and in what you added you seemed to imply that you did not attach much absolute importance to the "red light" aspect. Do you think that the change has rather been that the other effects of the Bank Rate have become much less important?——Yes.

4179. And that the "red light" aspect is quite unimportant now?——No, I think it is perhaps more important than what I might call the direct effects.

4180. Simply because the direct effects have become negligible?——Negligible for big business, anyhow.

4181. If the "red light" influence of a rise in Bank Rate is something of which we are to take note, does it follow that when the Bank Rate goes down it is impossible to avoid a "green light" atmosphere?——No, I do not think it necessarily follows. I should say that, generally speaking, it is much easier to put a brake on business by increasing the Bank Rate than to give a stimulus to business by reducing it. That is one of the problems the Americans are up against at present.

4182. *Chairman*: But take a recent case when the Bank Rate has been reduced; let us say February, 1957. Did you not think that in practice it was taken by a very large number of people as a sign that a "green light" was being given, and that they could go ahead with business plans?——I suppose there was a general boom going on during the whole time, and this came on the top of that.

4183. If you treat the movement as a "red light" when it goes up, it is very hard, if people are at all anxious to take it that way, to avoid its being treated as a "green light" when it comes down?——Business plans would depend on the general expectation of trade profits, and that might not be so good as the "green light" would suggest.

4184. I was wondering whether your experience had shown that it could be regarded, when it dropped, as a mere technical adjustment, the explanation given being that it was a mere technical adjustment to the money market's own achieved position, or whether the public must be expected to treat it on a wider basis?——I have not looked into the actual figures very closely, but I should have thought that a drop in the Bank Rate would have much more effect on the Stock Exchange than on general conditions over the country. Those were good all through. If anything, I think there was a slight tendency for investment not actually to drop but not to increase so much last year, despite the fall in Bank Rate.

4185. *Sir Oliver Franks*: You start off by reflecting on the successive steps by which the Bank Rate was raised to 5½ per cent. in February, 1956, and stayed there for a year until February, 1957; and the reflections which follow are largely, I think, in the light of the experience of a Bank Rate successively raised to that level. If one thinks about levels of Bank Rate, and therefore corresponding interest rates, higher than 5½ per cent. (we have had 7 per cent. since September last, and one might theoretically consider 8 or even 9 per cent.), do you think that the disabilities which you list would really apply with almost equal effect to these higher levels of interest rates?——I would have thought that in general these factors apply just as much as at the lower rates. Both the advantages and the disadvantages increase.

4186. Do you see any special disadvantages in trying to influence the state of affairs by these higher levels of Bank Rate?——I think in the long term there are very serious disadvantages; the tendency must be, if it goes on long enough, to discourage industrial investment, which is extremely important for the general economy of the country. When the Bank Rate was raised in September a great many concerns were actively engaged in expanding

* Memoranda of Evidence Part XIII No. 22.

† *Orthodox Credit Control in Post-War Conditions* (based on a memorandum by Sir Frederick Leith-Ross), published by L'Institut International d'Études Bancaires, Rotterdam, 1957. Not reprinted in the Committee's record of evidence.

their business. These plans had probably been made during the previous one or two years; they were in full swing and could not be altered. I have no doubt that, as time goes on, especially if there is a risk of tighter money, businesses will tend to be much more cautious in developing new plans for expansion; so that when the Bank reduce the Rate and turn on the "green light," then businesses would have to begin planning. It might take another year or two before plans got under way, and we might have a serious recession.

4187. This higher level of Bank Rate might have a serious effect on the economy in so far as it caused investment plans to be postponed, or not proceeded with, and in that sense it might have effects, possibly bad ones in the long run, which lower and more normal levels in the Bank Rate would not?——I think that is true. A higher Bank Rate, like 7 or 8 per cent., would have a serious effect.

4188. *Chairman*: Have you had the opportunity to observe effects since September?——I hear from my banks that there is a certain tendency on the part of the smaller businesses not to press their requests for advances so much. On the other hand, the position is still at a point where the total demand for advances is always pressing against the ceiling which has been fixed by agreement with the Government.

4189. *Professor Sayers*: When you were talking of the possible bad effects of the movement of Bank Rate, you spoke of the danger of a reduction in investment; but when you explained how this would come about, you spoke not of investment but of planning, and you said that the impact of high rates would be such as to cause people to reconsider their plans. Suppose that the high rates were not pushed to such a height as to create unemployment; is there any reason to believe that they would create a reduction of investment? Would it not be just a reduction of investment plans, so that realised investment would be not reduced but might even be increased?——I am regarding planning as being in the first stage of the realisation of the investment; if you delay the planning you will delay the time when the investment will be acually undertaken.

4190. But if you reduce the load on the economy, is not one of the first effects likely to be to alter the speed at which plans mature into actual realised additions to the capital equipment of the country?——Not necessarily. I would say that the load could be lightened in such a way that execution could be made very rapid. It would encourage people to go ahead.

4191. But if, by reducing plans, the load were reduced, then the pace, in the case of actual realised additions to the country's capital equipment, might increase, although investment plans were reduced by a rise in the rate of interest?——And that might leave a gap between the completion of the plans which have been made in the past and the initiation of the plans which are contemplated for the future.

4192. Yes, but in the state of affairs which we are envisaging, surely there will have been plenty of plans being thought about, and the reduction of them would be hardly likely to lead to a gap that would create unemployment?——That may be so. It is anybody's guess.

4193. *Chairman*: I am not clear in my mind why the higher Bank Rate should have any particular impact on the small firm. I can understand why the restriction of credits should: its range of manœuvre may be smaller, and it may have less chance to turn to other sources, than the larger firm; but why should the higher rate, in itself, have any special impact there?——I do not know; I simply repeat what I am told. I suppose their total resources are very limited, and they think more about the actual charges than the larger firms. I suppose that income tax has the same effect on both. But a large business man, to whom I have talked, said it would not make any difference to his plans; he went on to say: "After allowing for income tax, this will cost me 3 per cent. or 4 per cent.; but I do not go in for investment unless I can rely upon it getting something like 15 per cent.".

4194. *Sir Oliver Franks*: Does that lead one to suppose that, at the end of 1954, during 1955 and the first part of 1956, having Bank Rate at $4\frac{1}{2}$ to $5\frac{1}{2}$ per cent. instead of 6 per cent. and 7 per cent. meant that it would have been relatively insignificant in checking the boom, which was continuous through the period?——I would rather take that line, although my view is that the Bank Rate has much less effect than the operation of Government finances.

4195. *Professor Sayers*: Against that background, have you any view on the steps by which the Bank Rate should be changed? There has hitherto been a rather loose convention that it has gone up by 1 per cent. and down by one half. Would it seem to you that there might be advantages or disadvantages on balance in changing the convention to something like, say, up by 2 per cent. and down by 1?——No, I should have thought there is a lot to be said for keeping to the convention, except when you want, as the Government did last September, to give a general shock to the market. I think that to check it by 4 per cent would be a bit much.

4196. On your own argument about the Bank Rate, would it be a bit much, as compared with 2 per cent. in the old days?——I think there would be considerable difficulties.

4197. What would those difficulties be?——For one thing the cost to the Budget of Treasury Bills, which would go up roughly the same as the Bank Rate.

4198. Are not those the disadvantages of a high Bank Rate policy anyway, as distinct from the steps by which you move?——Yes.

4199. There is a convention, too, that the Bank Rate is generally changed only at the weekly meeting of the Court of Directors of the Bank of England; moves at other times are regarded as exceptional. Do you regard that as a useful convention, or do you think it would be better to have the changes at any time during the week?——No, I would attach no importance to that.

4200. You would have no objections to a more fluid arrangement?——No.

4201. *Chairman*: In the last paragraph but one of your note on this you say: "The experience on the Continent has been similar to that in this country. In fact, in many countries of Europe, Bank Rate increases have scarcely been used at all; the main deflationary measures taken in regard to bank credit in Europe have been increased reserve balance or liquidity ratio requirements or restrictions on rediscount facilities". Would I be right in inferring from that that you thought that methods of that kind might be usefully introduced or employed in this country?——No, I would not like you to infer that, because I do not think they have been very effective. Take the case of Germany: in 1950 and 1951 the central bank imposed on the commercial banks about five different ratios, a ratio of advances to capital, a ratio of debtors to capital and reserves, a ratio of inland bills discounted, and so on, as well as an ordinary liquidity ratio. These had very little effect. The banks got round them, partly by increasing their capital; they all doubled their capital in three years, which made quite a big difference to the effect of these ratios. Then the central bank had to go to the same length as we have had to go; indeed a little further. They called for a reduction of total advances in 1951; and they put a strict limit on the rediscounting of commercial bills, which, of course, is much more important on the Continent than it is here. Since 1952 these extreme measures of putting ceilings on bills have had little effect, because then they started taking up surplus resources from the market. During each of the last five years the central bank has taken roughly D.M. 1,000 million, say £80 million sterling, off the market. The result is to keep the market on a level basis, and prices have been stable. That has been the most effective measure that has been taken.

4202. Is that what is referred to on page 18 of the brochure of the Institut International d'Études Bancaires, which you sent us. "The operations of the Central Bank in Western Germany in selling Treasury Bills and neutralising the proceeds seem to have been a very effective means of tightening credit"?——That would be it.

4203. What was the process of "neutralising the proceeds"?——Simply that the central bank sells the bills, on the market, and the money is put to the credit of the government; but as the government has a surplus already the credit is not used. The result is that the government balances went up from DM.3,400 mn. in 1952 to DM.4,500 mn. in 1953, to DM.5,800 mn. in 1954, DM.6,600 mn. in 1955, and DM.7,300 mn. at the end of 1956; roughly a thousand million marks a year.

4204. *Professor Cairncross*: These reflect in part large Budget surpluses in Germany?——It is the total combined of the surpluses and of the sales of bills.

4205. Is not Germany's position rather different from our own? The central bank pursues this policy in order to create short-term government debt.——Yes, that is why these bills were created; to enable the central bank to tighten money. They did that on the basis of a Bank Rate which was never higher, I think, than 5½ per cent.; but there has been stability.

4206. But the German long-term rates are high, and have been higher?——And the short-term rates are, too. Another example is Switzerland, which kept its Bank Rate at 2 per cent., until last year, when it went up to 2½ per cent. It also has a stable currency without any inflation; again the government has taken measures to neutralise the import of gold from foreign countries.

4207. *Chairman*: But if our own experience shows that the use of the weapon of movements of Bank Rate has been comparatively ineffective for a number of years, and if you do not think we can usefully adopt any of these Continental methods like restricting rediscount facilities or liquidity ratio requirements, are we not left with a rather helpless position with regard to the control of the money supply, or the restriction of demand?——I think restricting rediscount facilities would not help here because the system is so different; rediscounting is simply of Treasury Bills, and you cannot stop that, unfortunately. The liquidity ratio has been found very much to facilitate inflation in other countries, because it forces the banks to take up Treasury Bills or bonds. I think that, if any of these were to be tried, the one I would prefer would be reserve balances, though that can be a great nuisance, as I know from experience, in countries which have it.

4208. *Professor Sayers*: You mean you would want to control the money supply by restricting the supply of cash?——Yes.

4209. And what would be the immediate effect in the present system of a reduction in the supply of cash?——It would tighten up money all round, I think.

4210. How would it tighten up money?——The clearing banks would have to keep the appropriate percentage of cash, and for that purpose they would either have to liquidate securities or advances.

4211. But if the clearing banks were short of cash, would they not proceed to call money from the discount market?——I am assuming all that has been done. The gap would appear in the clearing banks or the discount market; there would be a shortage of money in the market assets.

4212. But if the market found itself short, would it not go to the Bank of England?——It would temporarily, but with great aversion.

4213. Supposing that the discount market obtained the necessary cash, the system would be supplied with the cash to restore the clearing banks' cash ratio to 8 per cent., at the expense merely of a rise in the Treasury Bill rate. Is that not what would happen?——I do not follow you.

4214. *Professor Cairncross*: Are you assuming that the supply of liquid assets in the money market has already been diminished in some way, or are you starting from the situation we have now? In other words, when you put forward the restriction of the supply of cash, is it assumed that there is great liquidity in the money market or that something else has been done to restrict the supply of liquidity?——I would assume that some measure, perhaps similar to those in use in Germany, could be taken by which the cash received for the additional notes drawn by the banks was not put into circulation, so that money was, if not tightened up, at least not allowed to expand.

4215. *Chairman*: It is the pre-conditions that are puzzling us; as I understand it, one of the difficulties is that, with the volume of Government short-term borrowing, which we have taken more or less as a given condition, the heavy maturities year by year of Government loans which have to be paid off, and the system under which the Bank of England acts for the money market as the lender of last resort, it would be very difficult over a period of time to keep the cash supply down, because the hands of those who wish to keep it down could be forced regularly by these means?——As a temporary measure, certainly; it can be re-adjusted, as you say. The discount market would have to go to the Bank of England and get rediscounts, and the Treasury Bill rate would go up, but there might be a stage at which the Treasury Bills were not tendered for, and then I suppose the Bank of England itself would have to finance them.

4216. *Professor Sayers*: The Government has to sell the Treasury Bills somewhere, has it not?——Yes, unless it sells other things instead.

4217. What you are suggesting therefore is that the money supply may be controlled by a funding operation?——Yes.

4218. *Professor Sayers*: It is that and not the condition of cash, as such, that you are looking at?——The two things would be combined.

4219. *Chairman*: The one would not be much good without the other?——No.

4220. *Professor Sayers*: Would you agree that there has been a comparative failure in Government policy in relation to the size of the floating debt?——I think there has: long-term funding has been very difficult.

4221. Why do you think that has been so?——The gilt-edged market certainly had very few friends a year ago; it has a few more friends at the moment.

4222. How do you think the Government should increase the supply of friends?——If you assume that a high Bank Rate is going to be effective with regard to restricting business, the higher rate on long-term bonds might have the effect of increasing subscriptions to them.

4223. Supposing that the authorities thought it fit to put the short rate down, would you think it proper that the long-term rate should be kept up, in order to maintain an inducement to people to go into the gilt-edged market?——There is nothing unreasonable about that; I would expect it.

4224. *Chairman*: You have a note on the Government's funding operations; I would like to ask a few questions on that. You draw attention in the first paragraph to the way in which the thing is done now and its effect, that the funding process is a continuous one. You go on to say that no information is published as to the amounts of any issue which have in fact been taken up by the public. Do you think it would make any material contribution to the gilt-edged market obtaining friends if such information were published?——I do not know whether it would get any friends, but it would give some useful information.

4225. At the moment are we not told something when an issue takes place?——Yes, it is always said to be over-subscribed; that is the main thing we are told.

4226. But you do not think we get any adequate statement in effect as to what has happened to the issue?——No. I do not know whether it is important. There is a great deal of secrecy about it. I should have thought it would be useful to know what amount is really taken up by the public.

4227. *Professor Cairncross*: You do not think it would be damaging to the Government's credit to provide this information each time?——I should not have thought so, but perhaps I am not in a position to judge that.

4228. *Professor Sayers*: Do you think that Government issues and bonds, when they are shown on a prospectus, should be underwritten in the market in the ordinary way?——I think they are underwritten at the present time.

4229. Yes, but by the Issue Department?——I should have thought that was less expensive.

4230. *Chairman*: It is less expensive?——*Professor Sayers*: And therefore preferable?—Yes.

4231. *Chairman*: You say: "The open market operations of the Bank of England, which were originally intended to reinforce the monetary policy of the authorities, are now frequently used to condition the market for a new Government loan or, at least, generally to assist the debt funding operations of the Government." Is that remark based on observation?——It is inference rather than observation; it is extremely difficult to ascertain the facts. I have examined the weekly statements of securities held, and it is extremely difficult to follow what those securities represent and what the changes represent.

This was very marked in 1954 and 1955; the 2 per cent. Exchequer stock, 1960, was issued in February, 1955; and the market had been put up gradually during the preceding two or three months. My recollection is that a small issue of bonds was called for repayment before the final date, in order to get the market conditioned for the new issue. These 2 per cent. bonds were got out at par on the 15th February; the Bank Rate was raised to 4½ per cent. ten days later. As a result, these bonds fell five points in a month and ten points in a year. That is the sort of thing I had in mind. It shook the confidence of the market in the management of the gilt-edged issues.

4232. Would you say that an incident of that kind provoked wide criticism by people in the market?——Quite a considerable amount of criticism in the market.

4233. *Professor Cairncross*: Would you agree that any marked change in long-term rates is bound to react in the gilt-edged market in this kind of way?——Yes; but the question is whether the Government should issue a loan, having in mind that the Rate will be put up ten days later. That was the criticism.

4234. Would you then have all Government bonds issued immediately after the adjustment of Bank Rate? Sometimes the Government acts to its own surprise?——Yes; that may be possible.

4235. *Chairman*: How far are these defects capable of being corrected? You say it might be a good thing if the information could be published as to how much of an issue is taken up by the public; but how much else can be altered?——The Federal Reserve Bank in New York gives a great deal of information as to what it is doing as regards its funds, and I should have thought that the Bank of England, without doing any harm to Government credit, could also disclose much more than it does.

4236. Would that amount to stating what its policy was in conducting open market operations?——I should have thought that they could do that. They could do it as regards the past; they cannot possibly say what they would do in the future.

4237. Do you think that, if that information was made available regularly to the public, it would increase the public's confidence in the Government's policy?——It would increase the understanding by the market of the Government's policy and intentions, which would do a great deal to get away from this malaise. Of course, there are always unofficial contacts going on between high officers of the Bank and the market.

4238. But this is a problem which is always going on?——It is, but I think it is specially important with regard to the discount market, because after all they are the medium through which they get to the public.

4239. *Chairman*: Then you have a note on the Exchange Equalisation Account; I am sure that some questions will arise out of that.—*Professor Sayers*: I was puzzled to see that the present procedure "represents a radical departure" from the procedure under the gold standard. As I understand it, under the gold standard, when a favourable balance of payments led to an inflow of gold, the Issue Department's holding of gold was increased, and the amount of notes issued by the Issue Department was increased by the same absolute amount. In the Banking Department, one would see the notes held by the Banking Department up by that same amount; and on the other side the bankers' deposits up by that same amount. Outside the Bank of England the banks would have their cash in hand and at the Bank of England up by the same amount, and their deposits up by the same amount. There could then be a further increase in the total of bank deposits, because the banks, having found their cash reserves and their deposits up by the same absolute amounts, would have a rather higher cash ratio than before. All that would happen automatically; you had an increase in the supply of money following an inflow of gold. A crucial link in the chain was the linkage of the gold holding to the cash supply, and another crucial link was the fact that the supply of bank deposits was influenced by the cash position of the banks. Do you agree that that was the old system?——Yes.

4240. Now under the new system, we have an inflow of gold, and that gold is sold to the Exchange Equalisation Account. The effect of that is that the total bank deposits in the country are up by, say, £1m., and the Exchange Equalisation Account's gold is up by £1m. The Exchange Equalisation Account has financed that purchase of gold by selling Treasury Bills, which have to be taken up; in the first instance they would be taken up by the banking system, so that the banks and the discount market, have their holding of Treasury Bills up by £1m., exactly equal to the increase in bank deposits. The inflow of gold has increased the Exchange Equalisation Account's gold holding and the supply of the bank deposits by the same absolute amount. The liquid position of the banks is changed by there being an extra £1m. of Treasury Bills to be held by the banks; those Treasury Bills are the counterpart of the increase in bank deposits. The clearing banks' position is now that their Treasury Bills and their deposits are up by the same absolute amount. If they are working now on the basis that their holdings of liquid assets, including Treasury Bills, determine how far they are to expand credit, then you have the conditions for a further increase in bank credit beyond the original £1 m. Is that not exactly parallel to what has happened in the old system?——I would not have thought so. I do not see where you get the increase in bank deposits. The Exchange Equalisation Account takes money out of the market in exchange for Treasury Bills and places it in the hands of whoever supplies it with gold or dollars, and the total amount of deposits is not altered.

4241. But under the old system we were agreed that the effect would be that the people importing £1 m. of gold and selling it to the Bank of England would make an addition of £1 m. to bank deposits; now in the present system they sell it through their banks to the Exchange Equalisation Account. The Exchange Equalisation Account does not get it for nothing, it has to pay for it. It can pay for it in sterling, in English bank deposits, in effect by drawing a cheque on the Banking Department of the Bank of England, which is added to the bankers' deposits; and the proceeds of that cheque go to "the people" who have sold gold and are paid into their banks. So clearing banks deposits are £1 m. up, and their cash at the Bank of England is £1m. up, just as in the old system?——I do not agree. In the old system, the Bank of England were simply inflating the money supply, whereas the Exchange Equalisation Account gets Treasury Bills out, which are taken by the market and not by the Bank of England.

4242. *Professor Sayers*: But what do the people who import gold sell it for?——For sterling, and the sterling is raised by Treasury Bills.

4243. From the market, including the banks?——Yes.

4244. You mean that there is a possibility that the Exchange Equalisation Account is able to sell Treasury Bills right outside the banking system, to industrialists, or even directly to the people who imported the gold?——I think it very likely does. I do not know what the procedure is with the South African Reserve Bank, but I have no doubt that it gets the credit with the Bank of England and puts it directly into Treasury Bills.

4245. But there is no reason to suppose that the appetite of the outside market for Treasury Bills has gone up just because somebody has imported £1 m. of gold. To the extent that this is possible, it was also possible under the old system; £1m. might be wanted for hoarding somewhere, as, for example, when the French in the twenties wanted Bank of England notes for hoarding. They could get them by selling gold. If now you have the Reserve Bank of South Africa selling gold in London and taking British Treasury Bills in exchange, the impact on the system is the same. I cannot see what is the difference, provided you assume that the banking system now runs on the basis of these liquid assets?——I have always understood that the intention in creating this Exchange Equalisation Account was to insulate the market here from the effect of gains and losses in exchange, and I should have thought it does.

4246. *Professor Cairncross*: May I just interpose one question which may help to clear this up a little? You may have in your mind, Sir Frederick, the possibility of an inflow of capital from outside this country, the foreigners in effect parting with foreign exchange and investing the sterling proceeds in Treasury Bills. If that happens, then I think what you say would be correct, and we would agree with it. I think the question put to you by Professor Sayers relates to what happens when there is a change on the current balance of payments. I assume that, while it is perfectly fair to say that the Exchange

Equalisation Account was intended originally to insulate the economy from the effect of capital inflows and outflows, it was not meant to insulate the economy from the effect of an adverse balance of payments.——It was meant to even out the fluctuations, whatever their origin.

4247. *Professor Sayers*: When the Exchange Account was established it was not assumed, probably rightly, that the banking system regulated its deposits according to the supply of its liquid assets; it was assumed that the banking system ran on a cash basis. Therefore, though the intentions in 1932 may have been what they were, and may have been realised, the effect now might be different. I am only wanting to establish what difference there is, if any, between the procedure now, with the Exchange Equalisation Account running as it does, and the procedure prevailing under the gold standard?——The essential link that you mentioned when describing the working of the gold standard I think is absolutely right: when we imported gold it did at once expand the cash basis of the whole economy.

4248. And now it expands the liquid assets basis?——It may, but I think that is dubious.

4249. It is no more dubious surely than that under the old system an influx did automatically increase the supply of money?——For example, if the Exchange Equalisation Account, instead of importing physical gold here buys, as it often does, dollars in New York, it transfers a certain credit in sterling to some holder of dollars, British or foreign, and that is at once put back into the market.

4250. That is surely exactly the same; there is an increase in bank deposits in this country?——It just goes from one hand to another, say, from a private individual or a number of private individuals to the Exchange Equalisation Account, and then into the name of an American bank.

4251. *Chairman*: Suppose that the operation is that the Exchange Equalisation Account pays for the dollars by running off tap Treasury Bills; it is then able to pay for its dollars by transferring cash from the public account at the Bank of England into the bankers' deposits with the Bank of England; in other words, it adds to the cash outside the internal system. Does that not then add positively to the cash in the system?——I should imagine, from what I know of the state of Government accounts, that if it did that on any scale the Treasury account would have to be supplemented at once by issuing fresh Treasury Bills.

4252. I was rather assuming that that was indeed a concomitant, that the Treasury, since it must currently finance itself, must add to the outstanding volume of market bills by raising more money. Is that not the basis of what Professor Sayers was putting to you as the normal pattern of this sort of transaction?——Certainly they would have to issue Treasury Bills; but the money that they raised would also be invested somewhere, so the total supply and demand would remain equal, would it not?

4253. *Professor Sayers*: The two sides of the Bank's balance sheet remain equal, but the two sides would both be higher by the absolute amount of the gold influx, which is what used to happen under the gold standard?——*Sir Frederick Leith-Ross*: There is a considerable difference between the expansion caused by the increase in Treasury bills and the effect of the import of gold in the old days. The import of gold would have meant an expansion of eight or nine times.—*Professor Sayers*: And this causes an expansion of three times, roughly; I agree with that.

4254. *Professor Cairncross*: Towards the end of your discussion of the Exchange Equalisation Account you make a suggestion that it might be better for the Account to be returned to the Bank of England and for its position to be published regularly in the weekly Bank return; have you in mind that more information about the Exchange Equalisation Account might be made public, or is this a matter merely of a formal account?——I think it should be more frequently published; it would not then attract quite so much attention as it does every month.

4255. *Professor Sayers*: You are thinking primarily of the gold and dollar assets of the Account, which you would like shown weekly, as in fact they used to be under the old Bank Return?——Yes.

4256. *Chairman*: You make a suggestion that the sterling which the Exchange Equalisation Account receives for the sale of foreign exchange should be placed in a special account and not utilised except when the account again is able to purchase foreign exchange. That is contrasted with the present system, under which, I take it, the sterling which it receives is lent back to the Exchequer on tap Bills for the time being?——I imagine so.

4257. If it is not made available to be lent back to the Exchequer for the time being by tap Bills, *pro tanto* the Government would have to borrow that much more by Treasury Bills in the market?——Yes, unless it was in the position, that it always aims at being in, of having a surplus.

4258. There might conceivably be a period when it was, but, by and large, the effect would be as I have said?——Yes, it would.

4259. *Professor Sayers*: Would it not be the same as would happen if there was an inflow of gold and the Government said that public deposits at the Bank of England must be raised by the amount of this gold? That would be a way of sterilising, that is commonly adopted on the Continent, I believe; and that can be done whatever is happening to the gold position. One can bring about a tightness in the money market by doing that any day?——As long as the government is not overspending. It would mean a permanent credit balance.

4260. *Mr. Jones*: In the last paragraph on the first page of your memorandum about the Exchange Equalisation Account you say:—

"In view of the inflation which undoubtedly exists in our economy, the question merits consideration whether we should not revert to a system under which losses of foreign exchange would have their full effect on market liquidity."

Are you not arguing the same position here that drove us off the gold standard in 1931?——No, not exactly. I am simply saying that when we lose gold (as I see it; other people take a different view) it has very little effect on our internal economy. Before 1931 it had a very big and immediate effect; the cash basis of the economy was at once reduced by a loss of gold. Since we went off the gold standard that has ceased; but I should like to see, as near as possible, some automatic reaction on our domestic money market when we lose foreign exchange assets.

4261. *Professor Sayers*: There is an automatic reaction, but you are suggesting that we ought to go back to the proportion of nine to one instead of the present proportion of three to one. Would you want to see that automatic reaction whatever the source of the gold loss, that is to say, whether it was on capital account or income account?——Whatever the source. It is quite true that they are different things in a way, but a country must have regard to its capital liabilities as well as its current liabilities. The only thing is that where there was a big run on the exchange, this suggestion would, I think, be too destructive of the market; so I have made it clear that I would give a certain discretion about the extent to which this principle was applied.

4262. That is in fact almost the pure gold standard system. In the thirties, after all, we established the Exchange Account partly because we did not want to have the domestic system exposed to the effects of inflows and out-flows of hot money; now you want to see hot money have effects?——Yes.

4263. *Professor Cairncross*: If the balance of payments were adverse in conditions of increasing depression in the world, and if our exports were falling, would you want to put that kind of check on credit in this country?——I think you have to do that, or else have a major re-adjustment.

4264. Might not a major re-adjustment be preferable? Would you feel, in other words, to put it in its crudest form, that if we were creating unemployment, or suffering from it in our export trade, we ought to reinforce that unemployment in the domestic market?——Is not this a question of political determination? If we are losing exchange that is a sign that our money is too easy, and subject to the variations of political determination I think we ought to contract it.

4265. Just what have you in mind when you talk about a major re-adjustment?——I mean an adjustment in the exchange rate.

4266. Would that involve devaluation or revaluation?——One according to Professor Hawtrey, the other according to most other people.

4267. *Chairman*: Now may we turn to your note on the capital needs of industry? You mention that the banks are being urged to give further support to the Finance Corporation for Industry although they are themselves labouring at the same time under Government appeals to cut down their advances to what at first sight look to be the same ultimate beneficiaries; having mentioned the point, do you think the present system is wrong?——No. I think the F.C.I. has done a very valuable job; but I would like to get away from the restriction on the banks by having a stricter control of money which would make it unnecessary to have the ceiling on bank advances.

4268. Do you feel that channelling bank money for the time being through the F.C.I., as a form of selective investment, is a good idea, or a bad idea?——The banks do not like it; they prefer to do the selection themselves.

4269. *Mr. Jones*: In the last sentence of this note you say:—

"Investment on the scale desirable is, in fact, difficult to reconcile with the present monetary and fiscal policy".

What is the alternative; direct control or priority for essential investment?——The first thing I would suggest would be an alteration in the fiscal machinery so as to give more encouragement both to industry and to individuals to save.

4270. Would you give fiscal preference to the essential industries?——I would give more fiscal advantage to saving by industry.

4271. Would you do anything in the field of investment allowances, and that sort of thing, in respect of those industries that conserved and strengthened the economy?——I would do it generally.

4272. You would not have selective provision?——I assume, with what is perhaps only rough justice, that the market itself results in the more important industries making the biggest increases in their capacity. I think it is very important, much more important today than before the war, that industry should have plenty of capital for development with the technological advances there have been. Investment demand is likely to be twice as big as before the war, and I do not see how it can be provided when taxation on industry, apart from the investment allowances and initial allowances, takes such a very high proportion of the profits.

4273. Would you not differentiate against the luxury industries? There must be a tremendous number of industries and a tremendous amount of investment in the country that serves inessential purposes, that is not necessary for the economic life of the country?——Do they need very much capital? Pools, for instance, do not require a lot of capital!

4274. Surely there must be a substantial part of investment that is taken out of the resources of profitable companies that does not in any way seek to strengthen the economy of the country both at present and for the future? Would you do anything about that?——I cannot conceive what you have in mind, Mr. Jones. I should have thought that any company only developed things for which there was a demand, apart from the welfare services, which you do not want to stop.

4275. *Professor Sayers*: You have said you would encourage saving within industry; would you also take any steps to encourage personal savings?——Yes, I should try to, perhaps like the German fiscal system. They have a whole series of tax incentives for savings. We have it for life insurance but for nothing else.

4276. *Chairman*: Do we not have a number? We have a concession on National Savings Certificates, a concession on small amounts of income in the Post Office and Trustee Savings Banks; we have life insurance; contributions to pension funds; are they not all various forms of the same thing?——Yes, but I think the most important is the life insurance. You might also say that Premium Bonds are a useful way to save with exemption from income tax.

4277. *Professor Sayers*: Would you advocate any new steps in this direction?——In Germany, almost every form of saving allows for 25 or 33⅓ per cent. exemption from tax.

4278. You would not think the rate of interest has anything to do with it?——It has something to do with it; but exemption from income tax has a lot to do with it too.

4279. *Chairman*: Do you think the differential profits tax system is an encouragement to saving by industry?——If the rate of tax on distributed profits was applied to undistributed profits it would certainly be a disincentive. I am not personally familiar with all the problems of industry; I only see them from a banking angle, except in one case. In that case we have to apply a provision which is a great deal higher than the legal depreciation as further depreciation, and that special depreciation is subject to ordinary tax. So to enable us to put £500,000 into that we have to earn a profit of about £1 million. I think the depreciation provisions ought to be made more generous.

4280. *Sir Oliver Franks*: I think you assume that in most countries of the world probably, and very probably in our own, the demand for capital investment is likely to continue to be much higher than it was before the war and for quite a long time. Why do you feel that? What would you enumerate as the grounds which determine your mind?——The Sputnik for one; the whole general development.

4281. That is, so to speak, the technological breakthrough?——Yes; technological development has been speeded up so much. What I would like to see is the encouragement of savings and I think, inevitably, some temporary slowing down on the expansion of consumption. I am not in favour of the Russian system, but they at least put the accumulation of capital for industry above consumption, whereas we on the other hand tax capital in order to encourage consumption.

4282. Given that general position, and if interest rates can do less than formerly and the amount that interventions of a monetary kind can do is real but limited, you would want to see as the prime regulator of the economy the Budget? You think that fiscal provisions are all-important, and that the monetary provisions come in and are important, but secondary?——They are both important, but I think that, in present conditions certainly, the fiscal ones are much more effective in their operation.

4283. *Chairman*: What is your view about the effectiveness or advantages over a long period of time of the system of appeals to the banks to restrict their advances? Do you think that it is desirable or feasible over a period?——It is undoubtedly feasible but I think it would be better if it were not necessary.

4284. What weighs with you in coming to that view?——If you would look at the last sentence of my note on monetary policy and inflation, it says:—

"The ultimate solution has to be found in the political and social, rather than in the technical financial field."

I should like to add to that:—

"In the technical financial field, however, it would be a help if the Bank of England were required to set aside the deposits received in exchange for additional notes issued and not to release them except for the purchase of gold or dollars. Such an arrangement would at least put a brake on the inflationary spiral."

That is the same idea as I had with the Exchange Equalisation Account, but I thought it would apply better in regard to the issue of notes than for the exchange, because the amounts involved might not be of such a size as they would be at the time of an exchange run.

4285. *Professor Sayers*: But no matter how many arrangements of this kind are made, whether attached to the note issue, the Exchange Equalisation Account or anything else, the supply of money can only be tightened by operation on the liquid assets of the clearing banks; is that not right?——Yes, but I would prefer to say that this would only be effective if the Budget was properly balanced.

4286. Unless the Budget was properly balanced it would have to be offset in another way?——Yes.

4287. So far as the operation on the liquid assets of the banks is concerned, is not the limiting factor at present not the absence of new mechanics of this kind but the inability of the authorities to push their funding policy any faster?——Yes; but would you not see a slight difference between an increase in the issue of notes on the one hand and an increase in Treasury bills on the other?

4288. Whatever was done about the issue of notes would not affect the authorities' ability to exchange long securities held by the general public for liquid assets held by the banks, would it?——That is quite a different field. Restricting it to this simple proposal: when more notes are issued, at present the cash paid for them apparently goes straight into the Exchequer account, as I understand it.

4289. If you had this simple system established you would have to offset it by other operations, except to the extent that the authorities could go on funding; and they can go on funding without these new inventions?——Or if the Budget was balanced.

4290. The balancing of the Budget can be done without these new inventions, if it can be done at all?——It could be, but the issue of notes is at present one of the sources by which the Exchequer accounts are balanced.

4291. It is a very convenient source, but it does not hinder the Government's funding operations?——*Sir Frederick Leith-Ross*: No.—*Professor Sayers*: And it does not hinder the Government's control of the supply of money.

4292. *Chairman*: I think we have come to the end of our questions on your memorandum; but I should be glad if you could give us a little more of your time on something that is not in your paper. As you may have seen, it is the intention to include explicitly in our inquiry the question of the constitution of the Bank of England and its relations with the Treasury and other government organs. Could you from your experience give us any views on that question?——It is very difficult for me to give you any views which are not the views, so to speak, of the layman in this question. I have had relations with the Bank of England for a great many years but, generally speaking, my relations were with the Governor or the Deputy Governor rather than with members of the Court. However, I should have thought it was absolutely essential for any central bank to have a proportion on its board of people familiar with the actual working of the situation in the market, seen from the market angle and not from the official angle.

4293. You think it impossible that an adequate experience of what is going on in the market could be obtained by someone who was a full-time director or executive of the central bank?——They might be able to get hold of the facts, but they might not be able to get hold of the spirit or the "nose" for things which you get in the market.

4294. You do not think it could be done by what I might call contacts?——I do not know any central bank that does not have a proportion of people from outside, probably because they are afraid that otherwise the directors of the bank would get closed up in an ivory tower and not be able to appreciate what is happening in the market.

4295. How wide is the "outside" that you think it desirable they should be drawn from? If contact with the market that they deal with is the real point, should it not be persons from that market?——In many cases they have actual representatives of what we call the clearing banks. Certainly people with experience in trade and commerce with the outside world, with the Western hemisphere and, in the old days certainly, with India (though perhaps that is less important now) are necessary.

4296. *Professor Sayers*: There has been a convention against having clearing bankers on the Court, though there is a rather special exception. Would you regard it as proper for the Bank of England to include clearing bankers nowadays in its Court?——I never thought that this historical prejudice against the clearing bankers had any real foundation.

4297. *Chairman*: Do you think for the purposes you had in mind that it is essential that the outside people should be carrying on their ordinary business while acting as directors of the Bank, or would it be enough for them to have had previous experience and then pass into the full-time service of the Bank?——I should have thought it was important that they should have current experience. They would very soon be out of date if there were big changes in the international situation.

4298. "Current experience" meaning literally part-time service to the Bank and part-time service outside?——Yes.

4299. *Mr. Jones*: Is there any more reason for this in the Bank of England than there would be for commercial interests to be associated with the activities and policy of the Board of Trade or the Trades Union Congress with the Ministry of Labour?——I should have thought they were both pretty closely associated.

4300. *Professor Cairncross*: You say you do not know of any central bank that does not have outside people. If you take the Federal Reserve Board, the Chairman of which is an ex-Treasury official, what kind of contacts does that have with the outside market?——I forget now how they are constituted; but, after all, although they have supervisory and overruling powers, they are not the operative reserve banks, are they?

4301. *Professor Sayers*: But is not the Federal Open Market Committee of the Federal Reserve System, which is the operative body, entirely professional, in that it consists of full-time officers of the Federal Reserve System?——*Sir Frederick Leith-Ross*: They are governors of the different reserve banks, are they not?—*Professor Sayers*: They are the governors of certain of the reserve banks.

4302. *Sir Oliver Franks*: We shall have to reckon in all this with the much greater ease with which people can move into full-time government employment, and out of it again into full-time private employment, in the United States. I personally regard it as one of their strengths that people who may have done ten years, shall we say, in industry, can go into the Federal Reserve Board wholetime for five years or ten years, and then go back again out of the Federal Reserve System into industry. Take the present Chairman of the Federal Reserve Board: it is perfectly true that, before he went to the Federal Reserve Board in Washington, he had been an Assistant Secretary in the U.S. Treasury; but before that he had been out in the private sector as the President of the New York Stock Exchange for a number of years, putting through a major reform of that body. There is this pattern of "in and out," that is the advantage of a defect. The United States has so far never succeeded in creating a Civil Service or a Foreign Service which has been a career, in the way that it has in this country. They have, therefore, relied more on outsiders being brought in, and, as the sphere of Government responsibility has increased, more outsiders are brought in for periods. The system has some advantages which offset the disadvantages that it also has, and I think we have to bear in mind that this is a fact about the American situation, when we compare what they happen to do with what they happen to do here. We tend to make the whole thing more rigid; except in time of war there is very little interchange. That is what makes it difficult for us to avoid the part-time solution.—*Professor Cairncross*: As I understand it, Sir Frederick, you are not in favour of a solution along these American lines?——No.

4303. You would prefer to see part-time directors whose primary occupation is outside. There are some central banks with which you have had very personal associations. Did you find in that capacity that you wanted to make much use of the services of the advisers, or other members of your board who came from outside?——Certainly in the rather limited field of which I have personal experience. The National Bank of Egypt was a semi-central bank and had certain commercial functions as well; when I was Governor, I was constantly consulting with part-time directors; but perhaps it was very largely on commercial questions.

4304. *Sir Reginald Verdon Smith*: Do you see a distinction between advisers and part-time members with responsibility for the organisation?——Yes. I would have thought that with advisers you could not consult them with anything like the same frankness as when they are part

of the organisation. You have to be much more cautious with the information you give.

4305. To the extent that it would be a positive disadvantage?——I think so.

4306. *Professor Sayers*: You mean that a director necessarily feels more sense of responsibility for the confidence which he has received?——I should have thought so.

4307. *Professor Cairncross*: Would you agree that, if one looks back over the last twenty or thirty years, the Treasury has tended in all countries to take more of a hand in the determination of financial policy; and that, even in the sphere of the central banks, more has tended to be decided within the central bank than by contact and association with people outside it?——I think you are probably right on both points, but I cannot speak from personal experience.

4308. *Chairman*: Suppose that the flow of general economic and financial information to the central bank was even more abundant and more precise than I believe it to be today; do you think that would diminish the importance of having part-time directors for the purpose of keeping in touch with what is going on?——I think that the personal impression of the really able fellow is worth a great deal more than volumes of print.

4309. I suppose that primarily the central bank's problems, apart from the strictly market ones, are concerned with the general situation rather than the particular, with the general economic flow of affairs; I would have thought myself there was some difficulty, unless you had a very large body of part-time directors, in getting anything but a very partial aspect of the picture by your contacts?—They cannot all be "Panoramas"!

4310. *Professor Sayers*: Given that there are considerable advantages in this system, there are, of course, also disadvantages: there is always the dilemma of how much a part-time director can be told. Given that a great deal of information to the central bank is at once highly technical and highly confidential, is it possible to keep part-time directors sufficiently well informed about what is being done to enable them to contribute materially to the formation of policy without giving them altogether too much information, given that they are engaged in business outside? Do you think it is possible to solve that dilemma?——I think that is really a question that ought to be addressed to the Governor of the Bank of England; I suppose he is the only person who can give you an answer. But I should have thought that he could direct the searchlight on to one particular point without revealing everything.

4311. *Professor Cairncross*: Suppose that the Bank of England did not have on its Court any group of part-time directors drawn from the city or industry or elsewhere in this country; do you think that would have a prejudicial effect on the relations between the Bank of England and the money market and industry in this country, or on the relations between the Bank of England and the Commonwealth banks? Do you feel that this might give rise to a sense of exclusiveness or aloofness on the part of the Bank? Or do you think that is rather a secondary consideration?——There has been certainly a feeling sometimes that the Bank of England does not take the Commonwealth banks sufficiently into its confidence, but I should not have thought that the internal organisation of the Bank of England would affect that.

4312. *Chairman*: Would you care to say anything about what you think is the measure of independence that a central bank should enjoy, if any, as between itself and the Government or the Treasury?——I always like to see a central bank taking as independent a line as possible; but in cases where it is contrary to the Government, the Government view must of course prevail.

4313. Does that mean that in fact the central bank can enjoy no independence except that of arguing up to a point?——It depends on the arrangements between the central bank and the Government. For example, many central banks have the most detailed conventions between them and the government setting out their powers. In Belgium the central bank was able to stand up to the government and tell them to alter the whole system of raising short-term money, because of the provisions of the convention. That is a case which showed considerable power.

4314. With your experience of these different possibilities do you favour any particular one for this country? Should there be a convention which gives the Bank of England certain defined liberties, or should there be none except that of arguing?——These conventions seem to be alien to our national sympathies; and probably a convention written with the Bank of England by one Government would have to be re-written by the next one.

4315. *Professor Sayers*: Would you favour the degree of independence of the Bank of England from the Treasury being increased or decreased?——Has it any independence at present from the Treasury?

4316. Does your question imply that you think that the degree of independence should be increased?——I should have thought that if possible it should be increased.

4317. *Chairman*: How would you increase it except by defining some position which at the moment seems to be undefined?——In the old days the Bank of England was in reality independent of the Government and the only thing that could happen was that when there was a collision of wills the Government could force the Governor of the Bank to resign, not legally, but by freezing him out. That was the ultimate sanction; and the Bank of England certainly used its powers in those days.

4318. But those were the days before the nationalisation Act had been passed and a statutory power had been inserted for the Government to give directions to the Bank?——Yes. In those days there was a saying, I think, by Lord Norman, when he was the Governor, that was repeated to me: "My job is to think out what the Government wants before it knows it!"

4319. If in general you think it should have more independence than it enjoys today I am not clear how you think it should achieve it?——The only way would be for the consultations that must take place between the Treasury and the Bank to be more or less on the old basis; that, unless the Treasury had a very strong objection, the Bank of England made up its mind and simply informed the Treasury, as a matter of personal relationships. But I cannot believe that that is consistent with the system under which a Chancellor speaks of the Bank of England as being his "creature", or his instrument.

4320. *Professor Cairncross*: Do you think that monetary policy is so easily detachable from economic policy that you can just vary monetary policy without bothering about the rest of the economic policy?——No. I assume the Bank of England is sufficiently informed of what the economic policy is and would see to the results in the monetary system.

4321. Presumably any collision would imply that the Treasury and the Bank of England viewed the co-ordination of economic and monetary policy rather differently? ——Yes, or it might be due to actual factors of administration.

4322. *Chairman*: What are the demerits of the Bank's lack of independence, as you see it today?——It is very difficult to fix that precisely; but I have the impression (it might be wrong) that abroad there is not the same regard for the Bank of England today as there was twenty or thirty years ago. It may be a question of personalities, but I think it is partly the relationship between the Bank and the Government which has impaired its prestige.

4323. *Professor Sayers*: On the thirty years I would agree; but twenty years ago the Bank of England was, surely, if anything, less independent of the Treasury than it is today?——I should have thought that twenty years ago it was certainly working in close co-operation with the Treasury, but still——

4324. Do you not agree with Lord Norman's own account of the position in 1936 or 1937, when he said in effect that he would have his own views but in the last resort: "You tell me what to do and I do it"?——That does not seem very different from what it is today, but it surprises me.

4325. *Sir Oliver Franks*: One might turn today's position upside down and make it a bit paradoxical. This is illustrated by the Press conference at which Sir Stafford Cripps referred to the Bank as his "creature"; the journalists went on to say: "Your creature?", and he said: "Yes, but creatures develop a will of their own". I think a major institution does develop a person and a will of its own, and in a situation in which there are

no rules to determine the degree of its dependence I think it tends to develop power in proportion as there are no rules, provided that it is dealing with the facts out of which policy is made. The Bank of England, of course, is dealing with facts out of which policy is made; it is dealing with facts of the market from day to day; and there are no rules which limit its dependence; so that it is in a position, I think, to exercise very great power on departments of the Government which themselves are not so close to the facts. One might be able to argue that, while constitutionally it is dependent, *de facto* it is more independent than it used to be. Would you think that that was words but no sense?——No; that is a paradox that may well have some force. I think it depends upon the relative competence of the man at the Bank and the people he has to deal with. Sometimes it is easier for an institution like that to get its own way from inside rather than from outside.

4326. *Chairman:* So far as foreign opinion goes, you think the Bank suffers to some extent from a lack of status today?——I have that impression; but I would not like to put it too high.

Chairman: I think that concludes our discussion, Sir Frederick. We are most grateful to you for coming along this afternoon.

(*Adjourned until Thursday, 20th February, 1958, at 11.0 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

NINETEENTH DAY

Thursday, 20th February, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E. (Questions 4327 to 4684 only)
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

R. D. SMITH, ESQ., General Manager, Barclays Bank D.C.O., B. J. MCQUIN, ESQ., Assistant General Manager, Bank of West Africa Ltd., and W. S. WILSON, ESQ., London Manager, The Standard Bank of South Africa Ltd., representing the African sector of the British Overseas Banks Association, called and examined.

4327. *Chairman*: Mr. Smith, we have read with great care the memorandum* you have been good enough to put to us in answer to our questions. There will be a number of questions which will arise out of what you have told us, and I think it would be most convenient if we go through paragraph by paragraph, and then questions on the various points will come from members of the Committee as we go through. In the first section you are distinguishing movements of funds between offices in the United Kingdom and offices in territories outside the sterling area and movements of funds between offices in the United Kingdom and offices inside the sterling area. Then you say that the greater freedom of movement within the sterling area enables better advantage to be taken by the public of disparities in interest rates. Then in paragraph 6 you point out:

"The extent to which sterling funds accruing to the overseas banks in London are retained by those banks depends on the degree of control exercised by the authorities in the overseas territories concerned over their territories' external exchange resources."

That control, I suppose, takes the form either of the institution of a central bank, or transfer restrictions imposed by the territory concerned?——*Mr. Smith*: Yes, normally by the legislation of the country concerned. For example, the Union of South Africa has legislation which lays down that the banks operating there have to have assets in the Union equal to their liabilities, plus a measure of capital. So far as the Union of South Africa is concerned, therefore, we have to have a completely closed exchange position, so that we do not retain in London balances on behalf of South African branches, except the permitted working balance which is allowed us by the central bank.

4328. Which territories have neither a central bank, and whatever control results from that, nor transfer restrictions?——Within the sterling area, East Africa (that is Kenya, Uganda and Tanganyika), Nigeria, Sierra Leone, and of course South-West Africa, which is part of the Union. Ghana now has a central bank. Outside the sterling area, the countries without central banks are the Sudan, which I believe proposes to set up a central bank shortly, the Portuguese territories, and one or two other territories where British banks do not operate.

4329. Do those sterling area territories in Africa which have no central bank have no transfer restrictions?——None at all.

4330. *Professor Cairncross*: What proportion of your business is in the sterling area countries in Africa, and what proportion is outside?——I can only speak for my bank, which is Barclays D.C.O., and I could not give you the exact figures. I would say that 60 to 65 per cent. of our African business is in the Union alone.

4331. Have you many branches outside the sterling area countries in Africa?——*Mr. Smith*: We have about fifteen branches in the Sudan and about ten branches in Libya.—*Mr. Wilson*: The Standard Bank of South Africa has two branches in Portuguese East Africa.—*Mr. McQuin*: The Bank of West Africa has only two outside the sterling area, at Duala and Tangier.

4332. *Professor Sayers*: And presumably the business between those branches and offices within the sterling area is subject to the ordinary controls?——*Mr. Smith*: They are subject to local exchange regulations, which normally follow the pattern of the U.K. regulations.—*Mr. Wilson*: There is one aspect which we ought to mention: there are the New York and Hamburg offices which are maintained by our banks, and which do very substantial business with the help of the Bank of England.

4333. *Professor Cairncross*: I take it that your position in Africa rests largely on the volume of trade between this country and the African territories, but that you also finance trade involving third countries?——*Mr. Smith*: We do.

4334. And trade between two foreign countries?——I can only speak for Barclays Bank D.C.O., but I would have said we did little or no finance for transactions between two foreign countries. But we handle a lot of transactions between, say, the United States and Africa, and between Germany and Africa; both the Standard Bank and ourselves have offices in New York, and we and the Bank of West Africa have offices in Hamburg.

4335. Are you in competition with American and German banks in the African territories?——No. I would prefer to say that we co-operate with them or, to put it another way, facilitate the business which the domestic American and German banks have with those sections of Africa where we are represented. We do, for example, both in New York and Hamburg purchase bills for either German or American exports to places like South Africa, West Africa and East Africa, and with the permission of the Bank of England we give some modest sterling overdraft facilities to our Hamburg and New York offices to carry those hills for a very short period.

4336. Are these all sterling bills?——*Mr. Smith*: They are sterling, if you call sterling the normal currency of the African territories.—*Mr. Wilson*: I think that we are in competition with the American and German banks to some extent. After all, we are running a service which, if we were not there, they would have to do. They would have to make advances against these bills, and I believe they frequently do that.—*Mr. Smith*: We collect the bills for them, of course, if they are granting local advances.

* Memoranda of Evidence Part VI No. 15A.

4337. The American and German banks presumably have no branches in the African territories?——No, not in the African territories.

4338. *Professor Sayers*: When a customer of yours in South Africa exports goods to the U.S.A., that leads to an increase in your balances in your New York branch, I presume?——Only very temporarily, because the dollar proceeds have to be accounted for by us, of course, to the South African Reserve Bank, in the same way as a U.K. exporter would have to account to the Bank of England.

4339. The exchange control of the territory from which goods are exported would see to that, subject to your maintaining a working balance in New York?——Yes.

4340. *Professor Cairncross*: You are to some extent financing trade outwards and inwards?——Yes.

4341. *Chairman*: In paragraph 7 you refer to "those sterling area territories which do not have a central bank, do not impose exchange control regulations requiring the surrender of sterling earnings, and have currencies linked to sterling at par" which have, as you say in paragraph 8, "no alternative means of employing cash reserves locally"?——May I at this stage correct slightly paragraph 9? That paragraph was perfectly true when it was written, where it says that an excess of sterling exports would tend to produce a running down of the territory's sterling balances, but that in practice these balances remain constant or, if anything, tend to increase. That should perhaps be qualified as a result of the current high Bank Rate here, which has led, as a result of other considerations, to the balances generally running down. What has been happening has been that, to some extent, the U.K. has been exporting overdrafts, if you like to put it that way, to the African territories. If one takes a group of English companies, or a parent company operating with subsidiaries in Africa, the parent company at one time would probably have financed those subsidiaries from its own resources, borrowing, perhaps, in London itself at a comparatively cheap rate, and financing the subsidiaries. But as a result of the credit squeeze here there has been an increasing demand for local overdrafts from the subsidiary companies, so that we have found ourselves required to grant increased overdraft facilities in Africa. Again, some hire purchase companies who found their operations restricted in this country have endeavoured to offset that by increasing their turnover in the African territories; that, again, led to an increase in the demand for the banks' facilities. The attractiveness of the high rates of interest which are available on short-term money in London has also led to some reduction in our deposits: people who would normally have kept cash with us on deposit at a reasonable rate of interest, could not resist the temptation of the 6½ per cent. Treasury Bill rate.

4342. *Professor Sayers*: What kind of people are they? Are they big trading corporations, public corporations or private individuals?——I would say manufacturing, mostly, or people like the large mining groups.

4343. Has the movement of deposits been larger than the movement of overdrafts, or are the overdrafts the bigger factor?——*Mr. Wilson*: I would say the latter, so far as South Africa is concerned.—*Mr. Smith*: I would say from my own experience that we have lost our deposits as we have increased our overdrafts. It has been about fifty-fifty. But I would not say the whole of the increase in overdrafts is due to the export of overdrafts from the U.K. That would be due to other things as well.

4344. Both these movements have been substantial in relation to your normal level of London funds?——Yes.

4345. What kind of margin of interest rates causes these movements to appear? Did they appear before or only since the 7 per cent. Bank Rate?——*Mr. Smith*: They were in evidence to some extent even before the 7 per cent. Bank Rate.—*Mr. Wilson*: I think it is more the credit squeeze than the actual disparity in rates of interest which has caused this trend to take overdrafts overseas.—*Mr. Smith*: Yes, but I think that the attraction of the interest rates here has operated from about the beginning of 1957.

4346. *Mr. Jones*: Is the change in circumstances which you have in mind the rise in the Bank Rate on 19th September last?——I would say that has accentuated the trend that was there before.

4347. Is that substantially the reason for your qualification and amendment of that paragraph?——Yes. As we explained in the memorandum, many of these territories have tried to insulate themselves from the effect of the high rates which have been imposed here, but to some extent they have found it very difficult; for example, in Rhodesia when the London Bank Rate went up to 7 per cent. the banks were specifically requested not to make any changes in their rates, either debit or credit. But they have not been completely successful in insulating themselves and, as a result, only a week ago Rhodesia had themselves to institute a credit squeeze in order to try and take care of that situation.

4348. *Professor Sayers*: In some of these territories you have said that you are required by local regulations in effect to balance your local deposits and local lendings?——Yes.

4349. When there is a pull by London, in the shape of an unusually high interest rate, you would have from those territories a disposition to lose deposits and to import overdrafts?——Yes.

4350. That would throw the balance out, on the face of it. How do you deal with that situation?——We are limited in the extent to which we can meet the demand for increased overdrafts by our local resources.

4351. So if local deposits go down through people transferring to London, you have to cut your local lending?——Yes, we have to be restrictive.

4352. Has this enforced cutting down of local lending, by the attraction of London high interest rates and the credit squeeze, been an important factor in any of these territories in the last two or three years?——Yes, I would say that it has been. Even a year or eighteen months ago we had to restrict, and we endeavoured to bring down our lendings in the Union of South Africa, for example.

4353. So these local regulations operate to ensure that the credit squeeze in England cannot be exported?——Yes, that it is at least limited to the resources of the local banks.

4354. *Chairman*: Taking these various areas all over Africa, is this tendency to dry up your funds for local lending both noticed and resented?——*Mr. Wilson*: It is certainly noticed. I do not know whether it is resented. —*Mr. Smith*: It has not been sufficiently serious to have any serious effect upon our customers.—*Mr. Wilson*: It looks like being very serious in Rhodesia, but that is not entirely due to the credit squeeze; it is partly due to the worsening of the balance of trade, owing to the fall in the price of copper.

4355. *Professor Cairncross*: Do you find big variations in the rates of interest in the various African countries, since the rise in the London Bank Rate?——*Mr. Smith*: Yes. In many of the territories, for example in West Africa and in East Africa, the rates have been adjusted in line with those in the U.K. It is only in some territories, such as Rhodesia, where we have been specifically asked by the central bank not to alter the rates, that there is any very great difference.

4356. If there were no central bank, you would automatically adjust your rates in line with the London Bank Rate?——Yes.

4357. *Sir John Woods*: To the extent that rates have been increased, the rate of interest as such would not lead to an export of overdrafts; it would be the credit squeeze?——It would be the credit squeeze.

4358. *Professor Sayers*: Is there any reaction of local opinion against these rises in interest rates?——Yes, but in only a minor degree. There is a spirit of nationalism or independence abroad in a lot of the territories, and we have found it a little difficult sometimes to explain to people why their rates should go up, merely because the London Bank Rate has gone up.

4359. *Professor Cairncross*: In the case of Ghana, which now has a central bank, did the rates rise with the increase in the London Bank Rate?——They did.

4360. *Mr. Jones*: When you refer to Rhodesia, are you referring to the whole Federation or to Northern Rhodesia?——To the Federation of Rhodesia and Nyasaland.

4361. *Chairman*: You said that, whereas a parent company, before the credit squeeze at any rate, normally

financed its subsidiaries by borrowing in London, you now have a corresponding application from the local companies for the money. How far are you able to meet these applications? Is it simply a transfer of credit that takes place, or is it in the total result a failure of credit?——I would say that generally we have met the demand, where the request has been a reasonable one and measures up to the requirements of bank standards.

4362. *Sir John Woods*: That does not have any bad effect on your local customers who are not subsidiaries?——No.

4363. *Lord Harcourt*: You say that the effect on your local customers has not been unduly severe, or caused undue criticism?——Yes.

4364. Has the direct linking to London, particularly of those territories not having a central bank, led to any great criticism of the sterling area as such, and the workings of the sterling area?——Not to my knowledge. I have heard none at all.

4365. *Professor Cairncross*: The position you are putting to us is one in which some of the West African countries, which have large sterling balances, are suffering from a steep increase in interest rates, at a time when by drawing on their balances in London they could keep down rates of interest. Is this a position that they view with equanimity?——*Mr. Smith*: I do not know what they feel about it. The bulk of their balances are represented, I imagine, by investments which they cannot readily draw upon, except by realisation, and I suppose they would hesitate to realise their investments at current market prices.

4366. Your liquidity in West Africa is, presumably, still fairly high?——Quite high.

4367. Your liquidity cannot be equal in all directions all round. There must be some places where you are, from a local point of view, in a rather liquid state. Do you apply the same credit price throughout?——*Mr. Smith*: Yes. One of the advantages of banking in various territories as we do is that one can meet seasonal demands in one territory by utilising some of the larger credit balances which are maintained seasonally in other territories.

4368. Do you find that large trading corporations, which would normally extend a certain amount of credit in their own commercial operations, have been led by the higher rate of interest to grant credit less regularly?——No, I cannot say that I have seen any evidence of that.

4369. There has been no tightening up that would lead to greater reluctance to import stocks, for instance?——No. Where U.K. concerns control subsidiaries abroad, and where they finance the subsidiaries by open account, as it were, they will ask for remittances or transfers to the U.K. rather more freely.

4370. Would not that help our position here?——Yes; it would bring debts due from South Africa home to London more quickly.

4371. And your belief is that this is a reaction to the tightness of credit in London?——Yes. I would not say the figures involved would be highly important, but it would be one factor.

4372. *Professor Sayers*: Has your position in the last decade or so in most of these territories been that you would have liked to lend more if you could have found good borrowers?——At some periods, particularly during the war, we were all underlent in those territories, but since 1946 there has been a steady and increasing demand for advances, which we have been able to meet. What the territories still lack is, perhaps, medium and long-term credit for development purposes; but we do not feel it is any part of our duty as bankers to provide more than temporary borrowing.

4373. I was wondering whether you still felt underlent at all, or had done immediately before the credit squeeze. Would you have liked to have seen more short-term borrowers of the traditional kind asking for loans?——*Mr. Smith*: Again, I can only speak from the experience of my own bank. I would have said that we had an adequate demand for normal banking advances.—*Mr. Wilson*: I would go further, and say the demand of good creditworthy borrowers exceeded the possibility of accommodation, particularly in East Africa.

4374. *Professor Cairncross*: You do say that in effect in paragraph 10, because you speak of "sterling area territories where there is a deficiency of local deposits". I assume there are some territories in Africa where you lend by drawing, in effect, on deposits made in other parts of the continent?——*Mr. Smith*: Yes.

4375. Is this mainly in East Africa?——*Mr. Wilson*: Speaking for my own bank, I would say that in South Africa, also, before the credit squeeze we had no lack of opportunity for making good banking advances, but there was a tendency even then to become overlent.

4376. It is rather important to know how far you are prepared in your business to make advances in one country substantially in excess of the deposits in that country?——*Mr. Smith*: One would normally only do that as a very temporary measure. We do tend to meet seasonal requirements.

4377. *Chairman*: Where you say that London funds may be "invested in the banks' business in other sterling area territories where there is a deficiency of local deposits", we must read that as merely meaning a temporary accommodation to meet the demand?——Yes. I do not know whether Mr. McQuin's experience has been the same, but in this last season in Nigeria they are producing a record groundnuts crop, and it also happens that this year about 95 per cent. of the crop is of a higher grade than normal, and they are enjoying a higher price. Moreover, about 65 per cent., or even more, of the crop came forward in four weeks. All this meant that we lent very quickly a lot of money in Nigeria, and for a few weeks our advances in Nigeria might have been in excess of our Nigerian deposits, in other words, our Nigerian branches were overdrawn at head office.

4378. *Professor Sayers*: Do the big trading companies lend much to the producers?——They grant credit, but just on open account, as it were, in the course of their trading.

4379. *Professor Cairncross*: But substantial sums in total?——Yes.

4380. *Mr. Jones*: To what extent has the contraction in tin mining in Nigeria, and the fall in price of copper in Northern Rhodesia, resulted in a lesser demand for expansion and thus in credit?——Undoubtedly the fall in the price of tin is going to affect very seriously these small miners who operate in quite large numbers in the Jos area, and some of them may even find it difficult to produce tin at an economic cost.

4381. Is there not a contraction in the market for tin? Has there not been some rationalisation in the amount of tin to be produced?——Yes.

4382. What effect has that had on credit seeking in an area which needs capital very badly?——We have not noticed any particular effect yet, but undoubtedly these small miners will find it extremely difficult to carry on. As regards Rhodesia, as Mr. Wilson mentioned, the heavy drop in the price of copper has meant a substantial deterioration in the balance of payments situation of the Federation of Rhodesia and Nyasaland, and they have endeavoured to cope with that by applying a credit squeeze.

4383. To that extent there is a lesser demand, is there, for credit?——Yes; it is intended to operate to reduce the demand for imports.

4384. *Professor Cairncross*: In this paragraph you refer to the sterling balances accumulated in London being invested on the London market in medium or short dated securities. How long are the maturities that you are prepared to hold? Do you take bonds extending beyond, say, five years, or are you thinking here merely of Treasury Bills?——No, I was thinking here of five year bonds, Treasury Bills and money at call in the money market.

4385. *Professor Sayers*: You would not normally go beyond five years?——We do, but that I would prefer to regard as something rather different from the employment of these balances.

4386. That would be for part of your standing capital, so to speak?——Yes.

4387. *Professor Cairncross*: We have no indication in this submission of the total resources at the disposal of the banks in the African centres, either in aggregate or individually. Is it possible to give us a figure of the resources in funds?——*Mr. Smith*: The total resources of Barclays Bank D.C.O. are £600 million, of which deposits account for £560 million of which, I suppose, £230 million are raised in the Union of South Africa. The rest is spread throughout the African territories and the Caribbean and the Mediterranean.

4388. What proportion of that would represent London funds? It would vary, I suppose?——Yes, it varies quite substantially. It varies seasonally. The amount employed short-term in the London market would probably be of the order of £60 or £70 million.

4389. We are really interested in aggregate figures. I think that you make certain returns to the Bank of England?——Yes.

4390. Would you have any objection to the publication of aggregates based on these returns; not figures for individual banks, but aggregates?——No, I would not mind. The Statistical Office of the Bank of England, I think, will have most of the statistics that you are likely to require.

4391. *Chairman*: Since we are bringing it to the point of asking you whether you see any objection to the aggregates being made available, we ought to sharpen the question to see what it is we want.—*Professor Cairncross*: It is the resources in London that we are particularly interested in knowing about. It would be, in fact, the same headings as you originally submitted to the Macmillan Committee?——*Mr. Wilson*: I should not think our Directors would object to that.—*Mr. Smith*: No, I should not imagine so, as long as we were each giving our individual figures to somebody like the Statistical Office at the Bank of England for amalgamation, on the understanding that they would only be published as aggregate figures. There is a good deal of jealousy about the various territorial figures, which could be of use to non-British competitors, if they were disclosed.

4392. *Professor Cairncross*: The suggestion does not specifically relate to the African sector, but to all overseas banks, so that it would not be the intention to ask for totals in respect of your group.—*Professor Sayers*: We should want some split-up, not as between banks and groups of banks but as aggregates for all overseas banks, between the nature of the things held: what part is bank deposits, what part is Treasury Bills, what part is short bonds?——*Mr. Smith*: Are you only interested in the employment of short-term funds in London? That does not necessarily represent the whole of the banks' liquidity, because we would be holders of Treasury Bills in the Union of South Africa, and in other territories.—*Professor Cairncross*: There would be an interest in holdings of London sterling bills; that is, items in your balance sheet which are relevant to the external account of the United Kingdom.—*Chairman*: We will write to you and to the other sectors after the hearing, to let you know with what aggregates we hope you will be able to arm us.

4393. *Sir Reginald Verdon Smith*: Could we come back to your lending policy? You told us that you were being pressed to provide increased overdraft facilities in African territories, particularly for United Kingdom companies who could not get those facilities here. Is it any part of your policy to regard those facilities as of a long-term nature, rather than as purely temporary, possibly, with E.C.G.D. backing?——No; all the advances that we grant are normally short-term bank lending. To a very limited extent, of course, one sometimes has as a matter of policy to do something which might be of a three or four years' character, and one knows that at the outset; but one grants it on normal banking terms.

4394. And you would regard that as very much the exception?——Yes. The demand for advances has been such that we have had, on at least two occasions in the last three or four years, to remind branches that they must be particularly selective, and that we could only consider advances which measured up to correct standards.

4395. So these particular territories which are deficient in capital resources, and want to see capital development programmes carried out, would not really be able to look to you and your friends to provide financial resources on a long-term basis for these development undertakings that they might be carrying out?——Except to the extent that we in Barclays formed in 1946 a subsidiary company, Barclays Overseas Development Corporation, whose sole purpose in life is to provide medium and long-term finance for development projects in these various territories. That does not operate in the Union of South Africa, because they have their own industrial development corporation, which is a Government sponsored organisation. Through that subsidiary company we are granting quite a substantial amount in relatively small quantities for development purposes.

4396. *Chairman*: How does that obtain its finance? Does it borrow from you on long-term or overdraft?——No, initially the bank put up about £5 million of capital.

4397. *Sir Oliver Franks*: It is in your balance sheet as an investment?——As a fixed asset and investment.

4398. *Sir John Woods*: Over what period does that subsidiary lend up to?——*Mr. Smith*: Normally not exceeding ten to fifteen years.—*Mr. Wilson*: For long-term finance the banks themselves, apart from development finance corporations, have made certain advances. For instance, in the Kariba scheme Barclays and we are lending a long-term sum.—*Mr. Smith*: We have agreed each to invest £2 million in Federal Government loans, which is part of the money that is required to finance Kariba.

4399. *Professor Cairncross*: Could we hear a little more about your operations in the London market? Do you operate a good deal in the purchase or sale of bonds, or is it mainly in Treasury Bills?——Treasury Bills.

4400. *Professor Sayers*: Do you reckon your short-term bond holdings to stay put through the year?——Normally, yes.

4401. Do you vary, as a matter of policy, the proportion in which you hold call money and bills in London?——*Mr. Wilson*: We always keep very careful track of how much we have got of each category. Day to day it varies a little.—*Mr. Smith*: Sometimes it is just a matter of arithmetic whether it is better to take money off the discount market or sell Treasury bills.

4402. Do you have regard to relative rates?——Yes.

4403. *Professor Cairncross*: What would you do if you had no discount market in which to employ your funds in London?——I have not visualised that situation. We would have to keep large balances with the Bank of England, I suppose, or with the clearing banks.

4404. Is it clear that your funds would have to be in sterling?——I do not know that the answer is necessarily yes to that. If there were no discount market here, and I had an opportunity of employing the surplus at a reasonable rate of interest, I should retain it in the local territory.

4405. And build up, in effect, a market there, or help to do so?——Yes, much along the lines of the precedent which is being set in the Union of South Africa, where a discount house and an acceptance house have been set up.

4406. *Professor Sayers*: Suppose that you could get reasonable terms from a clearing bank for these balances that are held in the discount market from day to day; would you then prefer to continue holding the funds in London?——Again, it would be a matter of arithmetic, which suited us better.

4407. You would have no objection to dealing in this way with the clearing banks?——No. We do, of course, deal with the clearing banks; some of our funds are deposited with the clearing banks.

4408. Are those funds that you place with the clearing banks subject to the ordinary clearing banks rules, or do they have special terms?——They are subject to the normal deposit rates and the normal terms.

4409. *Chairman*: In paragraph 13 you say: "More latterly, there have been signs of increasing reluctance overseas to follow Bank Rate changes automatically." Is that a reference to what you have told us about Rhodesia, or are there other cases?——No, I am thinking of other territories, too: for example, East Africa. They felt a little diffident about increasing the rates there, because there was some local feeling about it. They did not see why they should pay London rates, or why their rates should be affected by what happened in London.

4410. *Sir Reginald Verdon Smith*: Who decides such a matter in East Africa?——It is a matter of a decision

between the commercial banks operating there. There is no central organisation. There are, of course, the Treasuries of the local Governments, but they do not exercise much control over us apart from exchange control regulations.

4411. *Sir John Woods*: What did, in fact, happen to rates?——They went up.

4412. They are pretty well adjusted to the London market?——Yes.

4413. *Professor Sayers*: When there is a change in the London Bank Rate, do the various banks operating in, say, Nairobi or Dar-es-Salaam get together and say: "What shall we do about our rates?"——Yes. What normally happens is that as soon as there is a change in the Bank Rate a cable goes out expressing a view from London, and suggesting that the local banks get together and cable their recommendations, which they do.

4414. *Chairman*: Except in Rhodesia have you had governmental representations about the putting up of your rates?——South Africa is a law unto itself, of course; otherwise no. But in one or two territories we are subject to other legislation, such as usury acts and things like that in places like Barbados in the Caribbean, where the maximum interest rate one is permitted to charge is 6 per cent. Malta is the same.

4415. *Mr. Jones*: Is there a complete physical control on the export of capital from the Union of South Africa to London?——There is control, yes.

4416. So that at the moment you have got an insulated situation, which rules out an increased Bank Rate in London, so far as South Africa is concerned?——Theoretically, yes; but in practice South Africa has not found that it works in quite so watertight a manner. There is an expression, I think, which has been used of "lags and leads"; people have delayed sending money to South Africa, in order that the money can remain here for a little while to get the benefit of London rates.

4417. *Chairman*: That has meant a lack of watertightness?——*Mr. Smith*: I think so, yes.—*Mr. Wilson*: There is only one actual control on capital transfers, which is that for South African residents. If they want to send out of the Union a sum in excess of £10,000 they must have official approval. Any foreign investor can get his money out without any trouble at all, so that parent companies with subsidiary companies in South Africa can make large transfers from South Africa to this country without let or hindrance, and transfers of profits are not interfered with in any way.

4418. *Lord Harcourt*: There must be large movements of capital, too, in the aggregate by means of the Johannesburg Stock Exchange and the London Stock Exchange, where there is constant arbitrage?——*Mr. Smith*: Yes. For the ordinary customer there is no restriction at all.

4419. *Mr. Jones*: What about your credit terms, say, in the other areas of Africa, as compared with your credit terms in the Union? What are your terms of lending? Are they affected by these conditions that are now referred to?——No. We meet the demands or requests for advances in all the territories as they arise, and judge each of them on their merits.

4420. A creditworthy customer at Barclays in Britain would pay something over 7 per cent., perhaps 8 per cent. Let us assume that you have got a different Bank Rate situation in the Union, and their Bank Rate is not so irksome. What would be the position of your bank as regards providing credit in those circumstances?——A borrower would pay a rate of about 6 per cent.

4421. *Sir John Woods*: The last sentence of paragraph 14 reads: "Overdraft rates have therefore also to be increased both to meet the extra cost of raising deposits and to check the increasing pressure of demand from local would-be borrowers." You said earlier on, Mr. Smith, that you have begun to meet the additional demand for advances coming from locally based subsidiaries of U.K. companies, without any harm to any creditworthy local borrowers; and Mr. Wilson said earlier on that in a good many of the territories there was no lack of local creditworthy borrowers and, in fact, there was some risk of being overlent. I am wondering whether those two things are really quite consistent, or whether in fact the export of overdrafts from London is not putting a squeeze on creditworthy local borrowers?——I can only say that from my experience we have so far successfully met the demand both from the local borrower and from the borrower who is a subsidiary of a U.K. company, who previously had not found it necessary to borrow.

4422. Am I right in thinking that, in view of the two statements made, there is perhaps a precarious situation, and that, if there were a continuing demand from London, you might find yourself facing too big a demand?——It would depend on the extent to which we had been able to maintain or increase our deposits locally, and the amount we had been called upon to grant in the way of advances.

4423. *Professor Cairncross*: Is this a theoretical case you are giving us here, or have you got some country in mind? In the case of South Africa, for instance, were rates forced up when the Bank Rate was increased here?——No, they remained unchanged; but within the last week South Africa has taken the step of increasing what it calls its pattern of rates; it has increased the rate for local Treasury Bills and things of that sort, and the amount paid by the local finance corporation; that is likely to be reflected by an increase in rates paid by the local commercial banks, and possibly there may be some adjustment in the rate charged on advances. So far the lending rate in the Union has not been changed since September, 1955.

4424. *Professor Sayers*: Have you in any country at all raised overdraft rates to check the increasing pressure of demand from local would-be borrowers?——No, the only change we have made is to increase the rate so as to bring it into a relation with the U.K. rate.

4425. *Professor Cairncross*: It is the increase in the rate on deposits which makes you put up the overdraft rate?——*Mr. Wilson*: It has that reaction. Putting up the interest rate does not really deter borrowers.

4426. *Professor Sayers*: It is this last sentence in paragraph 14 which is bothering us. I wondered what you meant by that?——*Mr. Smith*: The paragraph says that changes in the Bank Rate here have not invariably brought about a corresponding increase or decrease in rates overseas; but that nevertheless the trend is for local rates to follow the rates here; and that, if we have to pay more by way of credit interest, then ipso facto we have to charge a bit more on our lendings in order to compensate us from the point of view of revenue.

4427. *Sir Oliver Franks*: I follow the general argument, but we are being narrow-minded on the reasons you give at the conclusion. From what you have just said, the first reason in the last sentence follows, but the second does not: you have to put up overdraft rates "to meet the extra cost of raising deposits", but what about "checking increased pressure of demand from local would-be borrowers", particularly if putting the rate up does not happen to check local would-be borrowers, as Mr. Wilson said? Is this a form of words which one tends to use, but does not correspond so accurately to the situation?——Certain chronic and persistent borrowers may have been told to get their accounts down, and that, if they do not, the rate will go up by one half or 1 per cent. But they would be purely exceptions. I can never recall putting up our rates merely as a deterrent to borrowers.

4428. So that if we deleted the last clause of that sentence the general meaning of the paragraph would not have suffered loss?——No, I do not think it would.

4429. *Chairman*: In paragraph 15 there is a reference to possible action by governments in repatriating their own sterling holdings in London, and then making local deposits.——*Professor Sayers*: Do colonial governments actually shift their own balances about between London and the colonies?——No, I do not think so. This was just a suggestion that it might be useful to the banks, if the territory got into a situation where the commercial banks, by reason of a shortage of local resources, could not meet all the loan requirements of the territory, if it could be met by the local governments repatriating to their own countries some of their London monies.

4430. *Mr. Jones*: Would it be a right inference, in looking at the paper as a whole, to conclude that the main point you make is the undesirable effect of prolonged

higher rates of interest in London on colonial development and trade?——Undoubtedly that is so to some extent.

4431. *Professor Cairncross*: You are also anxious, I think, to stress the disintegrating effect on the sterling area which this has?——Yes.

4432. *Professor Sayers*: Have the English hire purchase finance companies advertised for, or solicited in any way, deposits on a big scale in the African territories?——They certainly have, particularly one of them.

4433. *Chairman*: Where do you see them? Are there advertisements in the local papers?——Yes.

4434. *Professor Cairncross*: What rate do they offer?——I think it is 8 per cent., and I think one or two of them may offer 8½ per cent.

4435. *Chairman*: Have you any idea how far they have been successful in attracting money?——I have only seen figures from East Africa and Malta. They might have attracted £500,000, perhaps, out of those two places taken together.

4436. *Sir John Woods*: Apart from the interest rate are their terms for deposit common, as to notice for withdrawal and all that?——*Mr. Smith*: I must confess I have never read their prospectus or advertisements in detail. I think their deposits are on demand.—*Mr. Wilson*: Some are on demand, for which they give a lower rate. The ones in South Africa are offshoots of the London ones, like the United Dominions Trust, and their methods follow very much the same pattern as they do here.

4437. *Chairman*: I think that concludes our questions.——*Mr. Smith*: Might I ask one question? Would it be appropriate for the Committee to consider the possible effect of an increase in the price of gold? It is something which is of considerable importance to this continent of Africa.

4438. It is no good taking it up at the moment, but if there is anything you would like to put before us in a written paper we should be pleased to have it.——Thank you.*

(*The witnesses withdrew.*)

B. STRATH, ESQ., London Manager, and W. S. HUNTER, ESQ., Assistant London Manager, the Royal Bank of Canada; and J. S. RODGERSON, ESQ., London Manager, and A. I. FOWLER, ESQ., London Accountant, the Canadian Bank of Commerce; representing the Canadian sector of the British Overseas Banks Association, called and examined.

4439. *Chairman*: We are much obliged to you, gentlemen, for the memorandum† you have put in to us. There will be a few questions from us arising on its contents, and I think it is most convenient if I just run through it in due order, and then the questions will arise on the subjects as we go along.——*Mr. Strath*: Could I raise one point? We should like to add two paragraphs at the end of the memorandum, to read as follows:

"At least some of the London branches of Canadian banks maintain fairly important deposit accounts with British banks, in some cases as a reciprocal gesture for business passing between the British and Canadian banks but, of course, frequently in cover of trade commitments.

The London Representative of one Canadian bank has put forward the viewpoint that the authorities' use of monetary measures since 1951 has brought about a curtailment of credit to clients, and at the same time has occasioned a decline in deposits by the fixing of a deposit rate out of proportion to the rates offering on Government Treasury Bills."

4440. There may be something in that last paragraph on which we would like to ask you a question in due course. Now the first part of the memorandum is mainly explanatory. Are there any questions on it?——*Professor Cairncross*: How many of the Canadian banks maintain branches in London?——Five.

4441. *Professor Sayers*: Are all these London offices doing active banking business, or are any of them hardly more than representative branches?——They are all active in certain fields, principally pertaining to Canada and other countries where they may have branches for foreign business.

4442. Are U.K. residents among the customers at those banks?——Yes.

4443. In a substantial way?——*Mr. Rodgerson*: Not in a substantial way.‡

4444. *Professor Cairncross*: There are no branches outside of London? There is only, I take it, the head office in each case?——*Mr. Strath*: Four of the banks have West End branches which are largely used for the convenience of visitors.—*Mr. Rodgerson*: In fact service branches for our clients.

4445. On paragraph 5, would it be right to say that the funds of the Canadian banks, are normally held in the New York market rather than to any extent in the London market?——*Mr. Strath*: The dollar funds. We in London hold the sterling surpluses of our branches.

4446. Would this be a substantially smaller proportion since the war, than it was before the war, or has there been no great change?——We have increased if anything since the war.

4447. Not a larger proportion of the total assets?——No, but the total deposits would have increased.

4448. The proportion of Canadian trade carried on with this country has declined quite substantially in relation to total Canadian trade, looking back over the last twenty years. Has this meant that the place of London offices of the Canadian banks in the total operations of the banks has declined compared with the expansion of the activities of the banks?——I suppose it is fair to say that, comparing the total expansion of the various Canadian banks over-all, with the London operation probably the percentage rise is smaller.

4449. In absolute terms probably larger than before the war?——*Mr. Rodgerson*: Definitely.

4450. *Professor Sayers*: Do the funds you hold in London just happen in amount as a result of the activities of your customers in trading, or do you deliberately seek to increase your London funds at some times, and decrease them at other times?——*Mr. Strath*: In our own case they just happen. We do not seek to increase or decrease.—*Mr. Rodgerson*: There is just one feature that does occasionally crop up, and that is that, if loan demands or overdraft demands are made on us where our money position is inadequate, then we have to turn to our international department, in Toronto in our case, for assistance, and they place sterling at our disposal here in London.

4451. A change in relationship between short rates in London and short rates in New York would not make you alter your London funds?——*Mr. Strath*: No, we would not help to do it unless it came about naturally, and as a result of business.—*Mr. Hunter*: Usually the initiative would lie the other side.

4452. *Chairman*: By "the other side" do you mean the head office in Canada?——Yes. If you are thinking of the movement of short term funds to this country, or from this country, due to differentials in interest rates in the two centres, then we can say that, whereas it would be unlikely that we would get any transfers of funds to the other side, we have seen transfers from the other side to London.

4453. *Sir John Woods*: You say in paragraph 6 (i) that there was a noticeable effect in 1955, but that it "diminished as the cost of swaps increased and Canadian interest rates began to harden", and it has not been seen again. Is that equivalent to saying that there has been no noticeable movement of short term funds since the Bank Rate rose to 7 per cent.?——*Mr. Rodgerson*: That has been our experience.

† Memoranda of Evidence Part IV No. 15B.

‡ *Note by witness*: While the total of deposits and advances of U.K. residents may not be very large in relation to the resources of the London branches, U.K. residents are important to us as depositors and borrowers and do deal with us in a substantial way in respect of their overseas operations.

* See Memoranda of Evidence Part VI No. 3.

4454. *Professor Sayers*: You are speaking there of what happens to your customers' funds? It was your customers who moved funds in 1955?——*Mr. Hunter*: That is true.

4455. *Chairman*: With regard to the use of your own funds which you have to keep in the short term market because they are part of your liquidity, is there some central control from the head office of the deposits that are available to the various branches?——*Mr. Strath*: In our case the sterling deposits in London are the net sterling deposits that our sterling area branches have. It is automatic.

4456. If there was a favourable interest differential in New York against London, you would not receive instructions to run down your sterling balances and transfer them?——No.

4457. *Professor Cairncross*: Do you find they fluctuate very much? Are they effective working balances?——*Mr. Strath*: Practically all our sterling is the net position of our sterling area branches in the Caribbean, and there are seasonal movements. They are not wide movements.—*Mr. Hunter*: We indicate in the memorandum that there are certain seasonal movements, particularly in relation to the West Indian funds, but apart from that, of course, there are daily fluctuations which I would say are in relation to our total deposits.

4458. This is inevitable in a working balance. From year to year are there any large changes?——Except I would say that there has been, certainly since the war and before the war too, from the beginning of the war certainly a steady growth.

4459. Has that been interrupted at any time?——*Mr. Strath*: There has been no noticeable evidence of an interruption in that steady growth that we have seen.

4460. What do you do with your London funds? Do you have much in the call money market, or in Treasury Bills?——Our funds are largely, as I said before, in foreign business, financing exports and imports. We have gilt-edged stocks, Treasury Bills, and call money in the discount market.

4461. Do you maintain a fairly fixed liquidity ratio? On what principle do you distribute your assets?——Our position is such that our liquidity is very great, and kept that way, and we never have a margin so close that we have to watch it very carefully. The percentage of our liquidity is very high at the London branch.

4462. Do you find you vary your assets a good deal as you move in and out of short bonds or Treasury Bills?——No, our bank does not move out and in. We buy them and stay in them until they fall due, and then we try to find something else to replace them. There may have been cases where we have switched for some reason, but it is not common.

4463. Is it true of Treasury Bills as well as of short bonds that you buy them and hold them to maturity?——Yes, largely.

4464. *Professor Sayers*: Are the short bonds confined to five years and under, or do you hold longer ones?——*Mr. Hunter*: We have never had anything more than five years.

4465. Would it be fair to say that the call money is the most variable part?——*Mr. Rodgerson*: In our case, yes.—*Mr. Strath*: I think in every case.

4466. *Chairman*: In paragraph 6 (ii) you are dealing with the position in the Caribbean, and the change that you anticipate will be brought about when a central bank is established in the new Federation of the British West Indies.—*Professor Cairncross*: You say that there are funds surplus to the requirements of the banks' branches in the Caribbean which remain on deposit in the London offices. Does this mean that there are large numbers of bank customers in the Caribbean in relation to the number of people wishing to borrow there, and that you have surpluses of funds arising?——Yes, total deposits are much greater than loans in the Caribbean.

4467. It is not just a seasonal matter? This is continuing?——Deposits fluctuate seasonally, but are much higher than advances all the year round.

4468. *Professor Sayers*: If you could find good banking borrowers there, would you be glad to lend more in the Caribbean?——Yes, with a view to proper liquidity; we should be very pleased to lend money in the Caribbean on sound transactions.

4469. *Professor Cairncross*: What governs your decision to bring that money for deposit to the London office rather than to put it on deposit somewhere else in the world?——*Mr. Strath*: The fact that it is sterling. It started off that way years ago, and it just carried on.—*Mr. Hunter*: The currencies in the territories we are talking about are either sterling or else they are linked to and have a fixed relation with sterling.—*Mr. Strath*: Some of them are expressed in dollars, but linked with sterling.

4470. *Professor Sayers*: Have you had any hesitations about carrying it on?——I have never heard of any, not in our organisation anyway. It has never even been discussed.

4471. *Professor Cairncross*: These funds are held from your point of view presumably in order to finance trade between the Caribbean and this country to some extent?——Yes, what is not actually borrowed in the field out there.

4472. When Bank Rate rises in this country what happens in the Caribbean? Do rates go up in line with it?——They are always adjusted, but they do not necessarily go exactly in line.

4473. *Professor Sayers*: Do the local banks get together and say: "There has been a change in Bank Rate. What had we better do about our local charges?"?——*Mr. Fowler*: They have local agreements between the banks in these various countries.

4474. *Lord Harcourt*: And there would be a local conference the moment a Bank Rate change takes place here?——Yes.

4475. *Professor Cairncross*: Your rates here would be governed by the current market rates at the time?——Yes.

4476. *Chairman*: Given the establishment of the central bank of the British West Indies, are you envisaging that the surpluses which are generated at the moment and kept in your branches in London will be on deposit with the central bank there?——*Mr. Strath*: That is in our minds.—*Mr. Hunter*: At least a part of them.—*Mr. Strath*: It would be reasonable to carry certain deposits with the central bank, whatever other arrangements might arise out of it.

4477. *Professor Sayers*: You might nevertheless go on holding some variable London balances?——Yes, we would expect that.

4478. *Lord Harcourt*: With the establishment of a central bank in the West Indies would you expect a probable growth out there of a local money market where you could profitably invest funds which otherwise would come to this country?——*Mr. Strath*: I should think so. Certain countries issue bonds now, but there is no money market at present.—*Mr. Hunter*: Except in Jamaica they are now issuing local Treasury Bills.—*Mr. Strath*: That is something comparatively new.

4479. *Chairman*: Are these three months' Bills?——*Mr. Hunter*: Yes.

4480. *Sir John Woods*: You say that there is being created in this area a demand for investment capital. Do you lend money at long term for investment in those territories?——*Mr. Strath*: We as an institution do not lend very much long term. We have, I suppose, a number of transactions longer than normal bank financing, but we do not have very much of it.

4481. Would you build it up to five, seven or ten years, or not so much as that?——I would say below five years, and not very many of them.

4482. *Sir Reginald Verdon Smith*: Are not the Canadian banks precluded by Canadian legislation from long term lending?——*Mr. Rodgerson*: No, but at the present time we are limited to the maximum of $250,000 in any term loan within the borders of Canada under present credit restrictions.

4483. *Professor Sayers*: Canadian law does not restrict your lending outside Canada?——*Mr. Strath*: The Canadian Bank Act does not stop branches of Canadian banks lending abroad, but, while such branches are guided by lending procedure in the countries where they

are located, the Canadian Act does contain certain restrictions.

4484. *Professor Cairncross*: You must see a fair amount of the workings of exchange control. How does it work in your case? Are you embarrassed by any of the exchange control regulations?——United Kingdom branches of Canadian banks are bound by the same regulations as any other bank operating here.

4485. *Professor Sayers*: Do you see a lot of "leads and lags" in payment over the exchanges? When sentiment is swinging against sterling, do you notice your customers behave very differently in the time at which they make sterling payments?——*Mr. Hunter*: We refer to that in paragraph 5 as one of the factors which might affect our balances in London. It is evidenced in our figures by a falling off of certain balances. At the time of the devaluation rumours last year there was a falling off, certainly in Canadian balances, which might have indicated there was some deferment of remittances. We cannot say that the drop in balances was due to this factor, but it could have been.

4486. *Chairman*: It is unidentifiable?——*Mr. Strath*: We cannot pin it down, unless we know of a certain case.

4487. *Professor Sayers*: How do ideas about the future of sterling appear to affect your customers? Do they do their business any differently?——I do not think so. Discussions on that, as we all know, are quite common, and customers might question the position or the situation; but I cannot say that there is any way we could make anything of that here. A great deal of it is purely gossip.

4488. When interest rates move differently in London and New York, and a bigger gap than usual appears, do customers of yours move money in substantial amounts from New York or from Toronto to London, or vice versa?——There was quite a movement in 1955, to which we refer in the memorandum.

4489. You saw it in your business?——*Mr. Hunter*: Yes.

4490. Was this mainly Canadian resident companies, or was it American customers of yours?——*Mr. Strath*: Both, but quite a number of Canadian companies.

4491. What was their interest in London? Was it in English Treasury Bills?——Yes, that was the only evidence we saw; they bought Treasury Bills. That was the only investment at the time that was of interest to them.

4492. There was no interest in short term bonds, for instance, or in putting money on deposit at the English deposit rate?——Not that we saw.

4493. It appears in your memorandum, and I have seen it stated elsewhere too, that in the last six months the high interest rates in London do not appear to have attracted Canadian money as they did in 1955. Can you account for that difference?——*Mr. Fowler*: The forward premium on Canadian dollars killed the profit. When Canadians invest money in sterling, most of it is covered forward.

4494. *Chairman*: That premium is still operative today?——*Mr. Fowler*: It is just about profitable to do it, but we have not seen any evidence of investment during the last few months in Treasury Bills.—*Mr. Strath*: Neither have we.

4495. *Professor Sayers*: That did not happen in 1955? ——No, because the premium did not come into it to the same extent; there was still a profit.

4496. Why was there that difference in the relationship of the exchange premium to the interest rate between the two dates?——*Mr. Fowler*: The governing factor of this premium on the forward market is the supply and demand element caused mainly by trade.

4497. I wondered whether there was anything in your experience that contributed to the supply and demand situation in the forward exchange market?——I cannot think of any particular reason; there are so many things that affect this.

4498. *Professor Cairncross*: Is it affected also by the strength of the Canadian dollar in relation to the American dollar?——The Canadian dollar is a good deal stronger now than it was in 1955.

4499. *Lord Harcourt*: In 1955 was not the premium of the Canadian dollar over the New York dollar almost at its peak?——*Mr. Strath*: It had not reached its peak.

4500. *Chairman*: Is there anything on the last section? I think we have covered the first two paragraphs; then we have your additional two paragraphs. Does anything arise on the second of those:—

"The London representative of one Canadian bank has put forward the viewpoint that the authorities' use of monetary measures since 1951 has brought about a curtailment of credit to clients, and at the same time has occasioned a decline in deposits by the fixing of a deposit rate out of proportion to the rates offering on Government Treasury Bills."

——*Mr. Rodgerson*: The very fact that our deposits have gone into Treasury Bills has precluded our placing at the disposal of our clients the assistance which they have been requesting from time to time. We have not had the funds, so it is axiomatic that when the Treasury Bill rate went up we might be unable to service our borrowing customers.

4501. *Professor Sayers*: You mean some of your customers operating in the U.K. with accounts in your London offices shifted from bank balances to Treasury Bills? ——Yes.

4502. And this has led to your curtailing your lending in your London offices?——We have had to from time to time.

4503. Who are the people to whom your lending has been curtailed?——It has curtailed our participation in the money market.

4504. It is curtailment of your call money, your credit to money market clients?——And to a lesser extent to our borrowing customers.

4505. By "borrowing customers" you mean ordinary traders?——*Mr. Rodgerson*: Commercial accounts.—*Mr. Strath*: I do not know whether that is general; it does not apply to ourselves.

4506. *Chairman*: You have not observed any such movement?——We have not had to curtail any.

4507. *Professor Sayers*: If you have good commercial customers in London to whom you are lending, and you suddenly fall short of London funds, can you not reinforce your London funds by drawing on head office? ——*Mr. Rodgerson*: That is what we have had to do.

4508. Surely that would be the normal recourse, rather than curtailing credit to ordinary commercial customers? ——That is true.

4509. *Lord Harcourt*: Would it be a head office decision as to whether they were prepared to make available additional sterling?——Yes.

4510. *Professor Sayers*: That is why I find the statement in this paragraph a little surprising, unless the clients are purely money market clients?——It is the money market we are referring to here.

4511. *Professor Cairncross*: Could you tell us who are the clients who withdraw their money and buy Treasury Bills? Are they mainly large companies, and not private clients?——*Mr. Hunter*: Industrial offices and merchants of all kinds who have surpluses.

4512. Commercial and industrial undertakings?——Yes.

4513. *Professor Sayers*: Do these customers run into dozens, scores, or hundreds?——*Mr. Strath*: In our case no figure like that. Over-all it would be half a dozen.— *Mr. Rodgerson*: The number is not important.

4514. But the money is?——In our case yes, quite important.

4515. Six figures, seven figures?——I can think of one client with an average of six figures.

4516. *Professor Cairncross*: Do you act as agents in the purchase of Treasury Bills, or do they buy them themselves?——They acquire them in the money market.

4517. I would like to ask you something about the scale of your operations, of which it is a little difficult for us to form any impression from your memorandum. You may recall that when the Macmillan Committee were taking evidence they were supplied with figures, for all the overseas banks, of the funds held in London in various forms, Treasury Bills, advances, the money market, and so on. I think I am right in saying that you make a return to the Bank of England of this character. Would you have any objection if the Bank of England were to make available to us aggregates for all overseas

banks, not figures for particular banks, under the headings which appeared in the Macmillan Committee report? —*Sir Oliver Franks*: We should like a split of the use of your resources, call money, Treasury Bills, short bonds, and so on; but that split would be made available to the public not banking company by banking company, nor sector by sector, but all overseas banks aggregated together?——*Mr. Strath*: I cannot see any objection to the disclosure of aggregate figures covering all the overseas banks together.—*Mr. Rodgerson*: I think it would be for our head offices to lay down policy, but I cannot envisage them having any objections.

4518. *Professor Cairncross*: Is this the first time you have been asked whether you would have objection to the publication of these figures?——Yes.

4519. *Professor Sayers*: Do you supply them at present to the Bank of England?——*Mr. Strath*: No. Since credit restrictions were imposed in the United Kingdom we have supplied figures to the Bank of England, which are quite searching and informative.

4520. *Chairman*: We will let you have a letter indicating what it is that we are asking you for; if you have to take it up with your head offices, we shall understand that; I think we shall probably press you to get your head offices to agree!——I cannot envisage any difficulty there.

Chairman: Then if there are no more questions, thank you very much, gentlemen.

(*The witnesses withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

G. L. Davies, Esq., Manager, the National Bank of New Zealand Ltd., C. L. Messner, Esq., Manager, the Bank of Adelaide, R. B. Scotcher, Esq., Deputy General Manager, English, Scottish and Australian Bank Ltd., representing the Australasian sector of the British Overseas Banks Association, called and examined.

4521. *Chairman*: Mr. Davies, we have your memorandum* for which we are very much obliged to you. There will be one or two questions which will arise from the Committee, to enlarge upon what you have told us, and I think it will be most convenient if we go through your memorandum. The first section is mainly narrative.—*Sir Reginald Verdon Smith*: Could we learn something about the "special services" to assist in the establishment of new industries and facilitate investment, referred to in paragraph 1?——*Mr. Davies*: For New Zealand we would give the ordinary sort of service: advertising that we are open to receive inquiries from this country for industry, telling inquirers about capital formation and company formation in New Zealand, and the sort of industries that they have there, and answering general questions on the remittance of capital to New Zealand.

4522. This would be in terms generally of good public relations from the bank's point of view, rather than necessarily advantageous financial terms or long-term credits, or anything of that sort?——Yes, purely public relations; selling New Zealand to the person who thinks he might go to New Zealand to establish himself there.

4523. *Chairman*: Have you a special branch in your organisation for these special facilities?——*Mr. Davies*: No, not a special branch. There are nine Australasian banks operating here on behalf of New Zealand and Australia, five operating only for New Zealand, and all of us have some sort of special department to deal with special inquiries on economic development, intelligence and things like that.—*Mr. Messner*: That is the case; and we would make inquiries if capital were required for example in Australia.

4524. *Sir Reginald Verdon Smith*: The service that you provide then is information, not finance?——Very largely.

4525. *Chairman*: Would you do any work in the way of putting people in touch with possible sources of finance at the other end?——We should endeavour to do so if requested.

4526. *Professor Sayers*: Are you often requested?——Yes, I had two last week just at my bank.

4527. *Chairman*: Then you say in paragraph 1 (*a*):—

"There are no restrictions on the movement of funds from the United Kingdom to Australasia, but transfers of funds to the United Kingdom are subject to exchange control by the Australian and New Zealand authorities, and this tends to discourage the movement of funds to those countries for speculative purposes."

—*Professor Cairncross*: How far does this leave you free to vary your holdings of sterling in this country?——*Mr. Scotcher*: As these exchange controls in both New Zealand and Australia operate, the banks are left with a basic volume of funds, their own so to speak, which is basically in the United Kingdom. The rest of the funds result from movements in exchange dealing. The result of exchange dealing causing variations in the volume of funds actually held for the time being in the United Kingdom, but any surplus above the basic sterling holding, or any deficiency below the basic sterling holding, is vulnerable; a surplus is called to the central bank concerned and thereby repatriated to the Dominion, and a deficiency will be provided out of the holdings of the central bank in the United Kingdom. As a result, the ability to vary the disposition of the basic funds is limited in that the funds themselves are limited; if they are greater for the time being, they are only momentarily greater.

4528. You refer to basic holdings Do you mean that there is some figure agreed upon between the banks and the Commonwealth Bank?——*Mr. Scotcher*: That is a question to which I do not think we can give an accurate answer, because each bank has its own separate arrangements. There are two United Kingdom registered banks operating in Australia and there is one United Kingdom registered bank operating in New Zealand, and it would be reasonable to expect that those three banks would probably have normally a larger proportionate basic investment in the United Kingdom than the others.—*Mr. Davies*: There is a slight variation for New Zealand. There we have from the central bank an approximately agreed figure at which they will maintain the level of the overseas assets (that is, overseas from New Zealand's point of view) held by the trading banks in London. Though we have a trading account we are only holding those assets as agents for the central bank.

4529. In the case of Australian banks, am I right in assuming that they have very little latitude in varying from the given figure?——*Mr. Messner*: They have a basic figure, which was computed at the outset of the war, and the Banking Acts of Australia, 1945 to 1953, provide that all extra beyond that is to be turned over to the Commonwealth Bank; that happens monthly.

4530. *Professor Sayers*: That implies that the disposition of Australia's London funds is almost entirely a matter for the Commonwealth Bank's operations?——*Mr. Messner*: To a very large extent, with the exception of the two Australian banks which Mr. Scotcher is representing, which have their head offices here.—*Mr. Scotcher*: There is no real difference, except that the two English registered companies traditionally held a larger volume of their working capital in London than the other banks, and when the exchange control in Australia instituted this method of accumulating overseas funds in the central bank rather than in the hands of the trading banks the basic sterling investments of those two Banks tended consequently to be larger than of the others. But exactly what it is as between one bank and another one does not know.

4531. *Chairman*: What are the individual banks' working balances in London represented by?——In the main by investments in gilt-edged stocks, Treasury Bills and day-to-day loans in the discount market. There would be some movement, of course, from time to time according to the degree of sterling funds required to support general trading movements.

4532. *Professor Cairncross*: When you say "some movement", do you mean seasonal or from year to year?——Mainly seasonal; and of course that also means from year to year: seasons vary from year to year.

4533. Can you approach the Commonwealth Bank and secure an increase in your normal working balance?——Not normally.

* Memoranda of Evidence Part VI No. 15C.

4534 You might stretch your facilities a little more in seasons when there was heavy financing to be undertaken? ——*Mr. Messner*: Not in London, as far as the purely Australian banks are concerned.—*Mr. Scotcher*: Not substantially. There is no necessity for that, because in the case of Australia the settlement with the central bank takes place monthly, and consequently any heavy demand falls on them.—*Mr. Davies*: New Zealand is different; it is quite rigid. It is controlled by the central bank and whatever sterling is made available by them to the trading banks is done on the basis that they will decide approximately what the British banks operating in London will require to finance general trade. If at any time we decide we want more, of course they operate the statutory ratio: there is this system in New Zealand by which they will take up our local funds so that we cannot buy the sterling.

4535 Some of your balances are held in short-term bonds; would we be right in assuming these holdings are fairly constant or do you operate by sale as well as purchase?——*Mr. Scotcher*: That is rather a difficult question to answer accurately. So far as the two United Kingdom companies are concerned, their holdings are fairly constant, but there may be a switch from time to time between very short and slightly longer.

4536 All within the five-year maturity, I take it?——*Mr Scotcher*: I would not know the accurate answer to that, but I should say probably yes. There might be a switch to Treasury Bills at some stage.—*Mr. Messner*: So far as purely Australian banks are concerned, I am afraid I can speak only for my own because we do not interchange our information. We hold a certain proportion, but they are always in Australian stocks on the London market, and are not necessarily of a short-term character. Indeed we aim at a long-term character with them.—*Mr. Davies*: For New Zealand I think the answer is that it is fairly constant, and broadly speaking short, owing to the fact that we are always vulnerable for any surplus balance of sterling held on behalf of the Reserve Bank; but within that portfolio we would operate as a normal bank here: we would switch if we thought it was right or fit to do so

4537. That would mean that on occasion you would sell short bonds?——Yes.

4538. *Professor Sayers*: On paragraph 1 (*b*) when there is a change in Bank Rate here, do the Australian banks at once get together and think what this means for them, or do they wait and see?——We get together, and most of the changes are completely automatic. Buying rates for bills will alter; the British bill, that is financing of exports from New Zealand, will reflect the foreign rate, which for this purpose is the London rate, and the interest factor in the bill would then go to 7 per cent.

4539. *Professor Cairncross*: I have some difficulty in reconciling the statement at the end of this paragraph: "no movements of funds occur", with the statement at the foot of the page: "there has been a significant reduction in telegraphic transfer and sight business and an increase in requests for terms up to 90 days." This appears to imply, in effect, a movement of funds; but perhaps not a movement in the funds owned by the banks represented here?——*Mr. Messner*: Customers may, but banks do not.

4540. *Professor Sayers*: You say customers may; do customers commonly?——Subject to exchange control.

4541 *Professor Cairncross*: In one direction only?——From that angle, yes.

4542. *Chairman*: In paragraph 3 you say:

> "The tightening of credit conditions on the London market in recent years appears to have been responsible for the increased applications for facilities in London which have been experienced by the Australasian banks. We point out however that, within the limited area of their business which is affected, these banks conform with any relevant instructions given to the London clearing banks."

So to that extent applications for increased facilities fall to the ground, because you are as much under the credit squeeze in London as other banks?——Yes.

4543. Then you say:—

> "In all probability, the tightness of credit also accounts for the lengthening in the time for which finance is required."

Then you say in paragraph 4 (*c*) that one further result of the credit squeeze in London is that local applications become larger for facilities in Australia or New Zealand? ——*Mr. Scotcher*: Yes.

4544. I understand the reason for that, but what happens? Are you in a position to meet it?——*Mr. Davies*: Yes; it would depend entirely on what the purpose was. Again talking about New Zealand, it is our function to facilitate the export trade of New Zealand. Normally speaking if money is cheap here the importer tends to borrow his money here, but if the rate here is $7\frac{1}{2}$ per cent. and the rate in New Zealand is $4\frac{1}{2}$ per cent. he tends to borrow the money locally. We would endeavour then, with the Australian banks, to finance that.

4545. *Professor Sayers*: In recent years have the limits on your lending to good banking customers in Australia and New Zealand been set by request from the Commonwealth Bank and the Reserve Bank or by a limit to the demands on the part of customers, or has there been some limit set by yourselves because of your liquidity position?——*Mr. Scotcher*: So far as Australia is concerned the limit is set by the central bank's liquidity requirement.

4546. It is a central bank decision, acting through your liquidity position?——Yes, plus some directives on qualitative lending.

4547. So that any tendency for requests for bank credit to shift from England to Australia, when things become more difficult in England, would not lead to any appreciable increase in the volume of bank lending in Australia?——*Mr. Davies*: For New Zealand it would be fair to say it should not, but I think it does create a demand. It is controlled by the pressure of the reserve ratio system operated by the central bank upon our liquidity; but in an important producing country like New Zealand where the lifeblood is exporting the banks do all they can to facilitate the export trade.

4548. *Sir John Woods*: And has the result been that you have been pushed up against your liquidity proportion? ——*Mr. Davies*: Yes.—*Mr. Messner*: Our experience, and I think it is quite general among the Australian banks, has been that there has not been a marked trend by U.K. importers for such accommodation in Australia. So far as we are concerned it has largely emanated from continental Europe. I think my colleagues would confirm that?—*Mr. Davies*: Yes.—*Mr. Scotcher*: Yes.

4549. *Professor Sayers*: It is a switching of continental borrowing to Australia?——*Mr. Messner*: Very largely. There is not a marked trend from this country.

4550. What has been the attitude of your central banks to this switch of continental demand for credit? Have they allowed you in effect to increase your total of credit outstanding in order to cope with this new trend?——*Mr. Messner*: I would say no.—*Mr. Scotcher*: I think that this point we are discussing at the moment is really in essence a switch from finance traditionally obtained by way of bills to finance by way of direct bank advances in Australia, mainly because of the differential borrowing rates in the different sectors.

4551. *Professor Cairncross*: Have not these continental demands for credit previously been financed from London through the holding of sterling bills here?——But those sterling bills are supported by money provided in the countries of origin.

4552. Are they financing New Zealand exports to the Continent then?——May I just provide an example, and I speak only in the case of Australia. Formerly a bank in Australia would buy a bill on London and thereby tie up a certain amount of its local resources until that bill was paid, and the resources in London were not affected during the term of that bill at all. Now the tendency has been, because as I say of the differential rates of interest and discount, for people to ask for bank advances in Australia. To that extent there is a greater degree of tying up of funds in Australia.

4553. It is a shift in the assets of the portfolio of the bank from bills to advances?——Precisely, although the same money is involved in both cases.

4554. *Chairman*: I rather gather from what you said that you have regarded the central banks in the two areas, Australia and New Zealand, as being in control of your credit operations by their power to operate on your

liquidity?——*Mr. Davies*: Certainly for New Zealand.—*Mr. Messner*: Certainly for Australia too.

4555. It has been an effective control?——Yes.

4556. And it has not needed to be supplemented by requests?——*Mr. Scotcher*: In the case of Australia, of course, there is statutory support. The Bank Act of 1945 and its subsequent amendments give the central bank power to insist on a certain degree of liquidity and to require a proportion of reserve deposits.

4557. *Sir Oliver Franks*: This is the system of special deposits?——*Mr. Scotcher*: Exactly.—*Mr. Davies*: Ours is slightly different. We have not any system of special deposits as such by law, but the central bank can adjust the ratios. The position is that under the statute the banks have to have frozen at the central bank a minimum of 7 per cent. on demand liabilities and 3 per cent. on time liabilities; the central bank can raise those rates, and they are at the moment 28 per cent. on demand liabilities and 15 per cent. on time liabilities. That is operated quite automatically.

4558. Has the special deposit system in Australia been operated regularly by the central bank, or is it only brought into operation at particular moments?——*Mr. Scotcher*: It started without statutory authority during the war because of government spending caused by the war, and subsequently, in 1945, it was given statutory authority. There have been various amendments, but during the whole of that period since 1941 or 1942 the system has been operating all the time.

4559. *Professor Sayers*: If you were advising another country on the form of its banking system and its central bank powers is this Australian system one which you would recommend?——My answer to that is a simple one: I would say yes, provided it is wisely administered, and provided that the government, or the central bank, pays a reasonable return on the funds that it borrows from the trading banks.

4560. How would you fix the interest rate? What rate would you consider reasonable in relation to other rates?——It is a very complicated question in the case of Australia, because Australia's interest rate structure is rigidly controlled. The government is able to issue Treasury Bills at a discount rate of 1 per cent today, and has done so for a long time; but that rate has no real relation to commercial discount or interest rates whatsoever. The maximum rate of interest for bank lending to the public is also fixed by the central bank, and it takes very little, if any, cognisance of the demand or supply of money.

4561. How would you fix this rate of interest in relation, say, to bank lending rates to good customers? Do you think it should be much lower, or should it be fixed in relation to the Treasury Bill rate?——This is a matter which requires a great deal of examination, and I am afraid that I have not come prepared to answer that question.

4562. Might I put a variant that perhaps may be easier for you to answer: do you think that the fixing of the rate in Australia has been reasonable?——I feel it has been unreasonably low for this reason, that whereas the government through the central bank is able to control this rate, and does control it at a very low level, it does not control and is not, for a number of mainly constitutional reasons, able to control rising costs. Consequently, whereas it does control the income of the banks, in respect of the income arising from the special accounts which is a considerable part of their assets, it does not control the costs of banking. So from that point of view I suggest the system is unreasonable, while that interest rate is so low.

4563. *Mr Woodcock*: This is not a negotiated rate?——No.

4564. *Sir John Woods*: What is the relationship between the rate of interest on special deposits at the central bank and the rate which is charged on bank advances?——*Mr. Scotcher*: The rate of interest allowed on the special accounts was raised as from 1st January this year from one-quarter of one per cent. per annum to three-quarters of one per cent. per annum. The maximum rate of interest allowed to be charged to customers is six per cent. per annum, but there is an overall directive from the central bank that the average rate which the banks obtain from their advances to the public shall not exceed five and a half per cent. per annum.—*Mr. Davies*: For New Zealand the position is somewhat different. We receive no interest at all upon our statutory balances, and if our liquidity is such that we cannot maintain them at the correct percentage the Reserve Bank lends us the money and charges us seven per cent. to maintain the statutory balance.

4565. *Professor Sayers*: That seven per cent. being the official rediscount rate?——That is right.

4566. Is this reserve ratio system one you would recommend were you advising another country?——I think it is excellent if it is administered properly.

4567. What are the criteria of proper administration?——We have been discussing this ourselves with the central bank for about seven years, and it is a little difficult to decide. I would think that the central bank has its eye upon the general economy of the country, and is entitled to take any steps it likes provided it leaves the banks with sufficient resources to conduct a satisfactory and adequate banking system. I think it can be simplified down to that.

4568. *Chairman*: Would Mr. Messner like to express a view about the Australian system?——*Mr. Messner*: Bound up into this question are so many factors, including, as you will be aware, the proposed legislation, which was put forward in the course of the last few months and which has not gone through, for the severance of the central banking from the trading banking functions of the Commonwealth Bank. It is not a question that one can have a very considered view about, other than a personal one, at this stage.

4569. With its drawbacks, it has been your experience that the special deposit system has been an effective system to achieve what it is intended to achieve?——*Mr. Messner*: It was voluntarily offered by the banks in the early part of the war, and then it became statutory in 1945, and of course has continued. There are proposals to change it by the present government in Australia.—*Mr. Scotcher*: In Australia a bill which has not yet been passed by parliament seeks to restrict the maximum of the proportion of special accounts to the deposits of the banks to 25 per cent., but gives the central bank power to give 45 days' notice to increase that proportion to some higher figure. The present position is that special accounts are working at an average of about 20 per cent. of deposits.

4570. *Mr. Woodcock*: Can you draw on the special account under penalty?——By arrangement with the central bank it is possible to rediscount or reborrow at a penalty rate. What that rate is is a matter of arrangement between the bank and the central bank.

4571. *Professor Sayers*: It is not the official rediscount rate?——There is no official rediscount rate.

4572. *Mr. Woodcock*: What is the purpose of the special deposit system; to finance government short-term expenditure?——*Mr. Scotcher*: That is not the admitted purpose.—*Mr. Davies*: It is to take the banks' money away in order to stop them lending it, in simple terms.

4573. *Mr. Jones*: To reduce the liquidity of the banking systems of Australia and New Zealand?——Yes.

4574. *Mr. Woodcock*: Does it vary, or is it a fixed sum?——In New Zealand the ratios are based solely upon a percentage of demand liabilities and time liabilities, which in the main are our deposits.

4575. It does not otherwise vary at the will of the government?——Not the basis; only the rates per cent.

4576. *Lord Harcourt*: In maintaining the proportion of your demand deposits and time deposits with the Reserve Bank of New Zealand do you withdraw or deposit additional funds daily, or weekly, or monthly?——It is worked monthly.

4577. *Professor Sayers*: If I remember rightly, the New Zealand percentages have been changed fairly frequently in the last five years?——Very frequently.

4578. Has the frequency of those changes been a nuisance to the trading banks?——They have caused embarrassment as they are so sudden; we get no notice of them at all. But I am given to understand now that the present government would prefer not to have so many changes as there have been in the last five years.

4579. That is a governmental preference; what about the trading banks?——The trading banks would always like to have reasonable notice of this. It is very difficult if one has been dealing with a customer one day and has committed oneself for a £1m. wool shipment, and the next day one finds the ratio has gone up from 23 to 32 per cent. against you.

4580 *Mr. Woodcock*: Does it go up as much as that? ——Ten per cent. would be rather an exaggeration. It has gone from 30 to 34; and on one occasion from 15 to 22½. It varies; it depends by how much the Reserve Bank wants to reduce the banks' liquidity.

4581. *Chairman*: What is the actual impact of sudden changes of that kind? What do you do to put yourselves right with the law?——We have to debit our current account at the central bank and transfer to our frozen account.

4582. How do you put yourselves in a position to do that without warning at short notice?——We always endeavour to keep sufficient liquidity to enable us to do that if the increase is going to be reasonably normal. One has to take a view about that.

4583. Would it mean, if you are under this system, that you have to keep as a matter of practice a margin of liquidity above the ratio in hand to meet any sudden alteration in the ratio?——That is what we endeavour to do; but in fact we could always meet it, because the central bank will lend to us, and charge 7 per cent. Since we cannot lend money at an average above 5 per cent., the trading bank tends to get the money back as quickly as it can.

4584. *Professor Cairncross*: But you do try to maintain yourselves in a more liquid position than you would if the system did not obtain?——Yes.

4585. *Chairman*: Suppose that you had to borrow at 7 per cent. from the central bank to tide over your position, and you could not get it in immediately from your clients' advances; would you fall back on your investments?——We would tend to borrow from the central bank up to the limit of our investment portfolio held in New Zealand. The New Zealand trading banks are not allowed to invest in government loans. They are always losing those that they have held as they run off.

4586. *Professor Cairncross*: What additional liquid assets do you hold?——In New Zealand they would be bills receivable mostly; commercial trade bills.

4587. *Professor Sayers*: Did I understand you to say that you are not going to be allowed to invest in future in New Zealand government securities?——It is difficult to answer for the future, but we have not been allowed to since 1943 under the Labour government.

4588. Is this a matter of statute law, or is it agreed? ——No, it is not law; it was by an agreement between the then Finance Minister and the banks, which we have always adhered to.

4589. *Mr. Jones*: What is the reason for that?——*Mr. Davies*: Professor Sayers could probably give you a more erudite answer than I can; but it is alleged in certain circles to be inflationary.—*Professor Sayers*: Yes, New Zealand did take a very strong line on this.

4590. *Sir Oliver Franks*: Suppose that in one country or another either a system of special deposits or a system of variable ratios for liquid assets is in operation, and also that the systems are reasonably operated: that is to say, whether from the point of view of the commercial banks or from the point of view of the government, the impartial spectator would think the procedure was sensible. Do you think, if that is so, that you can operate either the special deposit system or the variable ratio system and secure an adequate control of credit from the point of view of the central bank and the government, even though you leave your rate of interest absolutely constant throughout; or do you think alternatively that the rate of interest has to come along and help you out? ——*Mr. Scotcher*: This is a matter which we have had to consider very frequently. The effect of a statutorily controlled rate of interest in a time of credit squeeze is that would-be borrowers look to find their funds outside the banking system. It has been very noticeable that in times of credit squeeze in Australia the money markets outside the banks have been very active. Australia is in a special position in that the Federal Government under the Act of Constitution has probably (I say "probably" because I am not a lawyer) no power to operate any restriction of credit outside the banking system, so that the impact of a credit squeeze is felt not only by the banks but also, in a different way, by the other possible lenders outside the banking system.—*Mr. Davies*: If I could answer Sir Oliver's point based on our experience in New Zealand, I would say that both systems within my knowledge work well, but to be effective the banks must have power to use the interest weapon themselves, because both systems operate against the banks solely, not against the customers. Whilst the banks get penalised, the only way they can make it more difficult or less attractive to their own customers is to make the rate a penal rate. So I think one is complementary to the other and I would be of the opinion that if you adopt either of the systems the banks must have powers to increase the lending rate.

4591. *Professor Sayers*: How steeply must the lending rate rise before it operates as a substantial check on borrowers?——That rather depends if the borrowing is in the public sector or the private sector; it operates much more quickly in one sector than the other.

4592. I was thinking of the private sector?——I could not give an answer on that.

4593. *Sir Oliver Franks*: The effect of either the special deposit system or the variable ratio system, when the government wishes to exert a credit squeeze, is primarily to affect the capacity of the banks to lend; but subsequently and alternatively it alters the sources of borrowing for customers and make them pay more for their money?——*Mr. Scotcher*: That is the effect; whether it is the intention I do not know.

4594. *Professor Sayers*: There is a diversion?——It is a diversion from bank credit to outside credit. May I give you an example of that? In April 1956 the Federal Government of Australia asked the banks to restrict their lending to within the terms of a directive. It was a wish, nothing more than a wish; and the banks, of course, agreed to co-operate. At the same time the Government said: "You may raise your interest rates to a maximum of 6 per cent. from the previous maximum of 5 per cent., but you may not obtain a greater yield than 5¼ per cent. overall per annum." Then they wanted to deal with the hire purchase companies who are very active, but they had no powers; so they called a meeting of the managers of the hire purchase companies and asked them, as a voluntary effort, whether they would undertake not to increase their volume of business beyond a certain figure for the next twelve months. The responsible companies agreed to do that, but it had to be done, because of lack of powers, by a request. Now the hire purchase companies are persistent borrowers, and the rates that they offer, as in most countries, are very much more attractive to the lending public than those offered by other institutions. The government cannot control those rates in Australia. Similarly with other lending bodies outside the banks the government has no powers, so that interest rates outside the banking system frequently have no relation whatever to the rates within the banking system.

4595. *Chairman*: What are the alternative lending sources apart from the banks in Australia?——*Mr. Scotcher*: There are direct issues to the public; there are the life insurance companies; and various other commercial companies that may or may not be very liquid at the time, and so on.

4596. *Professor Cairncross*: As I understand it, you all lay stress on the domestic effects on the provision of credit by intermediaries other than banks when the rates are not put up and the squeeze is put on the banks. Do you find anyone, when there is a credit squeeze, trying to finance themselves outside New Zealand in London or elsewhere?——*Mr. Davies*: For New Zealand, yes; but to what degree it is difficult to say. Some industries in New Zealand have applied to American bankers, and the Export/Import Bank gave a credit to one of the industries in New Zealand.

4597. I was thinking not principally of industry, but mainly of trading. Does trade also obtain a good deal of its finance from outside?——If you are talking about the private sector and trade in New Zealand, no; because

no New Zealand national can enter into any commitment overseas without the central bank's authority.—*Mr. Messner*: So far as Australia is concerned, in my experience it has been extremely limited over the twelve years I have been in London. It is governed almost entirely by a scare of a change in the exchange rates. Even then it requires in most instances the consent of the Australian exchange control.

4598. In external trade there is an option of financing the movement of goods either through extra internal credit or through external credit. I do not suppose the system of control affects that option?——*Mr. Davies*: No, not for external trade.

4599. So if rates did not rise, and credit was restricted in New Zealand, and external trade was financed to any extent within the country, there would be an opportunity of turning to resources outside New Zealand?——I would have thought so.

4600. You do not notice that to any great extent?——No.

4601. Equally in your paper you do not appear to lay a great deal of stress, when credit is restricted in Britain, on a movement to finance external trade in New Zealand. You mention some degree of shift but you play it down. Do you mean to imply it is a limited shift?——It is limited; but there is a definite trend, depending on the differential in the rates in the main. It is very short-term, of course; usually covering the movement of goods.

4602. It is short-term, but the magnitude of the movement would be what might be of most importance here, since the shift would endure if the differential in interest rates endured?——Yes, other than as happened in one of our exports in New Zealand, and I think in Australia: wool. We put on a differential rate, almost a penal rate, so that it was up to the level of the foreign rate; then they tend not to make the switch quite so much.

4603. Does this apply equally in Australia?——*Mr. Messner*: Yes.

4604. From what source would the finance for wool and wheat exports from Australia come? Would it be mainly finance from this country, or is it now largely Australian finance?——We expect to finance the shipments only to port of destination in any case, and on arrival of the commodity there payment is expected.

4605. When you say you finance it to the port of destination, does that mean that the bills involved are held by the Australian banks or that some are in the London discount market?——In my experience the bulk, even over all these years, are held in the banks' own portfolios, at present at any rate.

4606. If I have understood your answers correctly the rise in interest rates here may have the effect of producing a spread of interest rates in Australia and New Zealand with a higher rate of finance for external trade?——Of course in the exchange buying rate in Australia we apply the Bank Rate of London.

4607. There is then no differential?——*Mr. Scotcher*: It has been a recent development within the last six months that for the first time, because of the pressure from importers of wool in particular to borrow in the cheaper markets, that is Australia and New Zealand, the banks, with the approval of the central banks concerned, have imposed what we regard as a penal rate of interest, that is today 8 per cent., 1 per cent. above the Bank of England rediscount rate, to transactions which in their opinion could have been financed in the traditional way which is on bills.

4608. Does it apply equally to Australian traders engaging in similar transactions?——Yes.

4609. *Chairman*: What is the policy: not to divert Australian money into this form of finance?——Yes. It was felt that the volume of money engaged in financing the export trade was getting greater and greater, because of the longer credit required or demanded by buyers of commodities, and because interest rates in those two primary markets were lower than they were in Europe, including the United Kingdom. Obviously that tendency was increasing till the time came when the central banks of the two countries agreed that the banks should employ the interest weapon only in those particular cases.

4610. *Professor Sayers*: But this has not been felt to force your hand as regards interest rates charged to all other Australian borrowers?——It has not been allowed to.

4611. *Professor Cairncross*: You now have an effective discrimination between transactions?——Only in regard to exports of wool. It is limited to wool.

4612. *Professor Sayers*: Not wheat?——Not wheat.

4613. *Professor Cairncross*: Has anything of the same kind happened in New Zealand?——*Mr. Davies*: Yes; we are inclined to call it a disincentive rate. It is slightly different. We only apply the disincentive rate if the money is taken in New Zealand for post-shipment finance; that is the distinction.

4614. *Professor Sayers*: Do you mean by post-shipment post-arrival?——No; after it is on board and coming to this country. The New Zealand bank's function in this is to finance the trade between New Zealand and this country. We would expect the exporters to use the traditional bill. The bill, which is an export bill, of course attracts the London Bank Rate of 7 per cent.; we thought it was wrong to let them borrow at the advantageous trading rate for the duration of the shipment, so we applied a disincentive rate. But we do not hinder them while they are getting ready for shipment; only when they want to take advantage of post-shipment finance.

4615. *Sir Oliver Franks*: In what you have been saying there is an example of a particular purpose being achieved deliberately by the governments and the central banks through the interest rate. If they had wanted to achieve the same result by another way, could they have done it, and would it have been equally effective?——In the short run I would have thought no.

4616. And in the longer run?——They could probably put a ceiling upon advances for that particular kind of commodity in the long run.

4617. *Professor Sayers*: Was the action taken at the initiative of the trading banks or the central banks?——*Mr. Scotcher*: The trading banks.

4618. *Chairman*: Does the disincentive rate in fact have a disincentive effect?——*Mr. Davies*: As Mr. Scotcher was saying, it has only been operating for this wool season. Speaking for New Zealand, it definitely has had an effect. —*Mr. Scotcher*: It is very hard to tell. This happens to have been rather a weak wool season, but it looks as though it has been effective.

4619. *Professor Cairncross*: These rates presumably apply also to shipments to the Continent where rediscount rates are substantially lower than they are in this country. You indicated earlier that there was a tendency for finance to be sought in New Zealand for some shipments to the Continent. I have difficulty in tying these two things together. Does not the differential in rates there tend to push continental finance into this trade rather than suck it out of it?——*Mr. Davies*: The rediscount rates are mainly substantially lower, but the trading banks' lending rates to the continental importer are not so much lower.

4620. Is there a control of issues of long-term capital both in New Zealand and Australia?——*Mr. Davies*: In New Zealand definitely.—*Mr. Scotcher*: There is no control in Australia except of issues by government agencies which are controlled through a committee composed of the States and the Federal Governments.

4621. It would be open to a large company interested in the wool trade to make a large issue freely in the public market for the purpose of obtaining finance?——There would be no bar whatever.

4622. *Chairman*: Are there any more questions on the paper?——*Mr. Davies*: Will you allow us to make one point on the last paragraph of the paper? In the last sentence we say:

"However, we express doubts as to the effectiveness of such pronouncements unaccompanied by the action necessary to enforce the required economic policy."

We have had second thoughts about that, and we would like to elaborate a bit by adding at the end: "on credit creating organisations including government departments concerned with spending." The point we are making is

that it is no good putting the brakes or skids upon the banks and leaving the other organisations out.

4623. *Professor Sayers*: From your knowledge of Australian and New Zealand and British conditions, is there any great difference in the amount of exposition of monetary policy in our various countries and, if so, what is the difference? What seems to be the moral of the differences?——I would not have thought there was very much difference between New Zealand and London. It is the same sort of pattern: exhortations by the Chancellor or the Minister of Finance, the central bank leading the trading banks, the trading banks co-operating.

4624. You have a Governor of the Reserve Bank who was brought up in the Bank of England?——No; Mr. Fussell was brought up in the National Bank of New Zealand, which is our bank. He left us and went with Mr. Lefeaux when the Reserve Bank was first started. But he has spent a considerable time over a period of years on visits to the Bank of England.

4625. What about Australia?——*Mr. Messner*: It is rather similar. As you know, we have Dr. Coombs, who is an Australian-trained Governor of the Commonwealth Bank.

4626. *Sir Oliver Franks*: There is room here for differences of practice and differences of opinion without necessarily being very clear which is the better. For instance, the American Federal Reserve Board attaches greater importance to trying to put over what the purpose and object of the change that it is making is than is always the case here in England, where the change is left to speak for itself; but either method may be the better. When your central banks are making changes, do they try to make clear to the people in your countries, and more particularly to those engaged in business and commerce, what the purpose of the exercise is at the time they make the change, or do they leave the change to have its own effect?——*Mr. Davies*: In New Zealand they would not tend to do very much more than is done here.—*Mr. Scotcher*: In Australia a great deal of publicity is given to any change in the requirements of the central bank in regard to interest rates or special accounts and so on; the reason for that is that in Australia banking and financial affairs are very much political.—*Mr. Messner*: I would like to add that in my experience the public of Australia is not as well educated in these financial trends as is the general public in the United Kingdom.—*Sir Oliver Franks*: I would not wish to argue with you on that, but even here we are puzzled at times.

4627. *Professor Sayers*: May I ask a general question, not on the paper? I wonder if you, with your experience of other countries and their contacts with people outside the United Kingdom, could tell us something of how much it means to the outside world when the London Bank Rate changes? Does the outside world attach great importance to this, and, if so, on what sort of grounds?——*Mr. Scotcher*: I think that, in regard to Australia, that part of the community which is concerned with importing goods or exporting goods is directly concerned; and to the extent that a man has to provide finance himself for that purpose of course his pocket is concerned too. So far as the general public is concerned I should say that they take very little interest. In Australia, as I mentioned before, a fairly independent pattern of interest exists (by "independent" I mean independent of international developments) and consequently I do not think that the man in the street is concerned at all whether the Bank of England rediscount rate goes up or not; certainly not if the Federal Reserve rate moves.—*Mr. Messner*: I would subscribe to that so far as Australia is concerned, and would merely add that with my limited knowledge of a number of countries of the world I think the impact on the commercial community is immediate, and, in the case of the recent rise, rather stunning.

4628. Have you any suggestions as to why?——*Mr. Messner*: I can only give the impressions that have come back to me. In the first instance it was unexpected, I gather. In the second instance the immediate thought was: "This is going to affect my pocket greatly". I personally think it had a psychological effect, particularly on the wool industry, with which we have a close association in several of the big wool-processing centres of the world including this country. That is purely my personal view.—*Mr. Davies*: It is a very wide question, which depends very much upon definitions and on such things as world opinion. I do not think I could answer that. In New Zealand I think the business community would be most interested, and would probably want to know why; certainly the academic world would. The ordinary man in the street would not be terribly interested, except in so far as it affected his particular pocket. But there would be nothing like the same reaction in New Zealand as there would be, say, in New York or Zurich or Dusseldorf or other centres of the world. New Zealand is much farther away, and I would not have thought it would affect the people of New Zealand very much.

4629. *Professor Cairncross*: There would be no feeling that it would herald higher rates all round in New Zealand?——No; I think they have sufficient experience to realise that, whatever the Bank Rate is put at here, the people of New Zealand seem to leave such Bank Rate as they have alone.

4630. There is a question which we have been putting to all other representatives of overseas banks on statistics. Some information was supplied to the Macmillan Committee, and is still supplied to the Bank of England confidentially and bank by bank. Would you see any objection to the publication, for all the overseas banks as a group, of aggregates of the figures supplied to the Bank of England relating to the employment of your funds in London, the magnitude of your funds and the division between the different purposes for which they are used?——At a given date, or a series of dates?

4631. On the basis on which you supply it currently to the Bank of England; I think it is quarterly, but I am not quite certain.—*Chairman*: What we had in mind was the split between money used in the discount market, in Treasury Bills and in short bonds?——*Mr. Davies*: I would have thought, speaking quickly, there would have been no difficulty about publishing the figures we give.

4632. *Professor Cairncross*: We should write to you and make it clear what information we had in mind, but we can say now that it would not involve the return of any additional information to the Bank of England. What is involved is the disclosure of figures relating not to one bank but to the aggregate of all the overseas banks.—*Chairman*: We will send you a letter in due course setting down clearly what it is we would like. Perhaps I may without unfairness say that we have asked the other groups, and I do not think there is any objection from them.——*Mr. Messner*: I am quite sure that we would have no objection.

Chairman: Thank you very much.

(*The witnesses withdrew.*)

H. MUSKER, ESQ., O.B.E., M.C., General Manager, British Bank of the Middle East, S. W. P. PERRY-ALDWORTH, ESQ., Chairman, British Overseas Banks Association, London Manager, Hongkong and Shanghai Banking Corporation, and W. G. PULLEN, ESQ., General Manager, Chartered Bank, representing the Eastern sector of the British Overseas Banks Association, called and examined.

4633. *Chairman*: Mr. Perry-Aldworth, we have your memorandum,* for which we are much obliged; there will be a few questions which arise on it for you to enlarge upon. We will take it through and see what questions come out.—*Professor Cairncross*: On paragraph 1, could you tell us which of the overseas banks represented have their head offices abroad?——*Mr. Perry-Aldworth*: The Hongkong and Shanghai Bank is the only one of our group.

* Memoranda of Evidence Part VI No. 15D.

4634. *Chairman*: In paragraph 2 (*c*) you say:

"At least 90 per cent. of the London resources, i.e. deposits and branch funds, of a typical eastern bank are of overseas origin or association."

—*Professor Cairncross*: Could we have some enlargement on this? It is not very clear to me exactly what is the source of your deposits and branch funds of which you speak?——*Mr. Pullen*: The main source is excess

deposits in countries in which we are banking. If the lending ratio is not high, we transfer them to London.

4635. *Chairman*: Does that mean that one or two of the countries concerned are very big contributors of excess resources?——*Mr. Perry-Aldworth*: Yes, I would say so. We are really trying here to stress that we do not go out and try to compete with the clearing banks to get extra money. All we have in London belongs to depositors who are either normally resident or have offices in the Far East.

4636. *Professor Cairncross*: Does this 90 per cent. relate to your entire funds or the funds that you employ in London?——*Mr. Perry-Aldworth*: The funds that are in London.—*Mr. Musker*: And in addition to branch funds the direct accounts of customers resident overseas who have direct accounts in London.

4637. I was taking this sentence in conjunction with a paragraph later in which you refer to rates charged in some parts of the world, which appear to be highly remunerative. I was a little puzzled that such a high proportion of your funds appeared to be employed in London when you simultaneously had opportunities for very advantageous use of the money in the East?——*Mr. Musker*: It may not be very good business at that very high rate; it may be available but not suitable.—*Mr. Perry-Aldworth*: A good deal of the business done by indigenous banks would not be handled by us at any rate of interest.

4638. *Chairman*: Is that because of the nature of the business?——*Mr. Perry-Aldworth*: The nature of the business and the impossibility of controlling many orientals.—*Mr. Pullen*: The money in London is the excess over the amount we can lend at those rates on what we consider reasonable business.

4639. *Professor Cairncross*: What proportion of your total funds would be in London?——*Mr. Perry-Aldworth*: I have never worked that out. Our books are in Hong Kong, and I have no access to them.—*Mr. Musker*: In our own case about 50 per cent.—*Mr. Pullen*: In ours about 30 per cent.; we have total assets at £220,000,000 and I should think we would be working with £60,000,000 or £70,000,000 in London.

4640. *Chairman*: Which are the big contributing areas of excess reserves today?——*Mr. Perry-Aldworth*: As far as I am concerned, Hong Kong and Malaya, including Singapore.—*Mr. Musker*: As far as I am concerned, the Persian Gulf.—*Mr. Pullen*: In our case, Malaya again, mainly.

4641. *Professor Sayers*: How is the proportion of these London funds to your total fixed? Is it simply a residual: you lend what you can overseas and the rest is in London? ——*Mr. Musker*: In my case we lend all we consider wise overseas, which is very different to lending all one can.

4642. Wise in relation to banking standards?——Yes.

4643. Not wise in relation to total reserves?——We keep an adequate cash reserve overseas to meet liabilities, and the surplus is employed in London. In my own area in the Middle East there is no money market, in the sense there is in London, where one can use day-to-day money.

4644. *Professor Cairncross*: Do you find an increasing tendency for money to accumulate in these countries that can be transferred to London, or do you find a trend in the other direction, that you have more and more opportunity for employing money locally?——Speaking for myself, with increasing oil resources, wealth is growing in the Middle East.—*Mr. Pullen*: As far as we are concerned the tendency is for larger borrowings overseas. The banking statistics for Malaya show that from December, 1954, to September, 1957, there was an increase of £40,000,000 in local lending which was offset as to 50 per cent. by withdrawals from London and as to the other 50 per cent. out of local deposits, which shows in a new country, particularly with Government help, a tremendous fillip to local lending.

4645. So the trend would be to a higher proportion of your total assets being employed outside this country?——Our resources in London are always running down which is rather worrying.

4646. *Chairman*: I was not quite clear that the answer with regard to the Persian Gulf was to the same effect?——*Mr. Musker*: No, the opposite.—*Mr. Perry-Aldworth*: It does fluctuate very considerably from month to month. A lot of it depends on political considerations: a lot of money was taken out of Malaya at the end of 1956 at the time of the Suez crisis, but it is gradually trickling back.

4647. *Professor Cairncross*: It would be true that some of the money you have in London is in effect in the form of foreign trade bills and therefore is, in effect, financing external trade?——Yes. It comes in our figures given later on. It is all employed.

4648. *Chairman*: In paragraph 2 (*e*) you say:—

"A very large proportion of the trade, both import and export, conducted by Asian countries with each other in sterling is settled through the British Eastern banks in London."

What order of magnitude are you speaking about in connection with that trade?——*Mr. Perry-Aldworth*: China and Japan are in the transferable sterling area, and China cannot do anything outside the area at all. She does all her foreign trade with sterling.—*Mr. Pullen*: We have the continent of Europe as well; as far as we are concerned that business is of some magnitude.

4649. Can we get an indication of the order of the magnitude for the British overseas banks as a whole?——*Mr. Perry-Aldworth*: We might find it out and send it to you. I do not think any of us could speak from memory about it.

4650. *Professor Cairncross*: When you refer to China, I presume you mean Communist China?——Yes.

4651. *Sir Oliver Franks*: On paragraph 4, would any or all of you be prepared to tell us in simple terms what was the Kuwait gap and how did it work?——*Mr. Musker*: It was completely miscalled the Kuwait gap. In effect the Kuwaiti lent his name to the transaction; the real transactions were done in Beirut.

4652. Would you be prepared to describe to us in a purely hypothetical case how such a transaction can be begun, carried through and ended?——In Beirut there is a market in transferable sterling. It is quite easy for a Kuwaiti to acquire transferable sterling. With this transferable sterling he can buy American securities. You, Sir, living in England can remit money freely to Kuwait; it is in the sterling area. Your agent there will remit the money to Beirut. There you have the circle.

4653. *Professor Cairncross*: Money was moving to Kuwait and from there to Beirut, and at that point American or Canadian securities were purchased?——Yes.

4654. These securities would be registered in the name of a resident in this country?——In this country.

4655. Can that still take place?——Not legally.

4656. But it was legal before?——It was legal before.

4657. *Sir Oliver Franks*: When this "gap" was closed, what happened?——*Mr. Musker*: It is finding other channels.—*Mr. Pullen*: Ethiopian trade through Aden is another leak, for instance.—*Mr. Perry-Aldworth*: But basically a Kuwaiti can only sell to a Kuwaiti and a Hong Kong man can only sell to a Hong Kong man.—*Mr. Musker*: The anomaly is that Kuwait is in the sterling area, but no one is in a position to enforce the Bank of England regulations. Kuwait is an independent state.

4658. *Chairman*: An independent state under British protection?——Not under British protection; it has a treaty which governs its foreign relations. That is a big difference.

4659. *Mr. Jones*: If this circle has been broken, precisely what has happened to break it? And what steps have been taken to ensure that another circle is not conducted similarly to the one which led to this leakage through Kuwait?——There is no way of stopping it; but if you perform such a transaction today you can only do it illegally, because you cannot transfer money from here to Beirut; you would not get a permit from the Bank of England.

4660. Has it not always been illegal?——Not to remit money to Kuwait.

4661. *Professor Cairncross*: Is Kuwait a member of the sterling area?——It is still a member.

4662. It was incumbent on the Kuwaiti authorities to prevent the removal of sterling funds from Kuwait to Beirut, but that was not, in fact, enforced?——They were, and are, in no position to enforce it.

4663. *Sir John Woods*: That is the sort of transaction which is covered, I suppose, by these words:—

"Places such as Beirut and to some extent the Persian Gulf, in which the exchanges are free and where the movement of funds is by no means governed solely by the flow of trade."

—*Chairman*: I have not got quite clear whether the transfer of funds which have reached Kuwait out of Kuwait into the Lebanon is now impossible?——It is not impossible.

4664. May they still reach Kuwait in the same volume as before?——*Mr. Musker*: They might, yes.—*Mr. Pullen*: Trading in gold.

4665. *Mr. Jones*: What is meant then when we are told that the Kuwait gap is closed?——*Mr. Musker*: Very little.—*Mr. Perry-Aldworth*: It has in practice meant that there is appreciably less "switch" sterling available for people in other markets.—*Mr. Pullen*: Kuwait is no longer creating switch sterling.—*Mr. Perry-Aldworth*: A Kuwaiti cannot sell it to a Hong Kong man; the Hong Kong man has to find somebody out there to get his sterling into U.S. dollars.

4666. *Professor Cairncross*: Can you tell us what was the precise measure that effected the change, such as it is?——*Mr. Musker*: The Bank of England no longer permits residents of the United Kingdom to acquire dollar securities from residents of the sterling area outside the United Kingdom. These transactions were all done by the Bank of England consent through brokers who found customers.

4667. *Chairman*: The whole market in American and Canadian securities in this country has been closed and cannot be added to now?——It cannot be added to now.

4668. *Mr. Jones*: Is this taking place illegally?——If you mean: "Are there no leaks from sterling into dollars?", of course there are.

4669. Through Kuwait?——*Mr. Musker*: There are leaks anywhere where there is an open market.—*Mr. Pullen*: Any shipment destined for Jordan off-loaded in Beirut creates an opportunity for a leak.—*Mr. Musker*: No country has yet devised a watertight control of money. It is beyond the wit of man to invent one.—*Mr. Perry-Aldworth*: It is now more difficult for the resident of one part of the sterling area to get hold of "switch" sterling through another part of the sterling area. It has been localised to that extent.

4670. *Professor Cairncross*: There are these leaks; can you form any judgment as to their magnitude?——*Mr. Musker*: It depends as much as anything else on the difference between the transferable sterling rate and the official rate. The wider the gap the more leaks there will be.

4671. Do you think there is some rate of discount on transferable sterling which gives rise to them? Would you like to quote a particular percentage?——*Mr. Musker*: I have no idea. For example, the leak of gold into India runs into millions and millions and millions of pounds a year, nobody knows quite how much.—*Mr. Pullen*: It is the biggest of all.

4672. Has it gone on for long?——*Mr. Musker*: For thousands of years and probably longer.—*Mr. Pullen*: Their profit is colossal. One shipment they caught last year was £2 million; that the smugglers lost, but that did not deter them.—*Mr. Musker*: That loss does not shake the faith of the people engaged in this trade; they make allowances for shipments caught by the Customs.—*Mr. Pullen*: The smugglers buy gold in Zürich; it goes on these fast dhows, and is then smuggled into India through Pakistan or direct off the western coast. They no longer go to Bombay because they cannot bribe the officials there: they are always changing them.

4673. That gold is bought mainly for sterling?——*Mr. Musker*: Anything. In the Persian Gulf it is cut into small pieces.

4674. In what currency is this gold paid for?——*Mr. Musker*: In India it is paid for in rupee notes. The great convenience is that the rupee note is the currency of the Persian Gulf. The smugglers hand over the gold and get rupee notes, and they are brought back by dhows and put into circulation.—*Mr. Pullen*: Smuggling gold is probably not a bad thing. It is not a wasting asset, and it can always be pulled out of the ground as reserves in India.—*Mr. Musker*: There are aeroplanes arriving in Kuwait every day from Beirut with cargoes of gold.

4675. Your proposition, as I understand you, is that this gold is a loss to the sterling area central reserve?——*Mr. Musker*: It gets out of the control of the Indian Government.—*Mr. Pullen*: The gold need not belong to the sterling area in the first place. There is nothing to stop anyone putting the gold into Europe, Russia, if you like.—*Mr. Musker*: A lot of gold has been shipped from London to Beirut against payment in dollars, with Bank of England approval. It is regular business; we help the shippers.—*Mr. Pullen*: And through Yemen. But I think that the leak is getting less and less in respect of gold shipments all the time.

4676. *Chairman*: Is that because of the comparative unattractiveness of Canadian and American securities for the time being?——*Mr. Musker*: That has something to do with it.—*Mr. Pullen*: Every now and again they put someone in gaol, which helps a bit.

4677. *Professor Cairncross*: Would it make a difference if the discount on transferable sterling disappeared?——*Mr. Musker*: The gold would go to India whatever happened. With the millions of marriages every year in India the demand for gold is insatiable; it will go on for ever.—*Mr. Pullen*: Commodity shunting stops at a certain rate in transferable sterling.—*Mr. Perry-Aldworth*: When the discount comes down to about 3 per cent. it begins to stop.

4678. Can I ask why you quote the discount on transferable sterling at which commodity shunting takes place? Has there been in the last two or three years any experience of commodity shunting?——*Mr. Perry-Aldworth*: I have personally no knowledge of it.—*Mr. Pullen*: I have not seen any big volume since the days when the Dutch were involved in it, switching their tin and so on from Singapore into Amsterdam and then out on to the United States, and getting dollars which should have accrued to us. Transactions like that are controlled by the price.

4679. Do you know of any calculation of the magnitude involved in those days?——It is impossible to tell. We saw it happening in tea and tin and rubber; but no one on earth could, I think, hazard a guess.

4680. *Mr. Jones*: There are still a good many pirates?——These Continental boys are always pirates at heart; they are always ready to take advantage of any divergence at all.

4681. *Chairman*: In paragraph 5 you say:—

"The eastern banks feel themselves obliged for political reasons to subscribe to Government-sponsored development corporations in the territories in which they operate."

That holds back a certain amount of your other funds which would otherwise come to London?——To a certain extent.

4682. Then you say:—

"The funds available are being further restricted by the formation of central banks to which Government deposits, formerly used by the eastern banks in financing trade and development, are being transferred."

—*Mr. Pullen*: That is important; Malaya is coming along now, and the moment they become a central bank presumably all the Government funds will be lodged with the Bank of England instead of us.—*Mr. Perry-Aldworth*: And the other banks' funds too.—*Mr. Pullen*: Yes, if they make local clearing houses.

4683. They may require deposits from you, quite apart from your funds in London?——*Mr. Pullen*: Their Central Bank Act probably will.—*Mr. Perry-Aldworth*: That will mean a big drain on our London resources.

4684. *Professor Cairncross*: Then these London resources would probably be turned over to the Bank of England through the Malayan central bank?——Yes.

4685. *Chairman*: Then you say:—

"Another factor affecting the normal movement of funds through the eastern banks is the action of the Governments in some British Colonial territories, which have taken advantage of high rates ruling in London if these have persisted over a period, to remit their surplus funds to London, instead of leaving them in their own territories to be employed by the banks in the financing of trade and development."

Does that mean that you have recently observed an increased tendency of these British colonial governments to take advantage of the high rates in London at the expense of leaving their monies on deposit with eastern banks locally?——Two governments have, to our own knowledge. I would rather not enlarge on that.

4686. *Professor Cairncross*: Could you enlarge on it to this extent: could you tell us whether in those cases the colonial governments, in order to obtain those funds, were obliged to cut down their expenditure on development, or restrict their expenditure in some way, or whether this was simply loose money that they remitted?——Possibly at the time it was loose money, though they were rather foolish about their investments here, and they could not bring the money back when it was needed without taking a capital loss; so they had to wait until the securities fell due and then bring it back. That meant that they had to get money from us and run down our resources, when they could have used their own resources if they had been a little wiser. It was rather like the Ideal Bank.

4687. *Chairman*: Has this been a matter of local comment?——It was mentioned in our Chairman's speech last year, and my head office particularly asked me to mention it here.

4688. *Professor Cairncross*: Do you think in these cases it was the high rates in London which were the reason for the transfer?——Yes.

4689. *Professor Sayers*: In paragraph 7 you stress the usefulness to the eastern banks of the London money and discount market; "otherwise the eastern banks' surplus liquid funds would be lying idle". Would life be difficult for the eastern banks if there was no discount market?——*Mr. Pullen*: Extremely difficult. We should not be able to lend our overnight money.

4690. Not even to the clearing banks?——*Mr. Musker*: It would depend on how much they would pay.—*Mr. Pullen*: On the overnight money to the clearing banks we do not get any interest.

4691. You mean to say that if you had millions to deposit with the clearing banks overnight you could not get a bargain with them to get some interest, if you were continually doing this?——*Mr. Musker*: At the present time I do not think the clearing banks would give us that.

4692. Yes, but there is a discount market now.——*Mr. Perry-Aldworth*: There is a highly organised set of runners who go round; we should have to supply those ourselves. —*Mr. Musker*: To see who would give the best rate. As it is, any day in the London market we can place our surplus funds. Even if they run down to £250,000 at the last two minutes of the day, we can place them at an economic rate, 6½ per cent. or something like that.

4693. The existence of this highly developed market is a great convenience to you?——*Mr. Perry-Aldworth*: Tremendous.—*Mr. Pullen*: I do not know how we would work without it. We have to pay quite high rates on some of our funds abroad, and if we were left with large surplus amounts it would be extremely difficult. It must be remembered that as eastern banks we are getting very big drawings. It is nothing to get a capital transfer of a couple of million pounds, and that may happen a couple of times a day. We have to keep liquid.—*Mr. Musker*: We pay interest on a much higher percentage of our deposits than the banks at home do. We have to pay interest on the bulk of our deposits, to get them. We are subject to world competition; it is not a closed market as it is in England where clearing banks can dictate the terms, if Sir Oliver will forgive my saying so.

4694. *Chairman*: Who are your competitors locally? Who are offering these high competitive rates?——*Mr. Musker*: Continental banks; and even London hire purchase people are coming into our markets and offering rates which we cannot touch.—*Mr. Pullen*: Circularising our customers in the east.

4695. *Mr. Jones*: Are you telling us that your surpluses at the end of the day can be offered by you to the discount market at 6¼ per cent.?——It depends how money is in the discount market; if they are fairly well supplied it might be 5½ per cent.

4696. Are they competing for your money?——Sometimes.

4697. Under circumstances like that you might get a high rate; but supposing you are offering them money?——Then we will get within a quarter or half per cent. at the most away from that.

4698. *Professor Sayers*: You said that you have in your own experience seen your overseas money going to the London hire purchase companies. What sort of magnitude would that take?——*Mr. Musker*: As far as my district is concerned I only know of one hire purchase company which has collected some accounts in Beirut, and I do not think they are of great magnitude. But it is the effect of these advertisements, advertising 8½ per cent., that is bad.

4699. You mean that you have to keep up your rates?——I do not think that the companies concerned have really great credit overseas in spite of attractive names; it has a hardening effect on rates but, so far as I am concerned I have not lost any money yet.

4700. How far is the effect to pull up rates in other countries and how far is it an actual diversion of funds?——*Mr. Perry-Aldworth*: I think it is a diversion rather than a pulling up of rates.—*Mr. Pullen*: We see remittances going to the hire purchase companies, but compared to the amounts that are diverted into Treasury Bills I would regard it as negligible.

4701. Not only hire purchase companies but the British Government has an effect on these funds overseas?——*Mr. Pullen*: A big effect. Our investments for our customers in Treasury Bills now outstanding at any one time run into some millions of pounds; even at a really moderate estimate probably half that money would stick with us otherwise.—*Mr. Perry-Aldworth*: It has not had much effect on us.—*Mr. Musker*: Nor on us; one customer I know has asked me to buy Treasury Bills for him.

4702. Does the existence of this competition make you think again about the rates that you offer for deposits in these countries?——*Mr. Perry-Aldworth*: It has made British members of the eastern banks think again. We did approach the clearing banks with a view to narrowing the difference between the deposit rate and the Treasury Bill rate.—*Mr. Pullen*: Overseas it makes us more competitive.

4703. You do tend to bid up?——If we are going to lose money. We will do anything to get money.

4704. Your deposit rates abroad are flexible?——*Mr. Musker*: Completely.

4705. *Sir Reginald Verdon-Smith*: Are these hire purchase companies of British origin or Continental?——*Mr. Perry-Aldworth*: There is only one British one impinging on our field; it is threatening to open in Malaya.

4706. *Lord Harcourt*: Is there an opening for hire purchase business?——We do not know; they have not said.

4707. *Chairman*: I did not follow your statement that you would do anything to get money?——*Mr. Pullen*: Always with moral reservations; but our trouble with all our branches is that with the increase in nationalism the amount of money coming to London, which is the hard core of our business, is being restricted. Because of controls everything goes into separate watertight compartments; so where we could easily attract money into this country hitherto, or even attract money to give us surplus local deposits, greater liquidity in our balance sheet and so on, we now have to be much more more competitive. The field from which we can draw on is getting narrower all the time.

4708. *Lord Harcourt*: The existence of the London discount market helps your competition in this?——*Mr. Pullen*: Yes. To be without it it would knock a hole in our profits. It certainly helps us to be more competitive. —*Mr. Musker*: We do not bid for money which we cannot use profitably.

4709. *Chairman*: Can we assume that up to the present, however high you have been forced to bid for money, you have been making a turn on it?——*Mr. Pullen*: We are turning away first class business that years ago we would like to have seen, because we cannot finance it.

4710. *Professor Cairncross*: In London or abroad?——Abroad where we earn this money. You must have a reservoir of big local deposits to do it. As the reservoir runs down so we have less and less elbow room for lending.

4711. *Lord Harcourt*: Have you less ability to lend abroad now than you had?——Yes.

4712. *Professor Cairncross*: I thought at the beginning that you were indicating to us that you had very large London funds for which you could not find employment. Was that a misunderstanding?——No; we have suggested that we could not find an outlet. For example, we might get a position in India, where our loans against tea or jute and so on might be above our local deposits, so that, for the time being, if we wanted to keep our business, we might have to draw a little on London. But the whole of our business now, as it gets more and more into these compartments, is to cut down lending in these countries, and we have more and more to reduce business.

4713. *Chairman*: You cannot find locally any employment for that part of your money which you put in the London discount market?——That is a difficult picture to give, because in some countries we are over-lending, while in others there are great reservoirs of funds and because of exchange control regulations we cannot switch them round as we would like to. So in some countries we are turning down business, while in others we are trying to attract funds to give us general liquidity in our overall balance sheets.

4714. If you kept some of your surplus funds in the local area could you find any liquid employment, in the sense that money in the discount market is liquid here?——*Mr. Pullen*: No. In India there is overnight money, but there is no money market in any place we operate. —*Mr. Perry-Aldworth*: There cannot be. We might lend overnight, but when it comes to an indigenous bank we would not like to lend to them on long term securities for which there are few buyers locally and which therefore the banks have to take up anyway. There is no short-dated stuff to make a market.—*Mr. Pullen*: There has been an attempt once or twice in India to make a money market, but it has been entirely unsuccessful. There is not the mechanism.

4715. *Professor Cairncross*: Are we right in thinking that the business you conduct in London on longer term, either in the market or Treasury Bills, is supplementary to the rest of your business, and could not be easily curtailed?——Completely.

4716. You are not in a position to transfer and take advantage of opportunities abroad?——*Mr. Pullen*: We are; but in such a case taking up an exchange position comes into it, and the various risks between individual currencies, and so on.—*Mr. Musker*: In my area there is a seasonal demand for money. Usually a bigger demand comes in the autumn, when crops have to be moved in Syria and Iraq. There is a seasonal demand for money there, and then it eases off.

4717. In paragraph 11 you say that you have about half of your London funds in sterling overdrafts and foreign trade bills. I take it that you would not want to cut that down substantially in order to make money available in a country where you had first class clients seeking further accommodation?——*Mr. Pullen*: Those sterling overdrafts are for overseas customers; it might be a large rubber company or something like that.—*Mr. Perry-Aldworth*: Or our own branches.

4718. *Mr. Jones*: From what is said in paragraph 8 it would appear that where there is a central bank, as in India, Burma, Pakistan and Ceylon, a higher Bank Rate in London has no effect in the movement of funds. To what extent does a higher Bank Rate in London affect the sort of business you and your customers have to do? Is it a good thing or a bad thing? I have had the impression, as I have read this paper, that you shiver at a high London Bank Rate; is that right?——*Mr. Perry Aldworth*: It is very hard to explain it. If sometimes, because of the use of the Bank Rate, interest rates on trade operations here go up, local rates of interest out there must move.—*Mr. Pullen*: It is very difficult to dovetail one's operations. A man may be shipping rubber from Malaya to this country. If hitherto it has been financed on a sterling overdraft, and we suddenly put that rate to 8 per cent., then the man looks for alternative finance. He will take finance in Malaya; if he starts doing that, and he is taking enough, we have to pull our funds back to Malaya to meet him there at their much lower rate. It is not always possible, through local conditions, pressure from governments and so on, to follow London leads in these things. Our bill rates even for exchange quotations are based on the interest for the time en route on the sterling rate, but it does not follow that a rise in rates in this market can be enforced. We would like to enforce a rise in this market immediately in every other market we are in, but we cannot.

4719. Does a rise in Bank Rate dislocate business in the East, so far as you can see?——*Mr. Perry-Aldworth*: It takes a little time to adjust itself.

4720. *Chairman*: You can push your London funds out and meet the man who wants accommodation at the other end?——*Mr. Perry-Aldworth*: In certain places, provided we can get it back again.—*Mr. Pullen*: Provided we are not in long term Government securities which immediately drop on the rise in Bank Rate.

4721. *Mr. Jones*: Would there be any damping in trade in consequence of this movement?——*Mr. Musker*: It makes exports from this country more expensive.—*Mr. Pullen*: There has been a tendency to push things a bit towards Germany. Independent countries of the East are very much inclined to look to the rates in Deutschmarks every time sterling becomes too dear as a means of finance. I have noticed that in the Philippines, and in one or two places like that.—*Mr. Perry Aldworth*: Indo-China did it to us.—*Mr. Pullen*: We had an order from the central bank to cancel all letters of credit in sterling and switch them into Deutschmarks.

4722. What effect would this have on our holdings of foreign exchange in England?——It would always lessen it, the moment they go into Deutschmarks and do not come through London.

4723. *Professor Sayers*: It is always said that it is necessary in times of acute difficulty to put the Bank Rate up in order to inspire foreign confidence in London. Do you see in your own sphere of operations any evidence of that? ——*Mr. Pullen*: It has to be taken in conjunction with general confidence. One bank from our area had many millions of pounds in the London market; when they were getting worried about sterling they switched a lot of their resources into Deutschmarks and Swiss francs.—*Mr. Musker*: Before 19th September last there was a lot of switching into Deutschmarks; Middle East customers were importing goods from Germany and were buying their Deutschmarks months in advance of when they needed them.

4724. What was it that happened on 19th September that mattered to these people? Was it the rise in the Bank Rate?——No, they feared for the rate of sterling during the two and three weeks preceding the 19th September. It was expected that sterling would have to be devalued.

4725. What would the attitude of these people have been if Mr. Thorneycroft had done everything he did do except put up the Bank Rate?——*Mr. Musker*: They would not have taken it very seriously.—*Mr. Pullen*: They would not have had the confidence. Money is gradually coming back, and I think confidence is coming back. The Bank Rate is *the* important factor in that.

4726. Is it so to these people?——*Mr. Pullen*: It shows our determination to protect sterling.—*Mr. Perry-Aldworth*: Certainly as regards the Continent. I do not know whether the Far Eastern people, except the Japanese, were affected.—*Mr. Musker*: The Middle East are watching very closely the position of wage demands. That had more effect than anything else.

4727. *Chairman*: Of a number of factors which may affect the confidence in sterling, why is this peculiar importance attached to the Bank Rate movement?——*Mr. Pullen*: To the eyes of the man abroad it was the only definite step in the whole of the measures taken.

4728. *Professor Sayers*: You mean it was the only one that was headlined?——*Mr. Musker*: It was headlined, and it was a mark that the authorities really intended to try and maintain the value of sterling.

4729. *Sir John Woods*: It is sometimes said that marked jump in the Bank Rate, especially to very high figures, leads to a loss of confidence abroad?——*Mr. Pullen*: Theoretically you could argue that way; but it is not so unless it leads to a series of events.

4730. At any rate it is not so in your experience?——No. I am sure the fundamental thing for confidence was the drastic jump in the Bank Rate.

4731. *Professor Cairncross*: Suppose the rate went up to 9 per cent.; do you think that would reinforce confidence?——*Mr. Pullen*: No; I think there is something uneconomic about that.—*Mr. Perry-Aldworth*: I think a lot depends on the level at which the big jump takes place.

4732. *Sir John Woods*: I observe that the authoritative source for what I said just now [Qn. 4729] is in paragraph 13 of this paper, where you say:

"At the same time it must be recognised that sudden and sharp increases in the rate are apt to undermine confidence abroad."

——*Mr. Pullen*: I think that is true. We have been treating this last one as an isolated and psychological case.

4733. *Professor Sayers*: This sentence seems to suggest that next time the Bank of England does it the effect might be the wrong way?——*Mr. Pullen*: I quite believe that is true.—*Mr. Perry-Aldworth*: It depends upon the level at the psychological moment they do it.—*Mr. Pullen*: Putting it down might be a sign of confidence next time.

4734. *Sir Oliver Franks*: But it does mean there is no rule?—*Chairman*: It makes its effect rather unpredictable?——Yes.

4735. Are your impressions derived from correspondence from the area in which people expressed these views?——*Mr. Musker*: Reports from managers.—*Mr. Pullen*: Talks with visiting people.—*Mr. Perry-Aldworth*: Talks with foreign officials in London, and the people who are using a lot of funds in London.

4736. *Professor Sayers*: Could we narrow it down geographically?——*Mr. Pullen*: I am thinking of the Japanese and Chinese.

4737. All these people see great importance in the Bank Rate?——*Mr. Perry-Aldworth*: Yes

4738. Have you any idea why?——*Mr. Pullen*: Most of those concerned are bankers themselves, or they get their knowledge from their bankers.—*Mr. Musker*: They are pretty keen.—*Mr. Pullen*: They know as much as we do.—*Mr. Perry-Aldworth*: Japan's trade is financed in sterling; it matters a lot to her what she has to pay for that sterling, particularly if she has not got a lot herself and has to pay for it.

4739. *Sir John Woods*: Do you have any information about people other than bankers: commercial people, and exporters?——*Mr. Pullen*: Yes, in fixing exchange forward.

4740. *Professor Sayers*: If one talks to English merchants and industrialists, it is often difficult to convince them that this is anything of real importance by itself?——*Mr. Perry-Aldworth*: The English merchant deals in sterling and sterling only, but the man abroad has to change sterling into his own money. He is taking the exchange position into account.

4741. Why does he think that the Bank Rate move means that devaluation is less likely?——*Mr. Musker*: I do not think that the average resident in the Middle East could give you a scientific explanation of the working of the 7 per cent Bank Rate.

4742. No; but if we are to make up our minds whether the Bank Rate should be used for this purpose or not, we want to know as much as possible of what lies behind the reaction?——*Mr. Pullen*: It would not be a regular thing; this could probably have happened once in that psychological moment.—*Mr. Musker*: The moment the Bank Rate went up 2 per cent. I increased the rate of interest which I paid to all my branches who have accounts in London. Their balances immediately began to grow; they are many millions of pounds bigger than they were in September. They found it wiser to keep their funds in London and cover the exchange risk. Perhaps they have taken less risk in business, and they have been free to cut down and put the money in London. That is the effect it has had on our own branches. I have not instructed them at all; I have merely put up the interest rate. Is that a common experience?—*Mr. Perry-Aldworth*: To some extent.

4743. Is it the level of the rate or was it the jump of 2 per cent. which was the important thing?——*Mr. Musker*: The level. It is a very attractive rate.—*Mr. Perry-Aldworth*: It was the jump at that level.

4744. We had a jump back in 1952 of $1\frac{1}{2}$ per cent. Was that jump anything like as significant?——*Mr. Musker*: No, not from the point of view which I just put forward of the effect on branch balances maintained in London, because it was still well below the rate which they could obtain locally.

4745. You get a critical level of Bank Rate after which a jump begins to pull the money in?——Yes.

4746. Where would you put that critical level?——I should say at 6 per cent.; it begins to be attractive to get 5 per cent. without any risk at all rather than, say, 7 per cent. with a little risk.

4747. *Mr. Jones*: Is it an economic consideration or is it a question of confidence in the value and status of the pound?——*Mr. Musker*: It is an economic consideration.—*Mr. Pullen*: There is another side to it: we are talking of branches, but when you come to outside customers and other banks, banks in Viet Nam and so on, I think the rate is of less importance to them than the confidence.

4748. *Professor Sayers*: Why did the customers, the people in trade, think that the rise in Bank Rate made devaluation less likely?——It was taken in conjunction, I think, with the firmness of the statement and all the circumstances at that time. No one bad any doubt that the Chancellor and the Government meant what they said. Before we were always a bit frightened that they would weaken on something.

4749. *Professor Cairncross*: Would it be your view that it was the fact that this rise from 5 to 7 per cent. was something new that impressed your customers?——*Mr. Musker*: I cannot really analyse it; it was startling.

4750. *Professor Sayers*: It is rather important to know whether this is something merely mythical that will wear off in time, or whether there is something more behind it which will make it a reliable instrument?——*Mr. Pullen*: We did a survey which would answer Professor Sayers's question. The only time we saw appreciable sums coming to this country which we could attribute to a change in the Bank Rate was in the beginning of 1956 when the jump was from $4\frac{1}{2}$ to $5\frac{1}{2}$ per cent. There was already confidence in sterling, and that was a purely economic jump.—*Mr. Perry-Aldworth*: Until this time.—*Mr. Pullen*: No, I have not seen big amounts come in.

4751. *Chairman*: In paragraph 10 you say

"Thus in general in the territories covered by the eastern banks, while a change in interest rates in London has some effect on the remittance of funds to this country, the same type of funds, if available, would come no matter what the rate prevailing here."

——By that we mean the sort of British company who owns estates and tea gardens and so on. The moment they earn surplus funds the tendency is to bring the funds back to this country, whatever the rate. They do not invest them locally.

4752. *Professor Cairncross*: Is it your observation that a rise in Bank Rate in this country does exercise an upward leverage on rates in other parts of the world?——*Mr. Musker*: It does exercise an influence; if you can get $6\frac{3}{4}$ per cent. on a British Treasury Bill, there is less inducement to lend overseas. In Iraq the maximum local rate is 7 per cent. There is not much inducement to

lend in Iraq when you can get $6\frac{1}{2}$ per cent. in British Treasury Bills. It does have a subtle effect on everyone in their study of business.

4753. Would you say that a change in the London Bank Rate would have more influence on rates abroad than would a change in, say, the Federal Reserve discount rates?——*Mr. Pullen*: That does not have any effect at all. There is no volume of trade in dollars; that is probably to a certain extent the answer to your question, in as much as on all the bills for trade in sterling the rate of interest ultimately goes higher for the time the goods are *en route*. That must in its turn have some effect on local prices and local rates.—*Mr. Perry-Aldworth*: Once you get interest rates on trade bills running at the same level as local rates then, if a rise comes, both rates must ultimately go up.

4754. Have you seen this happen?——Yes, we have seen it happen in Malaya and Hong Kong, where they have tried to resist putting up rates and they eventually had to.

4755. *Sir John Woods*: On your figures for securities in paragraph 11, are those primarily short?——*Mr. Pullen*: Two thirds are short.

4756. When you say short, you mean less than five years?——*Mr Pullen*: Only one-third of them are above five years, between five and ten years.—*Mr. Musker*: In our case three-quarters are less than five years.—*Mr. Perry-Aldworth*: As far as I am concerned, with my head office overseas, my main consideration is tax free interest. The date is not so important.

4757. *Chairman*: We are trying to collect aggregate figures, for the overseas banks as such, of their London resources and the distribution of those resources. They are not published at the moment, except by collection from the balance sheets at different dates. Would you see any objection to your figures being included in an aggregate?——If we could give them to an independent person like the Bank of England, who would be prepared to collect them and not divulge them to competitors, we would not mind at all.

4758. *Professor Cairncross*: You do, in fact, provide them to the Bank of England now?——*Mr. Perry-Aldworth*: I suppose we did originally. Periodically returns have come round from the Bank of England asking what changes we had made in holdings of certain securities in the preceding few months.—*Mr. Pullen*: We did not see it.—*Mr. Musker*: We do not do it.

4759. Figures were supplied to the Macmillan Committee, and I understood some figures had been collected in the meantime by the Bank of England. Perhaps we could pursue this with you later, and suggest what information we are interested in?—*Chairman*: We have suggested to the other sectors that we send you a letter putting in black and white what we want you to contribute to the aggregate figures, if you could supply them to the Bank of England?——*Mr. Perry-Aldworth*: That would be easiest. I know they have collected figures for the accepting houses. If they do the same for us, we should be very pleased.

Chairman: Thank you very much. We are much obliged to you for your help.——*Mr. Perry-Aldworth*: Thank you Sir.

(*Adjourned until Thursday, 27th February,* 1958, *at* 11 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTIETH DAY

Friday, 21st February, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 4760 to 5052 only)
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

WILLIAM WATSON, ESQ., Chairman of the Committee of Scottish Bank General Managers; Treasurer and a Director, Bank of Scotland; and A. P. ANDERSON, ESQ., General Manager, British Linen Bank, representing the Committee of Scottish Bank General Managers, called and examined.

4760. *Chairman*: We are much obliged to you for your paper*, Mr. Watson. May we take it page by page and deal with the questions from the Committee as they arise? You deal with the questions in our questionnaire. The first section is purely explanatory, covering the role and function of the Scottish banks in the monetary system; and then you give us some aggregate figures for the Scottish banks as a whole. Are there any questions on those figures?—*Professor Cairncross*: Why is it necessary for you to give us figures based on published balance sheets? Is there no way in which the figures for the Scottish banks are aggregated independently of the balance sheets?——*Mr. Watson*: No, Sir; there is no regular return of aggregate figures of the Scottish banks at any time throughout the year, so we bad to fall back on the balance sheets, which are not of course published on the same date.

4761. Each of you make returns to the Bank of England?——We make returns of advances.

4762. Not of deposits?——Not of deposits.

4763. You provided for the Macmillan Committee a great deal of data on Scottish bank statistics, and the Macmillan Committee recommended that those data should continue to be collected. I always understood that these were collected by the Bank of England but were not published?——They have not been collected by the Bank of England, and no formal request has ever come forward for such.

4764. Perhaps to make it clear I should say that the figures as collected by the British Bankers Association are forwarded to the Bank of England?——That is true of advances.

4765. The Bank of England tell us, rightly or wrongly, that they obtain from the British Bankers Association monthly figures showing in respect of the Scottish banks the total for coin, notes and balances, money on call at short notice, bills and other accounts, loans, acceptances, current accounts and other accounts, and they obtain these figures monthly?——*Mr. Anderson*: We make the returns to the British Bankers Association; we were not aware that these were passed on to the Bank of England. But these returns do not comprise the whole of the figures of the Scottish Banks. In the case of deposits it is a return purely of customers' deposits, not the full total.

4766. Is not that a figure of more interest for general purposes than the aggregate?——*Mr. Watson*: It could be, yes.

4767. *Chairman*: These figures were published by the Macmillan Committee, and you had no objection to their appearing?——No objection at all, no.

4768. Would you have any objection to the aggregates being published?——We would have no objection. I can see no reason why that information should be withheld.

4769. *Professor Cairncross*: At present it is rather difficult to get an aggregate figure; you have to go through the balance sheets which, as you say, are for different dates of the year?——One would agree on that.

4770. Could you tell us a little more about the effects of amalgamation of the banks in Scotland? There have been one or two that have amalgamated in the past few years; has that had the effect of reducing the number of branches?——Yes. I can speak with a certain amount of knowledge on that, since my own bank had an amalgamation which has led to unification of branches at certain points. It has to be approached gradually; there are various obvious difficulties in the way of quick action, such as the retirement of managers, or otherwise employing them, and the finding of suitable physical room for a combined office where, perhaps, it does not exist. These things take time. But there is a process going on of gradual unification of offices, which is going to reduce the overall number of offices.

4771. *Professor Sayers*: You expect it to go a good deal further than it has gone already?——Yes. There is another amalgamation now under consideration. No doubt when that is consummated, a similar move will commence in that combined bank to the one that I have been describing. In my own bank we have not yet got anywhere near the final possibilities.

4772. *Professor Cairncross*: You would agree there are rather a large number of bank branches in Scotland compared with England?——We agree with that.

4773. *Chairman*: You refer to "monies accepted, at interest, on Savings Account and Deposit Receipt". Your savings account is, I understand, an account which does not begin to bear interest until the money has been with you for a stipulated period, and the money is then withdrawable at notice?——Yes. The savings account bears interest on the minimum monthly balance at a rate which the banks decide is the appropriate rate in the circumstances of the time and which has varied according as the Bank Rate has varied. It is not a fixed rate such as operates in the Trustee Savings Banks. Accounts bear interest on the minimum monthly credit balances and the money can be withdrawn at any time.

4774. Without notice, except notice of withdrawal?——Yes. No cheque books are issued on these accounts, of course.

4775. *Professor Cairncross*: Do the rates of interest vary in some fixed relationship to the Bank Rate?——Not necessarily.

* Memoranda of Evidence Part VI No. 16.

4776. *Chairman*: What does determine it?——The Bank Rate does determine it, but the rate of interest does not necessarily move in direct relationship to the Bank Rate.

4777. *Sir John Woods*: Deposit receipts are also withdrawable on demand, but they only begin to earn interest if they have been deposited for thirty days?——Yes.

4778. Is the rate of interest there similarly related to the Bank Rate?——Yes, almost identically. At the present moment the rate of interest on deposit receipts is the same as on the savings account.

4779. It is not always the same?——No. When money rates go down it is possible that we would apply in Scotland one rate of interest to a minimum balance of, say, £500 in a savings account, and a lower rate of interest, say the deposit receipt rate if that were lower than the savings account rate, to anything in excess of that balance on the savings account.

4780. *Professor Sayers*: This paragraph would appear to imply that all the interest-bearing deposits are either on savings account or deposit receipt, and that you have nothing precisely corresponding to the English deposit account; is that right?——Not quite right; we do have deposit accounts in our London offices.

4781. But in Scotland it is either deposit receipts or savings account?——That is correct. There is no such thing as a deposit account in Scotland.

4782. Are the monies on deposit receipt all available at the same notice?——Money on deposit receipt is upliftable at demand, but only qualifies for interest after being deposited for one month.

4783. *Professor Cairncross*: Are they chequeable?——No.

4784. *Professor Sayers*: Have the Scottish banks considered instituting accounts on which the deposits would be fixed for a considerable period, which would bear a higher rate of interest?——The thought has crossed our minds, but we have not decided to adopt such a procedure in view of the complications and extra cost that the Scottish banks would be involved in.

4785. England and Scotland are rather unusual countries in this respect. Why should Scotland be like England and unlike most other countries of the world in this?——*Mr. Anderson*: England and Scotland are more highly developed financially than the other countries you speak of; for instance, these other countries have no money market as we have here in London. I think also that, if we were to offer higher rates on deposits at longer notice, the effect would be to transfer a certain volume of money from existing savings accounts and deposit receipts without actually increasing the total of our deposits, so that any additional money we attracted by offering long term rates would be relatively very costly.

4786. *Professor Cairncross*: Have you had any incentive in the past few years to attract more deposits?——No.

4787. Your difficulty, for a time at least, has been to employ all the money you held?——Our difficulty since the war has not been to employ money; our difficulty is related to the restrictions placed upon us. If we had attracted more deposits in the past six or seven years, in the absence of an outlet in advances we would have had to invest these sums in Government securities, and the depreciation in our investments today would be heavier than it already is.

4788. *Professor Sayers*: Do you feel that the banks have been too attractive to depositors for the last few years? Would it have been better if you had had a smaller volume of deposits?——*Mr. Watson*: I do not think so. We feel that we are there to take the deposits of the community in Scotland, to the extent that people wish to deposit their money with us. We do not try to influence them in one way or another. We pay what we consider are appropriate terms for the use of the money, but we do not wish to go out to attract money at higher rates, for the reasons Mr. Anderson has stated.

4789. But the rates you pay do attract deposits, presumably. Have you reduced your rates at all?——No; the rate structure of today in Scotland would hear fair comparison with what it has normally been in times of a different Bank Rate.

4790. *Professor Cairncross*: The relationship to the Bank Rate now is much what it was before the war, say in the 1920s?——Possibly the deposit rate in Scotland today, being lower than the comparable rate in England, reveals a slightly different position than prior to the war, when either the rates were level or, as at one time, Scottish banks actually paid more than English banks for deposits.

4791. You think the rates now are rather below the comparable English rates?——The deposit rate certainly is below. It is 4½ per cent. at the present time, and in England it is 5.

4792. *Chairman*: Does that reflect the fact that there is comparatively less opportunity in Scotland for the remunerative use of your money when you get it?——*Mr. Watson*: No, it is not for that reason that the rate is lower in Scotland than it is in England; it is simply that the Scottish banks, having sized up the effect of the movement in rates, did not feel that they could offer the same terms as can be offered in England and at the same time make a reasonable profit. We always understand in Scotland that the English banks succeed in earning a much higher income from charges than has been possible hitherto in Scotland.—*Mr. Anderson*: Also since 1920 the English banks have never been so fully invested as the Scottish banks have been. At the present time we are tied to an investment portfolio built up in the days of cheap money, and that inhibits us from offering a larger return on the money deposited with us. The return from these investments is under 3 per cent. on cost.

4793. But they are running off fairly quickly?——*Mr. Anderson*: They will begin to run off now, yes.—*Mr. Watson*: There is the further point that the proportion of our deposits bearing interest is much higher relatively than in England. As we say here approximately 50 per cent. of the total deposits are held on interest-bearing accounts.

4794. *Professor Cairncross*: Has there been a shift observable to you towards the interest-bearing accounts either in the last few months or in the years when the interest rates have been rising?——*Mr. Watson*: We have observed a shift towards interest-bearing accounts, and I notice, speaking from my own knowledge, a constant upward trend in the total of our savings accounts deposits. In the situation where total overall deposits are more or less static, and have been so for about five years, it is clear that the interest-bearing proportion is constantly rising.—*Mr. Anderson*: Throughout my experience in banking the ratio of interest-bearing deposits to total deposits has been much higher in Scotland than in England. Before the war the proportion in Scotland was perhaps 45 to 50 per cent.; in England it was about 30 per cent. Today, in the case of my own bank, the proportion is 55 per cent. and it is still rising because of the transfer, in recent months, of sums from current account to interest-bearing deposits to earn the higher rates now obtaining.

4795. *Chairman*: Is it your impression that that is due to a wish to earn higher rates and not to a panse in activity which leads people to put money into deposit accounts?——Up till now I think it has been entirely associated with the higher rate of interest; and perhaps people in Scotland are a little more interest-conscious than they are in England.

4796. *Professor Cairncross*: Do your London head offices offer the same rates as in Scotland, or are they very akin to rates in England?——*Mr. Watson*: They offer the English rate.

4797. And are your clients free to transfer their deposits to London?——Only if they have accounts there originally.

4798. *Mr. Jones*: Is there a lesser velocity of money and greater liquidity in the banking system in Scotland than in England?——I would not say that liquidity is greater; and I would say that the velocity of deposits in Scotland is on a par with that in England.

4799. You keep the money working as hard as it can?——*Mr. Anderson*: We do not keep the money working; our customers keep it working.

4800. *Chairman*: Then, speaking of agriculture in Scotland, You say:

"Not only by tradition but because of the high proportion of small undertakings and the predominance of

agriculture in the Scottish economy, the banks have been the principal, and in many cases the only, source of working capital for many of their customers."

What would you say about the provision of finance for agricultural undertakings in Scotland today?——*Mr. Watson*: The agricultural industry by and large gets the finance that it requires from the Scottish banks. That section of our advances forms in most banks the largest individual section.—*Mr. Anderson*: Four of the Scottish banks are the shareholders of a separate company, the Scottish Agricultural Securities Corporation, which attends to the long-term needs of farmers.

4801. If a man wants to buy a small farm, does he go to the Scottish Agricultural Securities Corporation for the money?——He may go to the Scottish Agricultural Securities Corporation, or he may go to his bank. If he goes to his bank at the present time, owing to the directives the bank is obliged to refuse him; but he can still get it from the Scottish Agricultural Securities Corporation.

4802. Leaving aside the restrictions, would you have made an advance?——If the advance was likely to be repaid over a short period, say, seven years, the bank normally would make the advance. I am speaking here as one of the shareholder banks.

4803. It is not therefore the conception of lending capital that worries you, but the length of time it would be outstanding?——*Mr. Anderson*: Exactly.—*Mr. Watson*: We would extend credit to farmers largely on character, background and faith in their abilities, just as with a normal advance, and in normal times, with freedom from restrictions, we would even do so to enable him to buy a farm, provided the situation measured up on these other criteria as being reasonable.

4804. *Mr. Woodcock*: Seven years again?——It could be, but retaining in theory the right to repayment at demand.

4805. *Chairman*: There would be three kinds of credit involved: for the seasonal movement of paying wages and providing material for the crops; for the improvement to buildings and the provision of agricultural machinery; and for the transfer of ownership, when the man wanted to venture his money in buying somebody else's farm. Could all these needs be catered for by the banks or, alternatively, by the Scottish Agricultural Securities Corporation?——*Mr. Watson*: My bank does not have an interest in the Scottish Agricultural Securities Corporation. Speaking purely as a bank, I would say that all these matters can be taken care of by a bank, should the circumstances of the individual requesting the facilities be right and reasonable.—*Mr. Anderson*: I would endorse that.

4806. *Sir Oliver Franks*: Does that mean that the considerations about which the bank would have to be satisfied before it was prepared to do business are more important than the exact term of years, that the years are flexible so long as conditions are satisfied?——*Mr. Watson*: Yes, so far as credit from the banks is concerned. Credit from the Scottish Agricultural Securities Corporation is, I understand, on a fixed repayment basis.

4807. *Professor Sayers*: In facing a request from a small industrialist would your attitude be the same?——Broadly speaking, yes.

4808. You would be prepared to lend for a quite considerable period to enable him to extend his factory, to put in new machinery, and so on?——Provided we had faith in him, and had reason to believe that he was likely to succeed and that this would help him to do so.

4809. In such a case would you have an arrangement with him whereby he would endeavour to repay so much per year of his loan?——We might or we might not.

4810. *Mr. Woodcock*: I rather assumed that that was implicit in what you said. I did not get the impression that, though you were flexible about the term of years, you envisaged a loan necessarily outstanding for, say, 21 years, which would be necessary in some cases, or that you had the belief that the man would be able to meet your demands if you made them; is that right?——Yes. It is stretching things a bit to talk in terms of 21 years. Again, it depends on what the advance was originally given for. So often it happens that we give an advance for a particular purpose (I am talking now in terms of freedom from restrictions); then that purpose is accomplished and the man comes back and we continue to extend credit to him over a number of years, but for different purposes. To complicate the position a seasonal demand operates in most trades. But it is possible to have a customer, and a very good one, who is a constant borrower from the bank for 21 years.

4811. I was thinking of the case where a man would not be able to repay the whole of it except over a period of 21 years. You said that the banking system in Scotland could take care of all cases. Would it take care of a case like that, or do you bring in this Scottish Agricultural Securities Corporation to deal with such a case?——Mr. Anderson and I are speaking rather as two different parties on this matter; but at the present time, when a man wants to buy a farm and comes to my bank, we have to tell him: "I am sorry but we cannot help you".

4812. Supposing you were not inhibited by any directions, could you accommodate a man who obviously would be repaying that advance in driblets over 21 years?——Yes, if we had faith in his background and the situation justified it.

4813. *Professor Cairncross*: Would you take security?——We might or we might not; it would depend on the nature of the advance. We might if the borrower was a young man and his knowledge and ability and experience were reckoned good.

4814. Is a substantial proportion of your advances unsecured?——*Mr. Anderson*: I should say more than half; about 60 per cent. I am not speaking now with knowledge of the actual percentages in my own bank in the last year or two; but in an investigation made five or six years ago the proportion was about 65 per cent. in volume of advances unsecured. The percentage in numbers of advances is not quite so high as that. But in giving any figures as to the proportion of secured and unsecured advances one might present a misleading picture. Sometimes the security is of a very much more tangible nature than others. For instance, if we lend a sum of £1,500 or £2,000 to a young man starting up in business on his own and take the sole security of a life policy, obviously we are running a considerable risk. The policy protects us in the event of the borrower's death but it does not protect us in the event of his falling into ill health and being unable to earn the return from his business which would enable him to repay gradually his advances.

4815. *Chairman*: Obviously if you are going to get a security realisable at any time there is not much danger involved?——The security is a hedge against something going wrong, something which cannot be foreseen when the loan is given. We have no wish to lend money in order to realise securities.

4816. But it is a hedge against something going wrong. That might be applicable to almost any case with an advance to cover any period. Does it cover the marginal case?——*Mr. Watson*: It covers the doubtful customer, of whose background we might not be very certain but who is prepared to support his request with good security.

4817. *Mr. Woodcock*: What is the size of your advances?——*Mr. Anderson*: Individual advances may be anything up to £1 million.

4818. *Professor Sayers*: In lending for these agricultural and industrial purposes do you feel that there is much competition from other sources of credit, or have the people to come to you or not get the money at all?——*Mr. Watson*: In the case of agriculture at the present time, if a farmer wishes to buy new machinery and comes to the bank first of all and is told he cannot get it, he goes and gets it from the hire purchase organisations. There is that alternative source of finance available to him.

4819. Have these alternative sources been growing?——*Mr. Anderson*: Very much so. There has been very much more competition from the hire purchase concerns because of the fact that our hands are tied.

4820. *Professor Cairncross*: Do you think he gets more credit from his merchants than he previously did?——*Mr. Watson*: He has always had a great deal of credit from his merchants. It is difficult to say whether it is more or less at the present time.—*Mr. Anderson*: I should think rather less; the merchants are also feeling the credit

squeeze. Otherwise I think the small man is suffering more; not at the hands of the banks, but the general effect of the credit squeeze operates to the disadvantage of the small man more than the larger operator, despite the fact that the banks individually are more inclined to sympathise with the small man. We know that the big man can get accommodation elsewhere, but we may be denying the small man his livelihood. Thus we should be inclined to give a borderline case a little more.

4821. *Professor Sayers*: Are you talking now of agriculture alone or agriculture and industry?——Agriculture and industry.

4822. *Chairman*: Mr. Watson, is your experience the same?——*Mr. Watson*: Yes, I think so. The banks try to be as fair as they can in this matter, and not to penalise the small man too much or put him out of business, but in present circumstances it may be more difficult than it normally is for the small man to carry on.

4823. *Professor Cairncross*: Do you think that there have been many cases in which your clients, after being denied a loan, have been unable to obtain the necessary credit?——*Mr. Watson*: I think in quite a number of cases denial of bank credit has meant that the project has been dropped.—*Mr. Anderson*: That probably applies at all levels, despite the greater ability of the big operator to get finance elsewhere. He cannot always get it. And there are people who have such a high sense of public duty that, when the situation is pointed out to them, they decide to defer the capital expenditure and they do not go elsewhere. —*Mr. Watson*: Yes, I think that operates.

4824. *Mr. Woodcock*: Do you vary your rates?——No. We have our minimum rates for lending on cash account, which means at the fully secured rate, and at overdraft rate. These are fixed from time to time.

4825. *Professor Cairncross*: What are they at the moment?——The cash account rate is 8½ per cent., and the unsecured overdraft rate is 9 per cent.

4826. *Professor Sayers*: And is the bulk of the lending at those two rates?——Yes.

4827. *Sir John Woods*: Mr. Watson said just now that he thought a number of projects had been dropped because of the inability of some people to get finance. Would you go further than that? Is there any appreciable number of cases of people who have literally been forced out of business?——*Mr. Anderson*: I have not had much experience of people being forced out of business. They have had to cut their coat according to their cloth, but they have not had to go out of business altogether. There are, always, of course, a few small people who go out of business from year to year, but I do not think that that trend has been accentuated by the present position.

4828. *Professor Cairncross*: Have any of your customers put it to you that, since there is more unemployment in the area, the squeeze should not operate so uniformly as to create further unemployment in Scotland?——*Mr. Watson*: We often get complaints, in exercising the credit squeeze, of the effect that it is going to have on the level of a particular person's business and his capacity to employ. But it is the question that a customer is almost by definition inclined to raise as it affects him only, and not in the broad general sense.

4829. *Professor Sayers*: Have you seen any cases of actual reduction of the labour force in a firm as a result of the credit squeeze?——*Mr. Anderson*: I have seen a few of these cases, but not a great deal.—*Mr. Watson*: I have seen them too; but it is a little difficult to say exactly that the credit squeeze has been the sole reason for them. There may have been other factors; there almost inevitably are.

4830. Has it operated at all to cut down the amount of overtime work being done in a firm?——It is difficult to answer that. Broadly speaking, I should have thought that where a concern is so heavily engaged as to need to employ overtime workers the credit squeeze would be unlikely to have affected that.

4831. *Mr. Woodcock*: I believe that whisky has to mature over a long period, anything up to twelve years. How is that financed?——The period depends on the nature of the blender's trade. He can sell it abroad to some countries when it is still very young, 1, 2 or 3 years. I believe whisky has to be four years old before it can be sold to the American market. Our impression is that blenders try to build up a revolving stock so that they can always have some whisky ready for sale, and they take in new whisky at the other end. The cost of that is carried by the distillers from their own resources in the great majority of cases.

4832. They do not come on you then? It is really part of the fixed capital?——Broadly speaking, yes. The blenders tend to come to the banks to enable them to finance the acquisition of suitable blending fillings.

4833. *Professor Cairncross*: Has there been any tendency since before the war for public companies operating in Scotland to finance their business without resort to the bank, or to go to England?——Many public companies have always gone to the London market for finance. I would not say that the recent developments in the banking field have really had any effect on their decisions in that way.

4834. You have noticed no particular trend for the companies in Scotland to try to keep out of debt?——No.

4835. What about the new American companies and English companies which operate in Scotland? Would they normally seek accommodation from the Scottish banks?——They seek accommodation both from the Scottish and, I think, from the English banks; and they also get money from the parent company if it is an American company or an English company. But many of them run short-term lines of credit with the Scottish banks.

4836. You see no difference between their behaviour and the behaviour of other companies?——No. Having come to Scotland and established their factories there, they are prepared to come to the Scottish banks if the banks are prepared to give them facilities.

4837. There is no body for industry comparable to the Scottish Agricultural Securities Corporation. Has that ever been contemplated?——*Mr. Watson*: At the time of the setting up of the Scottish Agricultural Securities Corporation all the Scottish banks were invited to participate. Some did not do so, so only four out of the six are represented.—*Mr. Anderson*: All the Scottish banks are shareholders in the I.C.F.C.

4838. It does not operate in Scotland, does it, to the extent that it has done in England; or has there been a limited demand?——That is rather a difficult question to answer. The I.C.F.C. are very anxious to do business in Scotland, but they have not been successful to the same extent as they have been in England. That may be because Scottish requirements, particularly in regard to some longer term facilities, have been more readily met elsewhere, perhaps from the Scottish banks or from other sources, than they are in England.

4839. Would you say that you are more ready to make a long-term loan to a firm than the English banks?——*Mr. Anderson*: Yes; they are always technically repayable on demand, but we probably do allow them to stand for a longer period than the English banks normally do.—*Mr. Watson*: I agree with that, as far as my knowledge goes; I do not speak with any real knowledge of English banking practice in this matter.—*Mr. Anderson*: It has to be remembered that we are short-term lenders; we may make exceptions, but we could not afford to make exceptions too generously, because otherwise we would undermine the foundation of our business. Our deposits are all repayable on demand and we can only lock up a small proportion of these deposits for a long period.

4840. You do not feel that there is a lack of an institution in Scotland, that might lend on long-term to industry to supplement what you and the I.C.F.C. are doing?——*Mr. Watson*: We do not think there is any gap at present.

4841. *Lord Harcourt*: You have not felt that there is a demand or a need for a fixed term advance on the American pattern?——A small proportion of our advances have taken broadly the form of an advance entered into to achieve a specific purpose, which would take a number of years and which would be built up towards a maximum and then gradually be paid off. That may fall into the category you have in mind. In making that advance the bank automatically gives up its right to call for repayment at any time.

4842. *Sir John Woods*: Those are the ones referred to in the answer to question 1 (*f*)?——Yes.

4843. *Chairman*: Is there any measure in your mind about the extent to which you can go in for this? I suppose that you have your own capital at the bank, to begin with?——We would regard the capital as reserve available to invest in any manner in which the bank would like, such as the holding of properties or that sort of thing. But I do not think that that would enter into our decision as to what percentage of our deposits we would be willing to advance in long-term fixed advances. If I may answer your question this way: the demand for these advances has not yet reached the stage at which it has been necessary to say: "There must be no more". But that stage will come, and I think it will be for each bank to decide according to its own ideas what is sound in that respect and what may not be sound. It could be that the proportion would be a small one, say something like 5 per cent. of total advances.

4844. I suppose in considering how far you could go the state of your investment portfolio would matter a good deal?——Yes; if, when we make these advances, funds have to be found from the realisation of investments, that is a difficulty in the present situation.

4845. *Professor Sayers*: You indicated just now that the demand for this type of rather long advance is growing. Is that a noticeable growth?——I think so, in so far as it is associated with the establishment of new factories and new plant abroad, involving a long-term business entered into by contractors in this country for the purpose of building and subsequently erecting such plant and seeing it into operation. I make this statement without very much evidence, rather on a feeling; the indication one gets is that Continental bankers are prepared to offer these facilities and that Continental contractors are thereby able to compete with British counterparts effectively, and that there is a demand emerging from contractors for similar terms in the banks here.

4846. You are thinking of the particular field of the export of equipment on these big contracting jobs, not of any general increase in the demand for long-term credit in Scottish industry?——No; though there has been of course a demand for long-term credits for ship building, be it tanker building or ore carrier ships. That may or may not be a continuing trend; it is difficult to say.

4847. *Sir Reginald Verdon Smith*: Do you regard this as a welcome development or a rather unwelcome duty, which you feel obliged to recognise for your customers?——*Mr. Watson*: Speaking personally, it is a development which we welcome.—*Mr. Anderson*: It all depends on the state of our advances at the time the request is made. Our real function is short-term lending, and if we got sufficient short-term lending, up to 40 or 45 per cent. of our deposits, there would be less inducement to do this long-term lending. If, on the other hand, our advances were at a very low ebb, as happened at the end of the war, we would be more inclined then to meet the demands for long-term loans. We should have felt that there was not a great deal of risk in doing this, if our advances represented only 15 per cent. of our deposits.—*Mr. Watson*: I agree very largely with Mr. Anderson on this; my remarks were conditioned by the fact that our overall lending position is low.

4848. *Chairman*: Would you regard the long-term loan as desirable if you made its terms more attractive to yourselves?——*Mr. Anderson*: I do not think that the rate would come into it. Our first duty is to see that our money is available for our depositors when they want it.

4849. I was accepting that; but, if you were free to choose, would you expect the long-term loan to be more remunerative?——I would not say so.

4850. *Professor Sayers*: Your advances are now below the proportion of deposits you have just mentioned?——*Mr. Watson*: Yes.

4851. Do you think that the gap between the limit you would be prepared to see and the proportion that now exists is entirely due to restrictions? Would the volume of advances go up very much indeed if there were no restrictions?——*Mr. Anderson*: If there were no restrictions I would expect our advances to increase. They would not increase so rapidly in the economic climate of today as two years ago, but they would still increase. But I do not visualise in my lifetime seeing our advances even 40 per cent. of our deposits. It would be a long time, I think, before we got back to that.

4852. *Professor Cairncross*: Was not the pre-war proportion well below 40 per cent.?——It was as high as 50 per cent. in the twenties; it fell to about 30 per cent. during the depression; and there was a slight upward trend just immediately before the war. In 1912 the proportion was 62 per cent.

4853. *Professor Sayers*: Would you be prepared to go back to 62 per cent.?——Not as long as I am general manager.

4854. Do you think your grandfather, as general manager, had many more uncomfortable nights than you?——I would not say that, but I think my predecessor of fifty years ago had more real money behind him than I have today. We had been in existence for almost 200 years at that time, and had ploughed back into our contingencies fund quite a large sum of money. That represented sovereigns, and therefore formed a bigger buffer against unforeseen circumstances than our contingencies account does today, looking to the heavy inflation in the intervening period.

4855. Your position was much stronger?——Relatively, yes.

4856. *Chairman*: Does the instability of value in your gilt-edged investments contribute to your reluctance to see the ratio of your advances to deposits rise much more than 50 per cent.?——*Mr. Watson*: I do not think we would be at all reluctant to see an increase in our advances at the present time.

4857. Not at the present time; but Mr. Anderson was indicating that, despite the fact that in the past there has been a larger proportion of advances to deposits, he would not like to see as high a proportion nowadays, even if he could get it?——*Mr. Watson*: My own feeling on that was that it would depend on the circumstances of the time. If there were a large demand for bank credit, and it was in accordance with public policy that that demand should be met, my own view is that the banks would do all they could to meet it, whatever the circumstances of the time might be in relation to investment portfolio values. My feeling would be that there would be a duty on the banks to do that, if it was expected of them, even to the extent of taking a loss, if such loss were necessary, on investment holdings, and the utilisation of reserves for that purpose. I may be not speaking for the Scottish banks as a whole on this matter, but that is my own view.—*Mr. Anderson*: When I said that I would not like to see our advances at 60 per cent., I had in mind that if we continued to hold a liquid ratio of about 30 per cent., and had 60 per cent. in advances, that would only leave us with 10 per cent. in British Government securities. I do not think that that is a situation which even the Government would like.

4858. *Sir John Woods*: What have your advances reached since the war?——*Mr. Anderson*: 26 per cent. in the case of my own bank.—*Mr. Watson*: My figure is 27 per cent. As to the ultimate ratio of advances to deposits I would not care to commit myself on that. It would depend on the circumstances.

4859. *Professor Sayers*: Given that the advances proportion is so low compared with what you would like to see, are there any other directions in which you might think of developing your advances business in the next decade?——The demand for advances is in the hands of the customers. "Other directions" might involve other financial engagements, stimulation of the hire purchase field, for instance. Was your question directed to whether the banks would be prepared to advance money on hire purchase?

4860. Yes. I had it in mind that the Scottish banks in their advertisements do not woo young people to come in and fit up their house with a loan from the bank or with a hire purchase arrangement, whereas the banks in some countries do; and I was wondering if you had any thought of raising your advances proportion by going into that kind of field?——*Mr. Anderson*: We already have one bank competing in the hire purchase field. As a matter of free competition we would have had to do something to meet that, had our hands not been tied by the directives. I do not say that necessarily we would have gone into hire purchase; we might, for instance,

have developed the personal loan business, which we have always been engaged in to some extent but not for the purpose of enabling the borrower to acquire consumer goods.

4861. *Mr. Woodcock*: You did say that you were more heavily invested than the English banks. Is that a purely temporary situation?——I would hope so, but it has been temporary for a long period. It began with the first war when, in the 1914-18 war and the years immediately afterwards, there was a very heavy inflation. In a period such as that debtors are enabled to clear their obligations. Our advances fell very rapidly during the first war, and the Government was pressing for money. We invested in Government securities, and we have since never really got our feet clear of over-reliance on Government securities.

4862. It has not been deliberate policy?——It has not been deliberate policy.

4863. *Professor Cairncross*: May we ask about your liquid assets? Your liquid assets show a lot of difference from those of the English banks. You hold very few Treasury Bills?——*Mr. Watson*: It depends. The amount of Treasury Bills held throughout the year may vary very much from what you see in the balance sheets. It depends on the attractiveness or otherwise of the holding.

4864. Presumably it would not at any time be much more than double the figure of £24 million for discounts, which includes commercial paper?——*Mr. Watson*: It is unlikely to be.—*Mr. Anderson*: The holding of a bank's Treasury Bills at the date of its balance sheet may well be less than half what it is at the end of the calendar year, if the balance sheet is produced earlier. Take the case of my own bank, balancing on the 30th September: the normal trend is for deposits to build up between, say, June and the end of the calendar year, and then there follows a drain upon us to meet taxation demands. By the end of December we might have quite a considerable holding of Treasury Bills maturing at dates over, say, January, February and March, and these reinforce our liquidity.

4865. In addition to what you hold in Treasury Bills, you have substantial advances in the money market at call?——*Mr. Watson*: Yes.

4866. And these might, I suppose, be at least as much as, or larger than, the advances made by the English banks in that way, relatively to deposits?——I would not have said so.

4867. You have a further liquid asset in the form of notes, which differ from the assets held by the English banks since they are your own notes?——*Mr. Watson*: They are a liability. The cover against the note issue appears on the other side of the balance sheet.—*Mr. Anderson*: The Scottish banks have a larger cash holding than the English banks, proportionately.

4868. You are obliged to have a larger cash holding, because you are obliged to have cover for your own notes?——Exactly.

4869. But you can regard the holdings of Bank of England notes as cash for your purposes, even though you could not in a sense realise that cash? It is backing for the Scottish issue?——Yes. It performs a dual function as cover for the note issue, and as part of our general cash reserves.

4870. Do you not count that into your 30 per cent. liquidity ratio?——Yes, we do.

4871. *Lord Harcourt*: Is there any great advantage in having your own note issue?——*Mr. Watson*: We have carefully examined that, as we have to, from time to time, and we are satisfied that, at the present level of circulation, it is still advantageous to the Scottish banks to have their own note issues in circulation.

4872. Is it a profitable operation?——It is. The degree of profitability varies from time to time, and interest rates play their part.

4873. *Professor Cairncross*: Are you not involved in certain costs because of the issue of these notes? You have to sort them, since your practice is that each bank only issues its own notes?——That is right.

4874. You did not pursue that practice during the war. Is it really necessary? Is there no possibility of an understanding between the Scottish banks on that matter, for the interchange of their notes?——The idea has been discussed from time to time, but no satisfactory solution has been found. During the war Scottish banknotes were declared legal tender, and therefore had indiscriminate value everywhere.

4875. Have you made any estimate of what it costs the Scottish banks to sort all these notes?——Yes, we have our own estimate fairly accurately worked out in man-hours.

4876. Can you give us any idea what it does cost? Is it comparable to the cost of sorting cheques, or much less?——*Mr. Watson*: Much less.—*Mr. Anderson*: Only at the very large offices does it mean an increase in staff: in the smaller offices it is a marginal operation, which can be undertaken without any addition to the staff.

4877. *Lord Harcourt*: You sort those notes daily, and you return them to the issuing bank?——Yes.

4878. *Professor Cairncross*: What is the opinion among your tellers?——It is not done by the tellers, as a rule. I may say that the Scottish banks are at present working on the idea of introducing an electronic device to do the sorting, which would possibly cut our costs a little. It certainly would reduce drudgery on the part of the staff.

4879. *Professor Sayers*: Has there been much change in recent years in methods of doing work of this kind, such as the sorting of cheques?——*Mr. Watson*: Yes. These are all now filmed on microfilm.

4880. Have you any estimate of the reduction in the cost of these operations?——I am afraid I have not that with me here. But the employment of female operators on machines for recording the bank's book-keeping has undoubtedly cut the overall salary bill. If it were not for the fact that these girls were there, and we had to employ men to do jobs they were doing in the past, our salaries bill would be substantially higher than it is today.

4881. *Professor Cairncross*: Can I go back to the money which you advance to the money market? What is your general policy there? Are you merely lending what you have to spare, or is there some fixed ratio which you try to maintain?——We are lending what we have to spare, but what we have to spare must be some suitable minimum, so that we are in a position to meet any calls made from day to day.

4882. Do you have some understanding with the discount market about rates?——Yes, we have an understanding which provides for a particular kind of money at a very low rate, which is callable in the event of an emergency.

4883. On much the same footing as the clearing banks?——*Mr. Watson*: It must be, though I was not aware of it.—*Mr. Anderson*: It is a comparatively recent development. We came to this arrangement to help the money market when interest rates were raised substantially a few years ago. Any rise in the rates hits the discount companies, because of their holdings of short-term bonds; the clearing banks decided that they would not pass on the full effect of the rise in rates to the discount companies at that time, and the Scottish banks came into line with a similar arrangement, governing part of their lendings to the market.

4884. Do you mean that you charged the same rate?——No; we normally charge slightly less for our money than the clearing banks.

4885. *Professor Sayers*: You said that your calls from the discount market are related to your desire to maintain a suitable minimum of cash. Would that suitable minimum be different on the balance sheet date and other dates?——*Mr. Watson*: Not necessarily. There are times throughout the year when the bank may be very much more liquid than it is on the balance sheet day. It depends on the circumstances; it may sometimes be sound policy to keep money employed in the discount market, rather than to invest it.

4886. When one of the Scottish banks is making up its balance sheet, does not the discount market say: "A Scottish bank is calling heavily today. It is making up its balance sheet." Is there any reason for that?——*Mr. Watson*: No. I think that would work the other way. I have never heard it put that way.—*Mr. Anderson*: I do not think that that applies to the Scottish banks. It may apply to the English banks with their monthly make-up dates, but it does not apply to the Scottish banks. I think that the Scottish banks regard their cash and liquidity ratio as somewhat more flexible than, perhaps, the English

banks do. It has become almost a fetish in some quarters in London to look for a 30 per cent. liquidity ratio as a minimum.

4887. Are you thinking of the cash ratio? The banks call in order to raise their cash ratio?——*Mr. Watson*: It does not present the same difficulty to the Scottish banks, by reason of the fact that they have these large cash holdings against their note issues.

4888. *Professor Cairncross*: If you deduct the notes that you are obliged to hold, are you not then left with a fairly small proportion of cash that cannot be allowed to fluctuate greatly?——It does not fluctuate greatly.

4889. What does fluctuate is the distribution of your liquid assets between Treasury Bills and money at call?——That is right.

4890. And there will be periods of the year when you are relatively large holders of Treasury bills, which you may then run down and replace with money at call?——*Mr. Watson*: Yes.—*Mr. Anderson*: Rates vary from time to time; there are occasions when it is well worthwhile turning money into Treasury Bills, if you can afford to do so, for a period of three months, whereas at other times the margin is so small that you might prefer to hold the money in the form of money at call in the market.

4891. *Professor Sayers*: That depends on your taking a view of what money market rates are going to be during the next three months. You speculate as to what is going to happen to the Bank Rate in the same way as the discount market does?——We take a view; I would not say it is speculation. If we are anticipating a reduction in the Bank Rate there is a very strong temptation to buy Treasury Bills maturing at three months, rather than to leave money on the market. But our understanding with the market is such that we never denude them of our resources; each bank always has several millions with the discount market, which it would not convert into Treasury Bills simply to get the benefit of a possible change in the Bank Rate.

4892. But you do take this into account in deciding how much to hold in the market, and how much to hold in bills?——To some extent. In my own bank we build up Treasury Bills to meet the tax drain in the first three months of the year, but at other times we normally prefer just to leave the money on the market, unless there is a wide discrepancy in rates.

4893. Is the management of your liquid assets run in London, or is London very closely under the supervision of head office?——A large measure of discretion is given to our London managers. I do not think it would be right that they should be too inhibited in what they are doing on the market, because head office is four hundred miles away. But they keep in close touch with head office; they do not necessarily report to head office before they do something, but they report to us after it is done. We are not left to find out two or three days later.

4894. One of the Scottish banks owns two of the English banks. Does the Scottish bank give the others directions on their money market policy, and on their liquid assets policy?——*Mr. Anderson*: I have no knowledge of that, but I should think it extremely unlikely.—*Mr. Watson*: I think it is most unlikely that that is so.

4895. Similarly, some of the Scottish banks are owned by English banks. Do the English banks concerned give any directions?——*Mr. Anderson*: None whatever. If I may say so, speaking as a Scotsman, the English banks which have acquired Scottish institutions have acted very wisely in leaving the control of the Scottish banks entirely to the Scottish boards. I think that anything else would have inflamed Scottish opinion. So far as I understand, all the banks which are affiliated to English banks have, perhaps, one member of the English board on the Scottish board, and vice versa, and if there is a decision to be taken, that member votes along with the other members of the board; there is no undue influence at all brought to bear from the south.

4896. At the end of this introductory section you mention the services that are provided by the banks for customers. Do you envisage any great extension in the banking habit in Scotland, a growth in the use of banks for the purpose of making payments of money and so on?——*Mr. Watson*: We see an upward trend in the use of the banks for that purpose. It looks as though it may continue.

4897. If one goes back 30 years, would you say that there has been a big change?——Yes, a very marked change indeed.

4898. As the proportion of moderately well-paid workmen increases, do you expect to see more and more of them in the banks?——*Mr. Anderson*: One would hope so. I cannot say that the increase in the business to which my colleague and I have referred has come mainly from workmen. Workmen in Scotland still tend in many cases, where they are interested in saving at all, to use the Trustee Savings Banks.

4899. What about the mass of white collar workers?——*Mr. Anderson*: A great many of them use the joint stock banks.—*Mr. Watson*: Many use the savings accounts of the joint stock banks.

4900. *Mr. Woodcock*: Is it illegal in Scotland to pay wages by cheque, as it is here?——*Mr. Anderson*: Yes.

4901. *Professor Sayers*: Do you want to see an extension of this business?——*Mr. Watson*: We would be very happy to see that, in so far as it is always a good thing to get new customers, although in the initial stages a lot of these accounts would not be remunerative from the bank's point of view. We would like to encourage it none the less.

4902. Have you thought how you might encourage it? Have you directed your advertising towards it? Have you considered the question of banking hours in relation to it?——We have directed advertising towards it, although perhaps not as much as might be done if there were a drive in that direction. As regards banking hours in Scotland, we have an hour's closing of the banks at lunch time from 12.30 to 1.30 p.m., and the normal day's work stops at 3 p.m. so far as the bank is concerned. We have considered the question of extending banking hours, but we decided against it, so long as the banks are to remain open on Saturday mornings. If that were to be altered, then there might be a change.

4903. What about nine o'clock in the morning? What about 5.30 in the evening on one or two evenings a week? Has that been considered?——Not those specific points; but we would have difficulty in making staff arrangements to cope with that sort of thing.

4904. Other concerns have to make staff arrangements to cope with the hours of business; I do not know about Scotland, but in this country the banks used to keep much longer hours than they do now?——The Trustee Savings Bank have a late night once a week.

4905. *Chairman*: Would it involve you in extending the number of your branches again, if you had a great many of these small industrial accounts?——I do not think so, not in its initial stages. If we saw a tremendous expansion in the use of the banks by people of the class we are talking about, then it might.

4906. *Professor Sayers*: An alternative line of development, of course, is for the Post Office to undertake a lot of this work, as it does in many other countries. If it did so, it might take a great deal of existing customers' work off the banks, and might well reduce the number of smaller customers of the banks. Would you envisage that prospect with equanimity?——We should not regard that with favour.

4907. You would like to keep your existing customers, but you are not chasing new ones?——*Mr. Watson*: We should like to encourage all the new customers we can, in all the ways open to us.—*Mr. Anderson*: The continental countries whose Post Offices have given these facilities are those countries which have not a highly developed branch bank system. I doubt very much whether the Post Office could compete with the existing branch banks in this country in the service.

4908. I am sorry, but I cannot accept the facts. Do not the countries in which these systems run include countries which are fully as banked as England and Scotland?——That is not my experience. In Germany, for instance, the number of branch banks in relation to the population is much lower than it is in this country.

4909. What about Switzerland, Holland, and Sweden?——I think it is true there, too.

4910. And Norway? They are very fully banked?——They may have quite a number of banks, but they do not have the number of branches.

4911. I am thinking of banking offices in relation to population; I know that there is no country in the world that can rival Scotland in that. But Norway rivals England?——There are geographical reasons for that; one country which comes pretty near to rivalling Scotland is Canada, where the same conditions apply and where you have large tracts of sparsely populated country.

4912. And Norway, of course, is comparable to Scotland?——*Mr. Anderson*: Yes, but they do not have the branch bank system that we have.—*Professor Sayers*: I think you will find they do.

4913. *Mr. Woodcock*: You say that you did not until recently make any charge for current accounts, and that even now it is modest. Is it that you are more efficient than the English banks, or are you subsidising your current accounts at the expense of your saving and deposit accounts?——*Mr. Watson*: We would not claim any greater efficiency than the English banks. This is a situation which the Scottish banks have allowed to exist for a long time. In Scotland the public expected their banking facilities for nothing, and that has had its effect on the Scottish banks' policy on investments; it has involved the Scottish banks in taking longer term investments, in order to gain a higher yield on the available investible funds. At the same time it has had its effect on making the Scottish banks unable to pay the same rates on deposited money as in England in recent years. It is our hope that by levying this charge which has just recently been devised we may gradually be able to work towards a similar situation to that which exists in England. —*Mr. Anderson*: In the twenties, when, as I have already mentioned, we were heavily invested and the yield on Government securities was high, we benefited as compared with our English brethren, who kept a lower proportion of investments; at that time upon occasions the Scottish banks' deposit interest rates were higher than they were in England.

4914. But you could have made them higher still, if you had charged on current account?——We could; but we were giving the service free. We were enabled to give the service free, despite the rise in overhead costs after the first World War, because of the high level of our investments and the high return we were getting on those investments. In the twenties the average return on our investments was over 5 per cent., whereas at the moment our present portfolio yields around 3 per cent. on cost.

4915. *Professor Cairncross*: Your method of charging is by the number of cheques passing through?——*Mr. Watson*: It has been up to now. We have altered the basis to a charge per notional ledger page of entries (40 entries), so that the charge is now being spread over both cheque transactions and lodgements.

4916. *Chairman*: Then you deal with our question 1 (*a*): "What action is taken when a change in Bank Rate is announced?" What is there in the requirements of your business that makes it necessary, when the Bank Rate is changed, that you should adjust your overdraft rate and your deposit rate?——A rise in the Bank Rate has an immediate effect on the deposit rate in London, and we have to revise our deposit rate upward.

4917. You say that it has an immediate effect. Do you mean that it is the arrangement in London that the banks should make an adjustment?——Yes, and we follow it; and because of the higher charge for deposited money we have to earn a higher income from overdrafts.

4918. *Professor Sayers*: In implementing the requests of the Chancellor about the reduction of bank advances in 1955, and again last September, did the Scottish banks consult with one another on just how the adjustments should be brought about?——*Mr. Watson*: Yes, through the Committee of General Managers. We issued instructions following the 1955 directive as to the manner in which we would expect each bank to carry this out. That manner was thoroughly discussed and was agreed, and was the basis of a circular to our managers.—*Mr. Anderson*: That circular is what is known as a general circular in Scotland. Each bank sends out a circular which is in identical terms to the circulars sent out by the others.

4919. *Mr. Woodcock*: What preliminary discussions did you have before you sent out that circular?——*Mr. Watson*: We had a meeting at which we tried to interpret what the Chancellor was after.

4920. Did you understand what he was after?——We knew that he wanted a "positive and significant reduction" in the banks' lendings over a comparatively short period.

4921. Did you think that that was an adequate way of putting the point to you?——We found some difficulty in finding out exactly what was meant by a "positive and significant reduction". We in Scotland did not feel that the level of our advances or the immediately preceding increase was such as to justify any request for a reduction at all, and we took the view that if we were to make a "positive and significant reduction," it could well be less than what was deemed appropriate in the south.

4922. How did you deal with that situation? Did you solve it entirely on your own?——We did, except that it came to be known by us that the English banks had decided that they would define this "positive and significant reduction" as a reduction of 10 per cent. in the level of advances. We decided in our Committee that 7½ per cent. was an appropriate figure affecting ourselves.

4923. And nobody higher up has subsequently challenged that point of view?——No; but as a matter of fact our reduction went further, as the figures show.

4924. Were you in consultation with the English banks? ——Not directly.

4925. You did not know what the Bank of England thought about your decision?——No.

4926. Nor the Treasury?——No.

4927. *Professor Sayers*: Did the Bank of England inquire what interpretation you were putting upon this phrase?——No.

4928 Did you volunteer the information?——We did not; but we had reason to believe that the level of each bank's advances was very closely scrutinised and watched, and there has been at least one case where a Scottish bank was called in question to explain what appeared to be a move contrary to what was expected of it.

4929. *Mr. Woodcock*: Did you feel a weakness in that you had to work on your own, and were not able to put your questions? Was it that you were not able, or you did not want, to put any questions?——We feel capable of putting our own interpretation on requests of that kind.

4930. Is not the request entirely against your instincts as bankers?——Entirely.

4931. *Professor Sayers*: Did you consider that you were adequately consulted before the 1955 request came?—— No.

4932. *Chairman*: Were you consulted?——*Mr. Watson*: There was no consultation at all. It had become widely known by reason of a letter which appeared in *The Times* about a month prior to this request, and from the returns of English bank lendings, that a very substantial increase was going on, and that that addition was causing embarrassment in more than one direction, so we were not altogether surprised when this directive emerged.—*Mr. Anderson*: There was no parallel increase in Scottish bank advances over the period that Mr. Watson has mentioned.

4933. *Professor Sayers*: And that was one of the reasons for your deciding that a reduction of 7½ per cent. was "positive and significant" enough?——*Mr. Watson*: That was the reason.

4934. *Professor Cairncross*: In arriving at that figure, you presumably excluded advances to the nationalised industries?——Not at that time, but we have done so subsequently.

4935. You quote in the paper a figure of 9·6 per cent., but that is not strictly comparable to the 7½ per cent., since it excludes changes in advances to the nationalised industries?——We fixed that figure of 7½ per cent., in the early days under the immediate influence of this directive; it was at a later stage that it became clear that the authorities wanted the nationalised industries excluded.

4936. Was there any suggestion made to you at any time that export credits, or advances against export credit guarantees, should equally be excluded?——Not at that time. In our own interpretation of what was expected of us we took the view in 1955 that certain types of advances had to be cut, and cut very substantially; this included advances to hire purchase concerns, to the

private individual who had credit for the holding of investments, and so forth. But we did not exclude the possibility of making new advances, while achieving this overall reduction, and one of the new advances that might be appropriate would be an advance of the nature that you have described. The directive which was issued last September is a quantitative one, and there is a specific exception for medium-term credit for a minimum period of three years covered by an E.C.G.D. policy. These are not very frequent in our experience.

4937. There are substantial advances by the Scottish banks to the nationalised industries?——Yes indeed. We take our share of the general level of bank credit extended by banks throughout Great Britain.

4938. Did that decline after July, 1955?——*Mr. Watson*: It has come down as a result of Government policy.—*Mr. Anderson*: At that time, in July, 1955, the Scottish banks took up a strong attitude in regard to nationalised industry borrowing, arguing that, if the ordinary run of customer was to suffer some reduction in credit, the nationalised industries should not be exempt. As a result of that, there was some reduction in the nationalised industries' requirements from the banks.

4939. *Chairman*: You say in the answer to question 1 (*b*) that to give the quantitative restriction practical effect "involves a restriction of the transfer of accounts from one bank to another; the maintenance of this arrangement beyond a very short period is regarded as extremely undesirable and over a term of years well nigh impossible." What are the reasons which make it not only extremely undesirable, but well nigh impossible over a period?——*Mr. Watson*: We like to feel that the banks compete freely with each other, and that when a customer is dissatisfied with his terms he is entirely free to go and chance his luck in another bank. In order to make this directive operate we have had to agree among ourselves that, where a bank has refused facilities to a customer on grounds of credit restriction, no other bank can give that advance.

4940. *Mr. Woodcock*: But surely that does not cut out competition?——There might be a slight difference of interpretation between one bank and another, and in the climate we are operating in at the moment, namely of a quantitative directive whereby a bank's advances are to be no greater on the average than the previous year, it might be possible for one bank to make an advance which another one could not.

4941. I would have thought that the easiest way of competing, where you would get the most competition, would be where one bank was willing to make an advance where another bank was not; but I would have thought that, if that kind of competition was cut out, then competition would become all the keener in other directions?——*Mr. Anderson*: I think it has become keener in other directions.

4942. *Sir Reginald Verdon Smith*: Has the number of transferred accounts declined during this period of restriction, over what was customary before?——*Mr. Watson*: It is difficult to give other than an impression; one's impression is that the number of accounts that are changing hands is less than normal.—*Mr. Anderson*: I would say that it is definitely less than normal. It stands to reason, if there is any question whatever of credit restraint having been put on an account under the terms of the directive, and that account is, therefore, not transferable to another bank. There have been very numerous cases where a customer has challenged a decision of his own bank, and he has not been free to go to another bank to have it remedied. He may go to another bank and, as a result of his approach to that other bank, they may suggest to the first-mentioned bank that they are being just a little too severe; but that does not happen very often.

4943. *Professor Cairncross*: Do you distinguish between the grounds, when turning down anyone? Do you tell him whether he is being turned down on banking grounds, or under the request?——*Mr. Watson*: Yes, in every case the customer is told of that.

4944. So if he is turned down on banking grounds, he can go to another bank and seek accommodation?——The agreement works this way: no bank may take an account from another bank without first of all inquiring what is the reason for the transfer. So if a customer banks with one bank and goes to another and offers his business, then it is the duty of that bank to inquire from the first bank what is the reason for the transfer. That applies not only to accounts that are overdrawn, but to those that are in credit.

4945. *Chairman*: When you say it is "well-nigh impossible" to maintain this, have you in mind that in a practical sense it becomes impossible over a period to deal with these cases of what is a permissible transfer from one bank to another, and what is not?——Yes; and there is also the reaction of the public who use the banks to be contended with. We feel they would not be ready and willing to put up with this sort of thing indefinitely.

4946. On general grounds?——*Mr. Watson*: Yes.—*Mr. Anderson*: They get to the point where they say: "We will have as little to do with the joint stock banks as possible. We will go elsewhere for our requirements."

4947. *Mr. Woodcock*: Where do they go?——They go in some cases to the hire purchase finance companies; in some cases to the discount market by drawing bills; and in some cases in the past they have gone to insurance companies, although I believe the insurance companies have also received a similar directive since then.

4948. *Mr. Jones*: So to the extent that the banks may have restricted credit to creditworthy applicants, that is not the end of the story?——No.

4949. Could we look at this in relation to the banks' attitude to creditworthy customers in what might be regarded as the provision of credit for the healthiest ends of the national economy? You say "The banks have some evidence of new businesses being severely handicapped by restrictions on lending—particularly regrettable in the case of those whose products may have an export potential but which require a period of trial on the home market in the first instance." If you have two creditworthy applicants for credit, one whose business is likely to develop the export market and another who has a profitable industry, would there be any operation of selectivity, so far as the bank manager seeing those two clients for applications was concerned?——It all depends on the purpose for which the advance is desired. If the advance is desired for capital expenditure, and the goods are to be placed, in the first instance, on the home market, there would be no question whatever but that the bank would be compelled by the directives to refuse the facilities. The meaning of this here is that we occasionally have people coming along who have invented a new process, and they want some money from the bank, in addition to their own resources, in order to develop it. According to the directives issued to the banks the banks must refuse advances related to capital expenditure, unless the product is destined for the export market. Now, in the first instance, where a new invention is being developed, it has to be tried out on the home market; indeed it is imperative that there should be a good home market base before you begin exporting. That is what is meant here, that there are some of these cases which potentially have an export demand some years ahead.

4950. *Mr. Woodcock*: But that would be a criticism as to the inadequacy of the direction, not so much the object of the direction?——We can only deal with the directives as we get them.

4951. I think Mr. Jones was trying to get at a further point. Suppose that you have two people, and only enough money for one. Let us assume that from the bankers' point of view they are both identically creditworthy, and that both qualify under the qualitative directives, and that, if you had the resources and were not restricted by the quantitative directive you would grant the credit to both of them. You have to make a decision: does the purpose come into it? Do you take a view of what is good for the economy, in that sense?——We have no experience of that in my own bank.

4952. *Mr. Jones*: But are you not telling us in this last paragraph that the instruction that you have to carry out may be anti-economic, that it may have a dampening effect upon our export trade?——Upon our export potential some years ahead, not upon our immediate export trade. For the immediate export trade we have hitherto been able to give all the assistance necessary.

4953. You mean that we are neglecting to do something, in consequence of this, that might put us in difficulties in

the years ahead, from the point of view of British exports?——Yes.

4954. *Professor Sayers*: I am wondering how deep your objection to these measures goes. Do you think that credit restriction broadly of this kind, but in which you were more closely consulted from month to month as to its operation, its exact terms and so on, would be appreciably less objectionable than the present, or is it that your objection is more root and branch and you would prefer some quite different kind of credit restriction?——We would like to get back to the normal course of credit restriction which was operated by the Government through open market operations, at a time when they could make effective use of the open market operations.

4955. You would rather have a system in which your liquid assets and your deposits both tended to contract, so that you were brought up against the need for reducing advances, if that was what the economy was requiring?——Yes.

4956. And in such a system you would feel that you could carry out a restriction of advances without the disadvantages entailed in the present system?——*Mr. Watson*: I think so. We would like to do away with the present form of credit restriction altogether, and operate within the field of overall monetary control.

4957. You do not think that an overall monetary control, forcing you to restrict your advances, would lead you into anything like these same consultations with each other?——It would be possible in the circumstances to dispense with this agreement, which we do not like, about the interchange of accounts.

4958. *Chairman*: If you were placed under the orthodox compulsion of having your deposits shrunk, and therefore your capacity to give a certain amount of credit at any one time, you would find yourself under another form of restriction in your advances, and each bank would be free to take its own decision?——Yes; and depending on its own reasonable reserves it could adjust matters.

4959. You are envisaging no quantitative or qualitative points made for you by the Government; as bankers you would be free to choose?——Yes.

4960. What would guide you in choosing, within the limits which the situation makes possible, between one advance or another, except the creditworthiness of the borrower?——I do not think there is anything else in the circumstances. We would not be called upon to project our minds into the value of an advance, from the national point of view, and therefore it might be that the quality of the advance from the banker's point of view would be the criterion.

4961. *Sir John Woods*: Would you not yourselves be taking account of the kind of case which you mentioned in the last paragraph of the answer to question 1 (*b*)?——*Mr. Anderson*: In normal circumstances there would be no difficulty whatever about granting advances of this type, provided the applicant was creditworthy.

4962. We are assuming that there is a "conventional" squeeze on you, which is making you selective in your advances.——If there was a conventional squeeze, we would only give priority to those we regarded as being in the national interest.

4963. *Sir John Woods*: That is an added criterion beyond mere creditworthiness.—*Chairman*: Is it not quite an enlargement on the answer I got before?——*Mr. Watson*: Yes; I am not sure whether I agree with Mr. Anderson, and whether he is visualising the circumstances which I am visualising.

4964. *Professor Sayers*: They would be quite novel in your experience?——*Mr. Watson*: Yes.—*Mr. Anderson*: And in mine, but I can visualise the position where, owing to the operation of a conventional credit squeeze, one bank is in a position to make an advance and another is not, and therefore there is no reason why the customer should not change from the bank which is not in a position to make an advance to the one that is. After all, if a banker who is now in a position to make an advance has been following a more conservative policy, and possibly losing a little business because of that, and if that policy has proved in the course of time to have been a wise one, why should not that banker get something back on the swings that he lost on the roundabouts?

4965. *Chairman*: The question we are up against is whether each bank, in taking its decisions about the quality of the advances, without requests made by the Government, would be able to apply in practice other considerations than the creditworthiness of the borrowers as they came forward?——*Mr. Watson*: Yes. Advances for the pure purpose of speculation would always be subject to the closest scrutiny and, possibly, denial. But we have often felt, in operating the present squeeze, that many advances, which did not appear to qualify under the directives in the earlier stages of this credit squeeze, might in the end be even more beneficial to the country's economy as a whole than those which are deemed directly to benefit the country's economy. That being so, with freedom to advance in any direction that was available, the quality of the borrower would surely be the predominant consideration in these hypothetical circumstances.

4966. *Mr. Woodcock*: In that case, there is no reason why you should operate at fixed interest rates; on that basis you would be entitled, and, if you follow it through logically, required, to charge what the traffic would bear?——*Mr. Anderson*: I do not think that would be in the interest of the public.—*Mr. Woodcock*: I do not know if the interest of the public has been emerging in these last questions.

4967. *Professor Sayers*: Could we pursue it a little further? You agree that this would be quite a novel experience throughout all your time of banking?——Yes, and before our time. I would think that within the last fifty years there has been no advance proposal turned down where the applicant was deemed credit worthy, and the purpose of the loan was approvable in Scotland.

4968. How would you and your branch managers decide which of the perfectly good borrowers you would turn away? Have you not been used to saying that, if a man brought a good banking case, you would lend?——Yes.

4969. We are now envisaging a situation in which you cannot lend to everybody of that kind, and there is no national policy telling you which to select. How would you, in fact, do the selecting?——*Mr. Watson*: It would tend to be the person who came first, provided he was a suitable borrower; but of course the level of advances at any one time is not an exact figure. You cannot draw a line through the ledger and say: "These are the bank's advances, and they must never vary". Even in the hypothetical circumstances we are envisaging now, it might be possible to give to the person to whom you deny facilities at the moment all the facilities he wants if he comes back in six weeks or two months' time; and you would probably tell him so.

4970. *Professor Cairncross*: Apart from that, in the particular example taken, creditworthiness would tell in favour of an expanding business, as against a business that was not expanding?——Yes.

4971. And you would take, on purely banking grounds, a favourable view of somebody who was likely to build up a flourishing export business?——Yes, indeed.

Chairman: I think that we will break off for lunch now, and come back again at 2.15 p.m.

(*Adjourned until* 2.15 *p.m.*)

MR. WILLIAM WATSON and MR. A. P. ANDERSON further examined.

4972. *Professor Cairncross*: Could I go back before July 1955, and ask whether in your recollection your advances were then restricted by any Government directives, or whether the level of the advances at that time reflected the level of demand?——*Mr. Watson*: Prior to July, 1955, we were operating under a series of directives that had been issued over a period of years, which said from time to time that certain specific forms of advances were or were not to be encouraged, and we were honouring these directives to the best of our ability. It is undoubtedly true in my recollection that they did have an effect on the overall level of the banks' advances in Scotland.

4973. If these directives had been removed would it have had a substantial effect on your total advances?——

It is conceivable that it might, though it would be truer to say that the demand for credit seemed to accelerate about the year 1955 to a degree which possibly might not have existed in the years prior to that.

4974. Is there any period in the last ten years when in your judgment advances were not seriously limited by Government directives?——There is no such period in my recollection of recent years. This goes back to 1940 when the directives on lending first came into being. Throughout the war years the demand for accommodation was small, the Government having taken over in very large degree the financing of industry.

4975. Would you like to venture a judgment as to how serious restriction was in the period before 1955, and what proportion of additional advances might have been made?——*Mr. Watson*: I would find that very difficult at this stage. Thinking back, I can remember certain advances which were sought that had to be declined. Just what they would amount to in terms of percentage of actual advances I find it almost impossible to estimate. It might be 5, 10, or 15 per cent.; something of that order, but it is very difficult to answer positively.—*Mr. Anderson*: If we eliminate advances for speculative purposes (which were decreed to be improper from 1940 onwards, and which the banks would largely agree should not, particularly under present conditions, be granted), I think that there was a pent up demand from about 1946 until 1955, during which time we had directives not only that certain classes of advances were not to be given, but also that other classes were to be encouraged: e.g. defence expenditure, exports, agriculture, and so on. In the case of my own bank, between 1947 and 1955, I would say that there would have been a very material increase in advances above the level which we eventually reached, had it not been for the restrictive effect of these directives. I would put it somewhat higher than my colleague does.

4976. Since the rise in the Bank Rate last September have you experienced any marked falling off in the demand for bank credit?——Yes; we have experienced a marked falling off in the demand for bank credit from some kinds of customers from the time that the Bank Rate was raised to 7 per cent. It had an immediate effect. Since then it is difficult to disentangle the effect of the rise in the rate from the effect of the changing economic climate.

4977. *Chairman*: What kind of customers?——People engaged in shipbuilding and heavy industry still have long-term order books, and their demands are certainly not diminishing, but are inclined to go the other way. But the great majority of merchants immediately took steps to cut their stocks; they felt that they were now paying too high a rate of interest for the carrying of these stocks. That feeling has been reinforced by the subsequent feeling that prices are more likely to go down than to go up.

4978. Would the distinction between the classes be those whose business is capable of rapid contraction as opposed to those who can only gradually adjust their level of activity?——To some extent, although in one or two special instances I know of people who had plans on hand for capital expenditure and who have changed their plans, partly as a result of the increase in the borrowing rates, and partly as a result of other considerations. But people holding stocks of raw material can fairly rapidly run these down, and that has been done to some extent, where they can be sure of replacements as required.

4979. *Sir John Woods*: Would it be too much to say that by and large the first most noticeable effect is on stockholders?——Yes, I would say that that is true.

4980. *Professor Sayers*: Stockholding by industrial concerns, and not merely by merchants?——More on the part of the merchants than on the part of the industrial concerns; it takes a little longer for an industrial concern to work its stocks down than for a merchant with a quick turnover.

4981. The impact you saw on the demand for bank credit to hold stocks was mainly on the merchant side?——Mainly on the merchant side, and also to some extent on the relic of the personal advances made many years ago. It had suited many such customers to continue to take advantage of the facilities placed at their disposal by the banks, and since probably reduced in amount, but not entirely repaid; but the increase in Bank Rate and the corresponding increase in advance rates was sufficient in some cases to make these people say: "We do not want to borrow any longer from the bank at $8\frac{1}{2}$ per cent. when we only get a 6 per cent. return on our investments.

4982. Did that extend to wholesalers handling mainly goods going into the retail trade as well as merchants in raw materials?——I would say it applied equally to both.

4983. This is a matter of your personal experience?——*Mr. Anderson*: It must be. I can only speak on this subject from my personal experience, and experience may, and frequently will, vary from bank to bank.—*Mr. Watson*: I agree broadly with Mr. Anderson on the subject of the running down of stocks by merchants. There must be a question mark about that, as to whether it is wholly due to a higher rate of interest, or whether, as this period has coincided with some fall in the general level of commodity prices, some downward trend was likely to continue. From my experience I have seen that. I have also seen no real falling off in the demand from the retail end of industry, and new requests coming forward with, in certain cases, C.I.C. consents for bank borrowing, which is a rare thing. Those generally fully replace, if not more than replace, any relief generated by the running down of stocks. That makes the control of the overall level of advances very difficult; without having to control advances to the average level of last year one would have expected to see the level increase somewhat.

4984. *Mr. Woodcock*: Could you sum up whether the effect that has been achieved was the result of the Bank Rate or of the other factors including the limitation on advances?——I would say a combination of both.

4985. Not any one?——*Mr. Watson*: No.—*Mr. Anderson*: I would agree.

4986. *Sir John Woods*: In your judgment Bank Rate at 7 per cent. by itself would not have held advances down; the other measures were necessary in conjunction?——*Mr. Watson*: That is my view.—*Mr. Anderson*: Some other measures were certainly necessary.

4987. *Professor Sayers*: So far as you ascribe results to the change in Bank Rate, do you think those results depended in an important measure on the fact that Bank Rate jumped by as much as 2 per cent.?——*Mr. Watson*: The impact of that had some psychological effect on certain classes of borrowers.

4988. If it had been a jump of 2 per cent. at a much lower range, say from 3 per cent. to 5 per cent., would it have affected people as much, or was there an important advantage from the point of view of the authorities in the fact that the rate had reached an altogether higher level, and that it was now going from 5 per cent. to 7 per cent., and not from 3 per cent. to 5 per cent.?——*Mr. Watson*: I would say that the fact that it was an actual rate of 7 per cent. had a bearing on its effect, and that a jump from 3 per cent. to 5 per cent. would not have had the same result.—*Mr. Anderson*: This question is related to the higher taxation ruling at the present time. A jump from 3 per cent. to 5 per cent. with taxation at its present level does not hurt nearly so much as a jump from 5 per cent. to 7 per cent.; and even 7 per cent. does not hit people quite so hard as it did in the days when taxation was much lower.

4989. *Chairman*: You have referred to the virtual elimination of advances for speculative purposes, from which I get the impression that they were quite a considerable element of bank advances before 1939?——*Mr. Watson*: Yes.

4990. Was one not covered by the Stock Exchange conditions on holding speculative accounts?——Yes, on stocks.

4991. *Mr. Woodcock*: These would always have to be secured?——If a customer wanted to put £10,000 into a certain security with the help of a bank advance of £8,000, we could put it up against the shares purchased. That sort of transaction has virtually been non-existent since the days of 1939.

4992. *Professor Sayers*: Do you mean stocks in the sense of paper securities or in the sense of commodities?——In the sense of paper securities.

4993. *Chairman*: Is there no money left on the market itself, in the hands of brokers, as far as the banks are concerned?——*Mr. Watson*: Virtually none in my experience.—*Mr. Anderson*: There was a marked change

in 1929 in respect of this practice. Even between 1920 and 1929 there was not so much of this advance business for speculative purposes as there had been prior to 1914, and everything was tending to make it a little more difficult for people to risk operating on borrowed money in the Stock Exchange. From 1929 until the outbreak of the last war the level of such operations was very much lower than it had been previously; and then in 1940 came the prohibition from the Treasury. That immediately had the effect of reducing such accommodation still further. No fresh advances have been granted for this purpose since 1940. That goes not only for stocks and shares, but also for stocks of commodities outwith what is regarded as reasonable to the particular business concerned.

4994. *Professor Sayers*: You would advance to enable a man to hold stocks if this was in the ordinary course of his business?——Yes. It varies from trade to trade. A manufacturer who requires to hold three months' stocks could borrow for that, but we should not allow him to take up nine months' stocks on borrowed money, simply because he thought he should speculate; whereas before 1914 we probably should have, if he was a credit-worthy borrower.

4995. Did you finance any appreciable additions to stocks in the Korean episode for people who thought that raw material prices were going up?——No, because we were under the directions from the Treasury that we should not do so. In any event we should not have been keen to do it.

4996. *Professor Cairncross*: In 1951 advances did rise pretty steeply?——Yes, but there were other reasons for the rise at that time.

4997. *Chairman*: You would not doubt that in that period there were, by one means or another, considerable additions to stocks?——*Mr. Anderson*: There may have been, but it was not, so far as the Scottish banks were concerned, on borrowed money. We have always taken these directives very seriously in Scotland; as I have no doubt they do in England, but I can only speak of Scotland.—*Mr. Watson*: If we were aware that finance was required specifically for this purpose it would undoubtedly not have been given.

4998. *Sir Reginald Verdon Smith*: How far can merchants be planning for a situation, arising after 19th September, in which they reduce stock levels and *pro tanto* their borrowing costs?——It is perfectly normal in industry to find a company that requires to buy raw materials holding a stock of three to six months' requirements, or covering itself for that; but it is equally possible to find that, when they think the price is going to fall, they run down stocks a bit, and then buy when they are near exhausting their stocks.

4999. I was thinking more particularly of merchants' stocks rather than of industrial stocks held by the manufacturer?——I think the same argument applies, possibly in a modified degree.

5000. *Chairman*: If more money is required in a period by industry for expanding requirements, is it possible for the banks to ensure that it does not go in fact into a larger stocking up programme?——*Mr. Watson*: It is very difficult for the banks to be entirely sure of that. A company may use a grant of credit in various different directions, and the bank really cannot direct which way it is to be used.—*Mr. Anderson*: If a customer who had no bank overdraft came along, because of rising prices perhaps, saying that he might require to overdraw £40,000 for this purpose, and if the industry was an important one in the national interest, we should have no hesitation in giving the accommodation; but we should be very careful to see that when the need had passed, if it did pass, the accommodation was repaid, or that there was no question of further advances being given ostensibly for this purpose and yet put to other uses.

5001. *Mr. Woodcock*: You say in the answer to question 1 (c): "The banks themselves must always pay due heed to the economic barometer in tendering advice". How do you form a view of the economic barometer? What is the barometer from your point of view?——*Mr. Watson*: It is some assessment of the probable course of economic activity based on a general knowledge of business activity at the time, on commodity price levels and so on.

5002. What is your machinery for forming this view?——It emerges, in my experience, from constant contact and discussion with directors and with chief executives.

5003. You do not maintain special staff?——Not for this purpose at present.

5004. How do you transmit this view to your branch managers who have to operate it eventually?——We keep our branch managers in view on this question by frequent contact with them.

5005. By personal contact?——*Mr. Watson*: Yes, indeed.—*Mr. Anderson*: Next Thursday, for instance, I am having a meeting with our branch managers in the Edinburgh area; I shall have something to say to them and I shall then throw the meeting open for discussion, and I will try to the best of my ability to answer all the questions.

5006. What preparation will you make for that meeting yourself?——As Mr. Watson has indicated, we have wide contacts with industry in Scotland; we are continually discussing these matters with our directors and the heads of industry; we read widely in financial and other publications; and so we come to some idea of what we think the economic trend is likely to be over a short or long period ahead according to circumstances.

5007. You do not employ specialists to do this for you?——No.

5008. *Sir Reginald Verdon Smith*: You say that the banks "can and do apply brakes to over-optimism on the part of the would-be borrowers", and then you go on to say that your resources have always been ample to meet demands. Would you regard it as possible that there might be a situation in which banks apply an accelerator to over-pessimism on the part of unwilling borrowers? Would you see a situation in which banks would be aggressively anxious for business?——*Mr. Watson*: It is difficult to visualise such a situation. The potential borrower must have some belief in his project that requires financing before he comes to you, and even if it were to be considered the banker's duty to inject that belief if it is lacking, he does not have the knowledge or sufficient information with which to do it. If it is lacking it must be lacking for reasons which the borrower thinks are good, and we are inclined to leave it at that.

5009. We are looking at a situation of excess demand and inflation at the present time; but that is not necessarily the only picture to have in mind; and there are, of course, advances on the part of bankers in some parts of the world who are aggressively anxious to encourage people to engage in new ventures?——If a bank, by following such a policy, encourages a customer so to expand his business that eventually he fails and loses his money, it is not a very desirable outcome; whereas if the customer himself assesses the position, then responsibility is his so far as expansion or lack of expansion is concerned.

5010. *Professor Cairncross*: What has your experience been of bad debts? Do you find a proportion of bad debts incurred from year to year?——There is a constant element of bad debts, which varies from year to year in amount. The degree of bad debts in relation to total advances, in my own experience, is fortunately small; but within that small degree the actual amount can vary quite sharply from year to year. Some years it may be that nothing happens at all in the way of new bad debts, and recoveries exceed what has gone; in other years, it is the other way.

5011. It would be well below one per cent. of your liabilities?——Yes.

5012. Is it substantially below what it was before the war?——*Mr. Watson*: Measured as a percentage of total liabilities, yes.—*Mr. Anderson*: It varies so much from period to period. In the early twenties the bad debt experience was low; by the early thirties it was high. Immediately after the war it was again high, because banks were asked during the war to give facilities to industry irrespective of the actual credit-worthiness of the borrower: if a man was engaged in very important war work we were asked to support him. We burned our fingers very badly as a result of that condition in some instances. Over the past seven or eight years the incidence of bad debts has been relatively light, but we have quite

a large number each year. It is the practice of all the banks in Scotland to provide for bad debts each year, and the provision is made on a liberal basis to take care of any possible loss. It is an invariable experience that there are recoveries of some of these debts, and these recoveries may in certain years be sufficient to offset the new bad debts which have emerged.

5013. I take it from what you say you would not expect to have more than one bad debt in one hundred loans you make?——*Mr. Watson*: I think that is a fair assessment.

5014. *Mr. Woodcock*: I take it that this brake you say you apply to over-optimistic borrowers is a refusal to grant the advance?——Yes; or we restrict the advance to a lower sum than requested.

5015. You do not vary the rates of interest?——This may not be universal practice, but in some banks it is customary to charge a half per cent. over the minimum rate where there is a little doubt as to the safety of the advance. It is not more than a half per cent. in any case.

5016. I would have thought, in the light of what you said this morning about the desire of the banks to compete, that there would have been much greater flexibility of the rates and competing with rates, and that it would not just be a question as to whether you could impose a half per cent. penalty, but that competition would take you to a point at which different banks would vary rates quite considerably?——*Mr. Watson*: Where the bank sees very heavy over-drawing on the part of a borrower, the bank would deem it its duty, quite apart from the present restrictions, to restrict the amount of borrowed money that that man should have, because of the risk that he might bankrupt himself; no rate of interest is really going to be an effective barrier to that unless it is absurdly high.

5017. No, but in the lower ranges you could compete for business by a lower rate perhaps?——Within a half per cent. there is not so much in it.

5018. *Professor Cairncross*: Do you not find some of your larger clients are beginning to go to the English banks to get bank credit there, when their rates are slightly lower than yours?——*Mr. Watson*: There is not any marked trend in that direction. Some of our larger customers have been borrowers at our London offices for many years, and get the benefit of lower borrowing rates from our own London offices.—*Mr. Anderson*: It may be in some cases that they are borrowing in London on terms on which they could not borrow elsewhere in London. In England the "blue chip" rate is applicable only to the very large companies, whereas it is possible that some of the Scottish borrowers at our London offices are getting the "blue chip" rate, although they are not strictly speaking entitled to it by English standards.

5019. You make no discrimination in Scotland between the large borrower and the small in the rate charged?——No.

5020. Your discrimination is by security?——*Mr. Anderson*: It is by security.—*Mr. Watson*: It is possible that a large borrower might get an unsecured advance in Scotland at the cash account rate; that is not unknown. The banks recognise that there is discretion to each bank to do that should it wish to do so.

5021. *Professor Sayers*: But not to go below that rate?——Not to go below that rate.

5022. You will be aware that there is a convention in English banking nowadays that the liquid assets ratio shall not fall appreciably below 30 per cent., and some official notice has been taken of that. Is there anything corresponding in Scottish banking?——We are aware of this conventional 30 per cent liquidity ratio, and we have it in mind; but it is not a fixed and firm regulation. It is only conventional as it exists, even in England at the present time.

5023. *Chairman*: Whether it is strictly called a convention or not it is effectively recognised by the English banks by arrangement with the Bank of England?——*Mr. Watson*: Yes.—*Mr. Anderson*: That is of very recent origin. It started as what I might describe as a journalistic fetish in the City. So far as the Scottish banks are concerned we have always regarded the liquidity ratio as a matter entirely for ourselves. For instance, in the twenties the liquidity ratio was as low as 20 per cent. in Scotland.

5024. *Professor Cairncross*: And in the thirties, too?——It may have been. In recent years we have seen fit to step up our liquidity ratios, partly perhaps out of regard for this convention in the City; but even today we do not regard it as absolutely essential in all circumstances to maintain a liquidity ratio of 30 per cent. It may go up to 35 per cent., or, as in the case of one bank, to 40 per cent.; but in other cases it runs down at certain periods of the year to 26 or 27 per cent.

5025. These percentages include all the cash, including the cash held as reserve for the note issue?——As cover for the particular bank's note issue.

5026. Since the liquid liabilities have been rising in relation to deposit liabilities, your cash has inevitably been rising as a proportion of your deposits?——And that has enabled us, practically forced us, to show a higher liquidity ratio.

5027. *Professor Sayers*: During the last three years the Governor of the Bank of England has drawn the attention of the London clearing banks to this 30 per cent., convention. Did he at the same time, or at some other time, communicate on the subject with the Scottish banks?——*Mr. Watson*: No.

5028. *Mr. Woodcock*: You said this morning that you would prefer to be subject to the "conventional" squeeze on your liquidity; if you have this enormous flexibility in Scotland, is that likely to be very effective?——What we had in mind was a combination of open market operations and interest rates, and if necessary for a short time a directive on the type of advance.

5029. Would there not have to be a directive, if you operate with a variation as large as between 20 and 40 per cent.?——It has on occasion risen very high; but in the case of my bank on the last balance sheet the liquidity ratio was 37 per cent., including the cash held against notes of issue. Eliminating that, and eliminating the notes, it was just under 29 per cent.

5030. *Chairman*: What date is that?——28th February, 1957.

5031. *Mr. Woodcock*: Would you have been worried if at that date it had been 20 per cent.?——Yes.

5032. *Professor Sayers*: At what rate would you have become worried as it went down from 29 to 20 per cent.?——*Mr. Watson*: Anything under 26 per cent. would be beginning to be on the low side.—*Mr. Anderson*: In Mr. Watson's case 26 per cent. at, say, August or September would be not too low; but in February it would be definitely too low, because we are then still in the middle of the taxation run-down.—*Mr. Watson*: This liquidity ratio fluctuates in Scotland quite markedly throughout the course of a financial year; at certain periods of the year it may be high for various anticipated and good reasons, and at others it may be a little bit below. We regard this ratio as possibly a desirable level of liquidity, but one which is designed to take up the slack from time to time, and again to receive the overflow, as it were, not as a fixed and positive sacrosanct figure at all times.

5033. It is a figure which would have a fairly effective minimum on purely banking grounds?——Yes.

5034. *Professor Cairncross*: Would not the situation be very different in Scotland from what it would be in England? You do not have the same call money because you can keep your own cash in the till?——Yes.

5035. And the seasonal fluctuations would be different, because there would be fluctuations in the note issue affecting the cash reserves as well as the fluctuations in the fiscal receipts and payments?——Yes.

5036. So the incidence and the magnitude of the fluctuations is different through the year?——*Mr. Watson*: Yes.—*Mr. Anderson*: Speaking generally, the level of the note circulation is low at the time when demand for withdrawal of deposits is high.

5037. *Sir Reginald Verdon Smith*: Does that mean, going back to the answer to question 1 (c) in the paper, that the liquid assets ratio is not in fact, although it could be, by itself the major factor, or a major factor by which you determine things, but is the result of a number of other considerations which you place first?

——*Mr. Watson*: The liquidity ratio is not itself a determining factor at a fixed figure, but the need to maintain the liquidity position is always present, and must be observed. We regard it as capable of flexibility from time to time, and when we think there are good reasons to expect that any reduction of this liquidity ratio will soon be put right we let it run. But we have in view the figure that I mentioned, something like 26 per cent., as the point at which something has to be done about it.

5038. *Professor Cairncross*: It may be important to see how one part of the country stands in relation to advances alone; is not the ratio of advances to deposits rather lower in Scotland than it is in the rest of the country? Has not this always been true?——Not perhaps before 1914. It is regrettable that the demand for credit in Scotland does not seem to have caught up with the acknowledged increase in deposits to the same extent as it has in England, but it is a fact.

5039. *Chairman*: You say in the answer to question 1 (*d*) that "the power to replenish liquid assets is a material consideration and, so far as possible, portfolios, are arranged to provide a regular succession of maturities, variations in holdings being made to secure this objective." Is there any difficulty in the present set-up, beginning with the Treasury Bill, and going on to short bonds and maturities throughout most years ahead of us, in arranging that regular succession?——There should be no difficulty at the present time. The opportunity to re-arrange portfolios since the war has now been taken by most of the Scottish banks. They emerged from the war period with rather big portfolios in some cases.

5040. *Sir John Woods*: You say that there has been a general tendency to invest in shorter-dated stocks. Taking that in conjunction with what was said this morning I have the impression that in all probability the Scottish banks have been in longer stocks to a much greater extent than the English banks?——*Mr. Watson*: That certainly was true.—*Mr. Anderson*: I do not know whether I would say "much"; but to a greater extent, yes.

5041. That would mean that you have not as big a cushion of near-liquidity as the English banks have?——*Mr. Watson*: That is possibly true, but it does not necessarily follow from your question; it might be possible that we have longer da'ed securities in our portfolios, but that we still have relatively as much in the way of short-term securities available.—*Mr. Anderson*: I would doubt whether on the average the Scottish banks have as large a proportion of their investments in the five-year bracket as the English banks have; but it is guess-work on my part as to what the English banks have, and as to what the competitor banks in Scotland have.

5042. *Professor Cairncross*: Do you not think that it would be useful if figures for the distribution of your investments by maturities were available to the public? I do not suggest that each individual bank should disclose figures of that kind, but rather that it might be useful from the point of view of general monetary policy if figures were published that showed for the aggregate of the banks how their investments were distributed between different maturities?——This question rather takes me by surprise. If we were giving this information in global form for the Scottish banks as a whole, and if from that information it appeared in a certain month that the Scottish banks were going longer in investments, what reaction would the public have to that announcement?

5043. *Chairman*: Let us for the moment leave the public out. Suppose that you were a monetary authority and concerned to operate a monetary policy on behalf of the Government; would not the availability of the figures on this question be important to you?——*Mr. Watson*: It might quite well be important, and the Scottish banks would probably be willing to give this information, if it were known that it was not for public dissemination.

5044. If it were important for the purposes of implementing monetary policy, and I can see a reason for saying that inevitably it would be of some importance, would it not be desirable that the people who have to operate the monetary policy should have the assistance of public knowledge of what they are doing and public discussion of the measures they have taken? You need not answer that; it is a purely policy question. But that is the basis of what we are asking you.——If you wish me to comment on the question, it is obviously stateable; but is it not equally true that hitherto monetary policy has been decided and framed by the authorities without the knowledge of the public as to what factors they take into account in doing so?

5045. *Mr. Woodcock*: Our problem is whether they have done it well or not?——Some public comment on these figures might be misleading, and might be unhelpful rather than helpful.

5046. *Professor Cairncross*: The same is true of a great many other statistics that are published; the gold reserves, for instance.—*Chairman*: What do you mean by "unhelpful"?——One sometimes wonders whether the intimation that the gold reserves of the country are so much every month is a good thing for the country to know. It seems as if certain opinions are formed on the basis of figures which are similar to a photograph of a moving train, and conclusions are drawn that have the effect of exaggerating subsequent events.

5047. *Sir John Woods*: Something may turn on what one means by the public. There is a good deal of informed, and indeed expert, discussion on these questions that goes on in public. Is it not a good thing that people so qualified to discuss these things should have this sort of information, because they will go on discussing it even without the knowledge?—*Professor Sayers*: It is a question whether they have accurate knowledge or inaccurate knowledge. Is it not in the interests of the working of the system that the knowledge should be as accurate as possible?——*Mr. Watson*: Most decidedly.—*Mr. Anderson*: I hope I am not going off at a tangent when I make this observation: the banks are, like other business concerns, concerned with their profit and loss account. The more statistics you want from us the heavier the debits to our profit and loss account, and that is a matter which as business men we must take into account. It is not that we are unwilling to give the authorities all the information that they need, but I doubt whether we conceive it as our duty to extend beyond that.

5048. *Professor Cairncross*: Do you at any time inform the Bank of England what your maturity distribution is?——*Mr. Anderson*: We have never been asked for that so far as I am aware. We were asked for some information recently, but I do not think it extended so far as that.—*Mr. Watson*: It did not take into account maturity dates. Many of the Chairmen of the Scottish banks make intimation, as do the Chairmen of the English banks, in a general way as to the character of their gilt edged portfolios: that it is all repayable at fixed dates, and a certain proportion within so many years.

5049. It is rather important to know what you do for your purpose on this. Do you have a break at five years? Do you distinguish between short and medium term bonds for your purpose?——*Mr. Watson*: Yes, I can confirm that; and each bank will no doubt take its own way after that. In my own bank we go from five to fifteen as the next category.—*Mr. Anderson*: In my bank we have the first bracket as under five years, the next from five to ten, and a third from ten to fifteen. Anything over fifteen is infinitesimal.

5050. *Professor Sayers*: It would be no great labour to tell the Bank of England what these figures are?——Not in this particular respect. When I was indicating the costs of providing statistics I had in mind requests varying over a much wider range.

5051. *Mr. Woodcock*: You might be willing, I understand, to provide some information to the Bank of England or to the public authorities, but not to the public generally. But it would not cost any more to make it public?——There is this trend for more and better statistics. These can only be supplied at a cost to the provider of the statistics. Even the operation of the credit squeeze has involved the banks in very heavy expenses; it takes twenty times the time to deal with an application for an advance, or for some advances, now than it would have done before the war.

5052. *Chairman*: I think we appreciate your general point. I do not know what charge you would make against the Revenue for operating the P.A.Y.E. system?——We are in the same boat with other people in regard

to P.A.Y.E.; perhaps we are rather more vulnerable on requests for statistics.

5053. *Professor Sayers*: On the last paragraph of the answer to question 2, given the disadvantages of the present system of credit squeeze, have the Scottish banks any views on alternative ways in which bank lending might be restricted, if the authorities decided that bank lending should be restricted?——*Mr. Watson*: We recognise that, if at any stage bank lending is going to be too high, a directive to the banks is probably the most effective way of putting a check on that. But in order that it should be fully effective we consider it should be coupled, as on this last occasion, with an upward movement in interest rates and proper open market operations to control the credit base.

5054. Suppose that you have a situation in which all the banks are well supplied, not only with liquid assets that they consider satisfy their present liquidity requirements, but also with such a volume of Government securities that are getting near to maturity within two, three or four years, that even very big open market sales by the authorities still leave the banks with a sufficient liquidity; if that is the situation what means do you consider should be adopted to enable the authorities to force credit restriction quickly?——It would have, as we see it, to be by direct request in the form of a directive.

5055. You would rather have a direct request of the present kind than a system like the Australian system, for instance, whereby liquidity is absorbed directly by the central bank?——We would rather have the directive, on the assumption that the directive is not going to be another lasting thing. That is our one reservation on directives: they come, and they stay, and they are never removed.

5056. Given that one may have these directives for quite a long time, long enough for the disadvantages to become very real, is not some alternative worth looking at?——In the particular circumstances which you are picturing, it would seem that some other measure might have to be found; but the particular circumstances that you are describing are possibly a little remote.

5057. Are they so very remote when such a large block of the national debt is short term? Am I not in fact describing the present situation of the banks? The English banks are certainly well stocked with Government securities under five years, and we believe from your Chairmen's statements that you are. Over and above your conventional liquid assets you have quite a big cushion which you could use to support your liquid assets if the liquid assets were reduced by open market operations?——Yes.

5058. Would that not stultify the effect of a successful funding policy on bank credit?——The banks are probably in a position to minimise the effect of such a policy.

5059. That is the situation I am envisaging; is it so very far from the present situation?——*Mr. Anderson*: There is one difference. With the present situation the Government has not got the monetary control by natural processes that we think it should have; in other words it does not have a balanced budget.

5060. It has a balanced budget in the sense that its current expenditure is more than covered?——I think they would need to go a bit further before they could get the control which is desirable; in other words they would need to get to the point where they could fund a very large portion of the present issue of Treasury Bills without recourse to the banks.

5061. Are we not in precisely the situation that I said: that the banks have this supply of near liquid assets that would stultify anything the Government can do in the next couple of years?——I cannot see it, because even at the present time, or within recent years, the Government have given indications to the banks through the Bank of England that they would expect certain new issues of loans to be taken up from the proceeds of maturing loans.

5062. Your suggestion is that there should be a forced funding?——It is not a forced funding, but an indication of the Government's wishes.

5063. An invited funding then?——An invited funding.

5064. *Chairman*. Were you referring to the 1951 serial funding operation?——I cannot just give you precise dates; but there have been occasions when the Government have intimated that they would expect the banks to take up a new issue out of the proceeds of the maturing issue.

5065. How does that intimation come to you?——Through the Bank of England to the Chairman of the Committee of London Clearing Bankers and to the Committee of Scottish Bank General Managers.

5066. *Professor Cairncross*: How often has this happened in the last ten years?——It could be often if the Government was at all anxious at the time. The probability is that in many cases the loans matured and new loans were subscribed in the ordinary course.

5067. You would prefer a forced, I mean "invited", funding to any other system?——I would.

5068. What length of bonds would you be prepared to be invited to take up?——That is rather a difficult question, but I would say that a bank could not be invited to take up a bond of a longer life than ten years at the outside. The bank's normal process, in the case of a security maturing in 1958, would be to allow it to mature and buy something repayable about 1968 or shorter.

5069. Would you think it necessary that there should be any sanction behind this invitation?——Is there not always a sanction behind an invitation from the central authorities?

5070. *Chairman*: I do not quite follow that. What is the sanction?——There is the Bank of England Act, for one thing.

5071. It has never been put into operation?——It has never been put into operation, but it is in the background. I should like to assure the Committee that, as far as I know them, bankers are most anxious to do what is best for the country, if only because they believe that what is best for the country is also best for the bankers in the long run.

5072. Supposing you did get into a situation in which you, having in mind the advantages to the country, did not agree with the action being taken by the Bank of England?——There have been many such occasions in the past.

5073. Then you have always done what they asked you?——We have done what they asked, but under protest in some cases. There have been varying degrees of protest, through Chairmen's speeches and so on.

5074. *Professor Sayers*: Would you prefer this "invited" funding to any system whereby the central bank called for special deposits, comparable to the Australian system, or a system of variable reserve ratios?——Speaking for myself now, not for the Committee of General Managers, I would much prefer the compulsory funding, if only for this reason: we had Treasury Deposit Receipts during the war, and I think it was most unfair that the Government allowed a rate of interest of only ⅝ per cent. per annum for the greater part of the time these Treasury Deposit Receipts were in operation. What happened was that there was inflation, our overheads were mounting year by year, and we were the only people in the country who were not allowed to increase our revenue in order to offset that expenditure.

5075. The attraction of an "invited" funding is that you get the market rate?——We get the market rate.

5076. If the Government chooses to set that market rate low by its influence at the short end of the market, you would take it?——That would apply right through the system. My point is this. Take the case of a bank with deposits of £100m. at the outbreak of war, and say that these deposits rose to £150m. by the end of the war. If the Government siphons off that £50m. and allows a purely nominal rate on it, then that is out of all proportion to the heavy increase of the overheads of the bank during the period. That is why the T.D.R. system operated unfairly. It also had the disadvantage that it was not a marketable security, and we as bankers have always uppermost in our minds the thought that the customer must be able to get his money when he wants it; so that from the theoretical angle the Treasury Deposit Receipt is not a good instrument from the banking point of view.

5077. You prefer to be invited to take a marketable security. What is there, from the point of view of the central authorities, to prevent you from marketing those and so defeating the object of the funding?——I do not see how you can get away from that.

5078. You could get away from it by compelling the banks to take an unmarketable security, could you not? That is the special deposit system?——I object to that on the ground of unmarketability.

5079. *Professor Cairncross*: You feel equally strongly about reserve ratios prescribed by monetary authorities?——Yes, because I have the feeling that these ratios would be in operation long after the need for them had passed. Each bank is in the best position to determine what liquidity ratio it requires itself. I think also it would have complications in regard to the gilt-edged market. If the Government raised the liquidity ratio required then we should have all the banks trying to sell investments at one time.

5080. *Professor Sayers*: But if one leaves the individual banks entirely free to determine their liquidity ratios, whether they do or do not sell their short-term securities, the authorities have no control?——They have control if they are balancing the Budget and are in a position to exercise strong open market operations, which they cannot do for any length of time at the present day.

5081. But that depends upon what the rest of the people are doing about their holdings of securities. If other people are tending to throw securities on to the market, or if concerns, whether nationalised or not, are selling a large amount of securities in order to finance new capital development, then is not the Government up against the problem, whether it is balancing its Budget or not?——It can take steps to remedy that.

5082. May not the steps take a very long time to act if they are limited to raising the rate of interest, which is your other suggestion?——Not only raising the rate of interest.

5083. What else?——Open market operations.

5084. You mean that the Government should press the sales of its long-term bonds, never mind whether that forces the rate of interest to 20 per cent. or 30 per cent.?——I was thinking more of the Bank Rate; you are talking of the yield on Government securities now.

5085. I was thinking that, if the Government is to do everything to the banking system by its open market operations, that may lead it into open market operations on such a scale that the long-term rate of interest is forced up to very great heights; would you be prepared to envisage that?——I would not like to see it going up to very great heights, but I doubt whether that would in fact happen in the circumstances you mention. We have never seen that in the past. When the Government had full control of the money market we never saw rates of interest being forced up to very large heights.

5086. *Professor Cairncross*: Suppose that the liquid assets in this country were not greatly changed, and it was necessary to operate through open market operations; these would presumably reduce total bank liabilities quite substantially; that would be the object of the operations. The banks would then require to dispose of assets, presumably investments, in compensation for the reduction in their liabilities. These heavy sales of investments would surely produce an effect on long-term rates?——Yes, they would.

5087. And might in fact be very difficult to make?——I think you are envisaging far heavier sales than I hope would be necessary, provided that we had a balanced Budget and that the floating debt was gradually funded. I realise that the Government cannot fund a floating debt of £2,000m. in a matter of months, but they could make a start.

5088. *Professor Sayers*: If they only make a start and do not do it in a matter of months, then it may well take three or four years?——They would need to keep on the present directives for that period.

5089. You would rather have that than any other system?——Yes I would.

5090. *Chairman*: I think the heads of your objection to the Treasury Deposit Receipt are two: (1) that it provided the banker with an asset that was frozen for an indefinite time contrary to his principles; and (2) that it enabled the authorities to fix what in your opinion was an unreally low rate of remuneration on that deposit?——Yes.

5091. The objection to the compulsory liquidity ratio was that you feared that, once it was imposed, it might be kept on for an unreally long period of time without the necessity of the situation requiring it?——Yes.

5092. Would these objections be mitigated if you felt you had a more constant and effective relationship with the central authority, so that your point of view could be actively and regularly represented?——*Mr. Watson*: We have ready access to the central authorities, and we have frequent contact with the Bank of England. That applies not only to the Chairman of the committee, but to all the general managers. We are not in any way out of touch.

5093. *Professor Sayers*: But in July, 1955, you appear to have been left in the cold?——Yes, in July, 1955, the request came on us without any prior intimation; that is correct. I think I see the problem which is being posed, and it is a very difficult one to which to provide a proper and effective answer in all circumstances. I agree with Mr. Anderson that we should he very sorry indeed to see the reinstitution of Treasury Deposit Receipts again, and also to see this other possibility of deposits with the central bank. Our attitude on imposed liquidity ratios remains as stated in our written submission, that we do not like them, and see important disadvantages in them coming on, and fluctuating and so on.

5094. Is it not a matter not of simply saying that there are disadvantages, but of choosing between the disadvantages of this and the disadvantages of the present system?——Those are indeed many, and we have already referred to them, but we are persistent, in the present state of affairs, in the hope that the need for continuance of the present system would disappear for other reasons. We are dealing with a necessity to control credit which has arisen because of special circumstances, which will not always be with us. At a time when trade shows a less spontaneous desire to expand it may be possible to operate the present system as we have had it in the past.

5095. *Sir John Woods*: In your answer to question 2 you say—". . . certain automatic checks on the expansion of purchasing power no longer operate." Could you be a little more specific as to what you mean by "certain automatic checks"?——We are talking about the Gold Standard, and the effectiveness of interest rates at a time when taxation was much lower.

5096. *Chairman*: In the answer to question 3 you say:

"Increases in Bank Rate resulted in substantial withdrawals of deposits by customers for investment in Treasury Bills."

What class of customer was that?——Large industrial companies who happened to have certain liquid funds with us at the time.

5097. Was their switch primarily the result of their having a financial manager who was interest conscious?——Exactly.

5098. *Professor Sayers*: For the Scottish banks as a whole, would this movement run into seven figures or eight figures?——*Mr. Anderson*: I would say seven figures for each bank. In the case of my own bank, which is now the smallest of the Scottish banks by virtue of the amalgamations which have taken place elsewhere, our losses here would be in the region of a few millions.——*Mr. Watson*: It might well be eight figures overall.

5099. *Professor Cairncross*: Over what period?——*Mr. Anderson*: That was just over two years ago, in 1955. We have not seen a continuance of that tendency. The big money deposits to some extent have gone. We had a recession in deposits at that time of several million pounds, which so far has been permanent. There has been very little variation since then.

5100. *Sir John Woods*: You say:

"It is not apparent that this restriction has contributed in any marked degree to the restraint of inflation . . ."

That may be so; but is it not possible that without restrictions the inflation would have been worse?——*Mr. Watson*: It is indeed possible.

5101. You are not implying the restrictions had no effect?——No, we are not implying that. What we are trying to get at in this paragraph is that we see other people taking on the function of banks. I have made clear our views as to the desirability of the maintenance

of these directives on the banks as the most acceptable of the several alternatives, but I should like to couple with that the statement that we want to see proper control exercised over competing lenders.

5102. *Professor Sayers*: If these competing lenders are so many and various, if there is such an expansion of credit between traders, for instance, that the aim of the restriction on bank credit is being substantially defeated, you surely would not say that the remedy for the situation is to have an enormously elaborate mechanism of direct control of credit?——No, we hate controls as such; but if the authorities control one section and leave another free, which seems to be the case now, then finance companies can seek all the money they can get from the public on deposit and lend it more or less at their own discretion in whatever direction they like. That does not seem to me to be a desirable state of affairs.

5103. It follows from that that one should aim either at more extensive control or at less control. When I put to you the possibility of having less control of the present kind you said that you would rather stick to the present control. The alternative of having more control might well be the development of a Schachtian system?——Not as a pemanency. Our feeling in preferring the directive is in the hope that it would prove a temporary necessity.

5104. *Professor Cairncross*: In the answer to question 4 you refer to borrowers who are "inclined to defer their negotiations for funding arrangements". Are borrowers from the Scottish banks in a position to defer these negotiations? Are they not under some pressure from the banks to push ahead with their funding arrangements?——Yes indeed; but it is possible to find a borrower who plans for expansion and who, having indicated that he would like to have bank credit to see him through the initial stages of this operation and having been told he can get it from the bank, then gets Capital Issues Committee permission for borrowing on these terms.

5105. Your point here is that he may hang on longer because the new issue market is difficult or expensive?——*Mr. Watson*: More expensive, yes. In fact he shies off permanent borrowing as long as he possibly can, and continues to rely on the bank, in some indirect way possibly, for his financing needs. We bring what pressure to bear on him we can, but he may seek temporary finance to ease him out from another quarter.—*Mr. Anderson*: There are a few cases where the bank borrowing was made under Capital Issues Committee consent. Where that is the case it is a little more difficult for the bank to press the customer, particularly if he is an important customer, to get rid of his bank indebtedness now and fund the debt.

5106. *Sir Oliver Franks*: You have been saying that you prefer the present system of voluntary restrictions on our banking activities to an enactment which would restrain them in one of a number of different ways, provided that it is a temporary necessity. Is the general view of the Committee of General Managers in Scotland that the nature of the experience we have had during the last ten years is in fact likely to prove exceptional? Take the prevailing high demand, the tendency to push demand on resources right up to the limit, the accompanying inflation, and all the other features with which we are familiar; do you think that it is reasonable to assume that more probably than not these will not characterise the next decade? And, if that is not so, where does your main argument go?——*Mr. Watson*: One must admit that hoping for directives to remain a temporary necessity is hoping for a lot. What governs the whole situation as we see it more than anything else is political considerations. It would appear to be a perfectly valid statement on pure economic grounds that a situation might come about whereby neither directives nor any form of control would be necessary, but with our two main parties equally wedded to a policy of full or near-full employment, and all that that means in creating demand where demand might not otherwise exist, we have to admit that the prospect of overall demand falling to a point at which the present very liquid position of the banks is altered and the banks can be left to work in an untrammelled way is unlikely. It is unfortunate, as perhaps you have detected from our answers, that the influence of politics and political methods is a very important part of all this present difficulty that the banks are now faced with. But, briefly, we stick to our answer, which is that we prefer the devil we know to one we have not had. We think that by and large it has worked well; we do not think it can work indefinitely; we make it clear we do not think that this is a permanent form of control. It may be that a form of invited funding will have to take its place, but we approach all these various other methods of control with a good deal of reserve.

5107. *Sir John Woods*: You say here:—

"So long as there is an expectation that depreciation of the currency will continue in line with the experience of recent years, interest rates, even at the present level, cannot be expected to exert much pressure towards the deferment of capital expenditure."

You are contrasting that with people's unwillingness to fund an overdraft. If some people, at any rate, regard the rather dramatic rise of the Bank Rate to 7 per cent., plus the pronouncements of the Government, as making a real effort to check inflation, then is it not a little early to say that a 7 per cent. Bank Rate is not likely to have much effect on deferring capital expansion?——*Mr. Anderson*: I do not think we said that; I think we said that it is not likely to have much effect *by itself*.

5108. Does this quotation mean interest rates unaccompanied by other measures?——It is governed by the opening clause: "So long as there is an expectation that depreciation of the currency will continue, etc.". You have to get rid of inflation.

5109. Was not the 7 per cent. Bank Rate obviously meant to be a signal, and a dramatic one, to everybody that the Government intended one way and another, with other measures, to stop inflation?——We have had very many assurances over the past few years.

5110. You have not had a 7 per cent. Bank Rate. You have not had an absolute ceiling on advances, or the restriction of the programmes of nationalised industries to stabilise the figure. May there not be some people at any rate who take it quite seriously and say: "Here is a good chance of checking inflation; if so, let us wait, we do not want to raise money at 8½ per cent."?——There is no doubt some people have taken that view; but in the face of repeated disappointments of Government action following Government statements, other people are more dubious, and inclined to think: "We shall believe that inflation has stopped when we see that it has stopped."

5111. I do not deny there are many doubting Thomases; but I thought there were some faithful followers who would defer capital expenditure?——*Mr. Anderson*: We have seen some evidence of people deferring capital expenditure.—*Mr. Watson*: This note was written just after the Bank Rate had been raised to 7 per cent. The opening sentence of that paragraph which you are quoting implies what we have in mind: "Until recently movements of interest rates . . . had not by themselves exerted" etc. We reserved judgment on the effect of the 7 per cent. Bank Rate at that time, because we had no evidence. In the next paragraph we go on to discuss the 7 per cent. Bank Rate.

5112. Is that not mainly in relation to funding arrangements? I took it that you were contrasting capital expenditure on building factories and equipping them and so on on the one hand and funding arrangements on the other?——*Mr. Watson*: I am sorry, Mr. Chairman; we have not expressed our views clearly, as Sir John has pointed out. What we had in mind was that at the time of writing this we did not have enough evidence to say what the effect of the 7 per cent. Bank Rate was going to be either on those who wished to borrow for capital expenditure, or on those people who had money and wished to lay it out for capital development. The urge to do that obviously exists as long as people think if they do not do it this year it will cost more next year. We were not clear whether 7 per cent. made any difference to that.—*Mr. Anderson*: We have also been a little at fault in the construction of the second sentence. We start off by saying: "So long as there is an expectation that depreciation of the currency will continue". That gives the impression that we feel that is still the position. It would have been better if we had written: "*If* there is an expectation that depreciation of the currency will continue".

5113 *Chairman*: In question 6 we raised this point about possible defects in the law of Scotland. I gather that that is not really a question you want this committee to go into; there are other more direct organs for bringing about alterations in the law of Scotland?——*Mr. Watson*: That is, if I may say so, very fair, Mr. Chairman. We bring out in this memorandum that these fundamental legal differences exist between Scotland and England. We would like to see those ironed out. If we could gain your support for that view it might help us. Scottish legal committees are slow to move in a matter of this kind.

5114. On general grounds, if you increase the power of the borrower to dedicate his assets to the lender, which is what is really involved in facilitating the giving of security, you may prejudice the interests of a great many other persons when the moment of crisis comes: the small creditor or the employee, all those who are normally looking to the assets to provide their debts or their wages. There is an advantage in favour of facilitating commerce by extending the range of the security or the easiness of it; but is there not also an argument against it?——Yes, we recognise that.

5115. I feel that it is difficult for us merely to consider the facilitation of the giving of security. You have your other avenues: you can go to the Scottish Law Reform Committee or to the Secretary of State for Scotland to alter the law of Scotland?——Indeed we could do so; and, if you would not wish to make any reference to this, we are quite happy to leave it at that.

Chairman: I think it would be better that you should exercise more direct pressure elsewhere. Are there any other questions? Then we have spent what has been from our point of view a very useful day, and we are very grateful to you, gentlemen, for the help you have given us. ——*Mr. Watson*: Thank you very much indeed; it has been a pleasure to be with you.—*Mr. Anderson*: Thank you, my Lord Chairman.

(Adjourned until Thursday, 27th February, 1958, at 11 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-FIRST DAY

Thursday, 27th February, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (Questions 5116 to 5288 and 5354 to 5524 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E. (Questions 5289 to 5524 only)
SIR JOHN WOODS, G.C.B., M.V.O. (Questions 5116 to 5288 and 5335 to 5524 only)
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

PERCY LIVSEY, ESQ., C.B.E., Managing Director, Mutual Finance Ltd., P. J. GREAVES, ESQ., a Director, North Central Wagon and Finance Co. Ltd. and R. E. ALLEN, ESQ., Chairman, Deputy Chairman and Secretary respectively of and representing The Finance Houses Association, Ltd., called and examined.

5116. *Chairman*: We would like to take the memorandum* which you have been good enough to give us through page by page, and see what points emerge on it for questioning. You open by giving us the names of the twelve members that comprise the Association, and you say that membership of the Association is restricted to companies having paid-up capital and free reserves of not less than £500,000, which engage in hire purchase finance on a national basis. Did all these members come in at one blow, or have there been admissions since foundation?——*Mr. Livsey*: The admissions since the Association was formed have been the Astley Industrial Trust Ltd. and the Wagon Finance Corporation Ltd. The Astley Industrial Trust came in some years ago and the Wagon Finance Corporation only recently. The Scottish Midland Guarantee Trust Company also came in not at the formation, but quite a time ago.

5117. How long have you existed as an association?——Since 1946.

5118. But many of you have been in business for many years before that?——*Mr. Livsey*: Yes. For instance, Mr. Greaves' company goes back to 1861.—*Mr. Greaves*: North Central Wagon and Finance Co. Ltd. is, I think, the oldest in the country, and probably the oldest in the world.—*Mr. Livsey*: The British Wagon Co. Ltd. goes back, I think, to 1869. United Dominions Trust goes back well before the war.

5119. Do you have a set of rules governing the conduct of your members?——We are a limited company, and we have a memorandum and articles of association which set out our objectives.

5120. What are the objects of the Association?——We formed it in 1946 because we visualised a lot of legislation and negotiation on legislation. Our primary object is to represent the industry, if one can call it that, in negotiations with Government departments, banks, and people of that type.

5121. *Sir Reginald Verdon Smith*: Had the wagon companies already considerably diversified their interests before nationalisation of the railways, or was the liquidity created by compensation and so on a substantial factor in this diversity?——*Mr. Greaves*: They had appreciably diversified their interests, starting really after the first world war. During the early 'twenties they went first of all, as a natural corollary to rail transport, into road transport heavy haulage vehicles; and then into motor vehicles, and plant and machinery of all types. There was a sizeable payment of compensation to the wagon companies when their fleets of railway wagons were nationalised, and that, of course, did put them in funds.

5122. *Professor Cairncross*: Are all the members interested in consumer finance as well as industrial finance?——*Mr. Livsey*: You will have to define "consumer finance" for us. We have never yet been able to define it.

5123. In the case of motor cars it would be very difficult. Perhaps if I ask you whether you all engage in financing durable goods for sale to consumers, that would be easier?——We cover the complete range. Apart from motor vehicles we finance machinery, contractors' plant, machine tools, and then, mostly by block discounting, we handle what we call the smaller and domestic units. The agreements on domestic units are mostly entered into by the vendor with the customer, and we then discount a proportion of those agreements, with recourse to the vendor, of course.

5124. You do not give in your memorandum any indication of the magnitude of the block discounting. Can you give us any impression of it?——*Mr. Greaves*: It would vary enormously from company to company. Those figures are not separated out by the Board of Trade, and it would mean going to every individual company and asking them to disclose their actual analysis of outstandings as between block discounting and ordinary hire purchase.

5125. An estimate of the outstanding balance of about £40 million or £50 million has been published. Do you think that is unreasonable, as an aggregate?——I should think it is a reasonable figure; but it is a very wide guess.

5126. *Chairman*: Is that part of the figure of £200 million that you give us in paragraph 2 as "due directly to retailers and others"?——*Mr. Livsey*: Finance houses do not return to the Board of Trade the business they do on block discounting, because that is mostly returned by the people that enter into the agreements.

5127. Are they normally the collecting agency?——Yes; they collect and render accounts monthly.

5128. You refer on the bottom of page 1 to "numerous small hire purchase companies". Is there any means of knowing the number of operating units in this business?——I do not think there is. The Board of Trade some time ago estimated in the region of 1,200, and they probably have the most reliable information; but they told us then that it was purely an estimate.

5129. *Lord Harcourt*: Do many retailing or manufacturing organisations in this country own their hire purchase organisations?——A great number.

5130. Normally would it be a subsidiary?——Mostly a subsidiary.

5131. *Professor Sayers*: You say: "No member of the Finance Houses Association is controlled by a manufacturing or retailing organisation". Is any member controlled by any other organisation?——*Mr. Livsey*: Mr. Greaves's company is controlled by the Prudential Assurance Com-

* Memoranda of Evidence Part VI No. 7.

pany. My own company, Mutual Finance Ltd., is controlled by Thomas Tilling.—*Mr. Greaves*: Scottish Midland Guarantee Trust Ltd. is, of course, controlled by the Commercial Bank of Scotland. I think in the case of the last two mentioned companies it is virtually one hundred per cent. control, and in the case of North Central Wagon and Finance the Prudential's holding is just over 50 per cent.

5132. Are those all the cases?——*Mr. Livsey*: The others are completely independent. Lombank Ltd. is a subsidiary of Lombard Banking Ltd., but for all practical purposes it is one company.

5133. *Professor Cairncross*: How many of the members of your Association operate overseas?——*Mr. Greaves*: Seven, according to my calculations.

5134. *Chairman*: Do they take deposits overseas too?——Certainly in some cases they do, and I should imagine in all cases.

5135. *Professor Sayers*: By advertising overseas?——*Mr. Greaves*: I should imagine so, but as my own company does not operate abroad I have not any specific information.—*Mr. Livsey*: Most of them, of course, have credit facilities with the banks overseas as we have here.

5136. *Professor Cairncross*: Would it be right to say the overseas business is a fairly limited proportion?——*Mr. Livsey*: I should say very limited.—*Mr. Greaves*: The Chairman of United Dominions Trust said in his statement two years ago that it was anticipated that in the very near future more than half of their profits would come from overseas. I imagine in their case at any rate the proportion is substantial.—*Mr. Livsey*: Apart from United Dominions Trust the excursion overseas of the companies has been quite recent, and I should say none of that business is included in the figure.

5137. *Professor Sayers*: Is it confined to the sterling area?——The sterling area and Canada.

5138. *Chairman*: You say in paragraph 7, where you are giving a list of the activities of Finance Houses, that in addition to this primary function of providing medium-term finance for the acquisition of durable goods "some Finance Houses carry on activities as bankers in varying degree (including financing exports)." What activities do you cover by "acting as bankers"?——I would say acting in every sense as bankers: the operation of current accounts, acceptance of deposits, the granting of overdraft facilities.

5139. *Professor Sayers*: Drawing of cheques?——Yes. In the case of my own company the current banking and granting of overdrafts is very much restricted to people such as motor traders from whom we do receive hire purchase business. It is not a service we offer generally to the public.

5140. *Lord Harcourt*: It is an ancillary service to a hire purchase relationship?——Supplementary to our normal hire purchase business.

5141. *Professor Sayers*: Do you clear cheques through your clearing banks?——Yes; in the case of my own company cheques come through the clearing with the help of the Westminster Bank.

5142. Have you ever thought of applying for membership of the London Clearing Houses?——We have just been advised that we are to be included in the Bankers' Almanac for next year, which has given us a thrill. We then may get on with the clearing house problem; we have contemplated setting up our own clearing house.

5143. *Sir John Woods*: Any foreign exchange business?——No.

5144. *Chairman*: In paragraph 8 you are dealing with the period of the normal financing of hire purchase arrangements, and you refer there to "equal monthly instalments over periods varying between 12 and 24 months. The latter period is the maximum at present permitted for plant, machinery, motor vehicles and a wide range of goods, but it is safe to say that in the absence of all controls the average period for payment would be somewhere in the region of 18 to 24 months from the commencement of the agreement." How far with regard to those kind of goods have the terms imposed upon you as to the length of agreements varied what would be normal practice if there was no control?——The longer periods used to be used for plant and machinery, coaches, and that kind of thing. I would not say that the 24 months limit has to any great extent restricted our business. At one period it was 18 months, and that did restrict it very much. As always happens with controls we have developed other ways of doing the business. For instance, most of us today are financing quite a lot of equipment for open-cast coal mining, where the price of the piece of machinery is anything from £60,000 to £100,000 per unit. People find it impossible to pay for that over two years, so we have developed a simple hire agreement, instead of the hire purchase agreement, which means that they can never become the owners, but the business comes outside the control order. However, on the ordinary run of business, motor vehicles and the smaller units of machinery, I do not think the 24 months is restrictive at all.

5145. Would that correspond to the pre-war pattern when there were no controls on the duration of agreements?——*Mr. Livsey*: Yes, except, of course, in the cases I have instanced of expensive machinery, expensive coaches, when we would have done three or four possibly years on hire purchase agreement.—*Mr. Greaves*: Four years is by no means an unreasonable period for a new long distance heavy haulage lorry, for instance, costing £5,000.

5146. What life do you give a lorry of that kind in commercial work?——A very long life. The chassis will last for anything up to ten to fifteen years. It may have a new body or a new cab fitted, but the high-class vehicles will last a very long time.

5147. *Professor Cairncross*: There is nothing said here specifically about consumers' durables; I take it that what you say as to period would apply there too even more?——*Mr. Livsey*: It is mostly a shorter period, because that is coming into a much lower price category.

5148. Would it be right to say that the existing controls bear rather more heavily on the business firms than on the private consumer?——*Mr. Greaves*: There is no doubt about that at all.—*Mr. Livsey*: Until fairly recently in relation to the total period of control, items of machinery were not subject to control at all. They first came under control when the deposit was put up to 50 per cent., in February, 1956.

5149. In the case that you quoted where a rental agreement has been in use, do you take property in equipment?——*Mr. Greaves*: It is a principle of our business that we should always own the goods which we are letting.—*Mr. Livsey*: With the hire purchase agreement at the end of the period the customer pays a nominal sum to purchase the equipment from us, but with the rental agreement he can never become the owner. The advantage to him is that he can charge the whole of the rentals he pays for tax, and we have to pay income tax on the whole of the rental we receive. On the hire purchase we only pay on the charges we make to the customer, and he can only set that off for tax.

5150. *Chairman*: How far has this simple hire arrangement got? Is it widely practised?——It is very widespread now.

5151. *Professor Cairncross*: Did you ever do this for railway equipment?——*Mr. Greaves*: Yes, we let out fleets of railway wagons on simple hire agreements, as well as on hire purchase agreements.

5152. *Lord Harcourt*: In paragraph 9 you mention the credit sale agreement. Could you just explain the difference between that and the others?——*Mr. Livsey*: In the case of credit sale the title to the goods immediately passes to the customer; we do not retain the title, and he agrees to pay by instalments. If he defaults, there is a clause that the whole of the amount becomes payable. our only remedy if he did not pay would be to take proceedings for recovery of the money.—*Mr. Greaves*: It is a simple debt payable by instalments.

5153. *Chairman*: How far does the security, in the ordinary sense, matter in all this kind of business? In the credit sale agreement are you not left with only the prospect of bringing an action in the county court if anything goes wrong?——*Mr. Livsey*: That is right.—*Mr. Greaves*: The credit sale is only practised as a rule where we have recourse to the original vendor of the goods and he guarantees the transaction; in the ordinary course of our business the security in the value of our goods is all-important. We are well protected on that side by these

control orders, which have specified minimum down payments; consequently at all times the value of our goods should be in excess of the outstanding balance and nearly always is.—*Mr. Livsey*: Provided that the minimum deposit laid down in the order is a figure which does help: we had a period when the minimum was 15 per cent., and then we had a short period with the minimum fixed at 20 per cent.; that is quite inadequate in our experience. We feel that nothing less than 25 per cent. is satisfactory.

5154. The amount of re-taking that you do is minimal, is it not?——*Mr. Livsey*: Yes, and has been so since the end of the war. Before the war we did quite a lot of re-taking of motor cars, but when we had that period after the war when second hand motor cars were selling at a premium we rarely got things back; when a man could not pay he went round the trade and got an offer for the vehicle and sold it and paid us off. There are really very few re-possessions.—*Mr. Greaves*: To re-possess is the last thing in the world we want to do, and at the outset we take precautions to see that the down payment is sufficient to maintain our equity.

5155. Is it really the amount of the down payment that is the essential thing, rather than the theoretical right to re-possess yourself?——*Mr. Greaves*: I would say that that is the most important thing. The principle to be aimed at in hire purchase is to see that at all times the hirer is in possession of an article which is worth more than he owes on it.—*Mr. Livsey*: We do not rely entirely on the physical security; we have carefully checked the financial standing of the proposed hirer. We have no selling organisation for any re-possessions we make; the most we can do with a motor car is sell it to the trade, and we find their views on values are very different when we ask them to buy back from when they sold to us. Machinery and machine tools would present a very difficult problem if we had to re-possess and re-sell.

5156. I know that when you have block discounts you have recourse against the retailer who is handing you over the debts, but do you always have recourse against the supplier?——Very rarely, I should say, on normal business.

5157. *Professor Cairncross*: Do you do any business in accounts receivable?——*Mr. Greaves*: Certain members of this Association do it, but it is the exception rather than the rule.—*Mr. Livsey*: Mutual Finance do it through a subsidiary, Sales Intermediate Credit Ltd.

5158. In relation to the amount of business on this in the United States it is very small?——Very small.

5159. *Chairman*: What is the difference between dealing in accounts receivable and block discounting and credit sale?——*Mr. Greaves*: Between dealing in accounts receivable and credit sale very little; but there is all the difference in the world between these and block discounting hire purchase agreements, when we buy contractual rights including ownership of the goods.—*Mr. Livsey*: Credit sale has really only developed to a certain extent because of control orders. The minimum period is usually nine months, and on accounts receivable the maximum period is 90 days, or three months, and the amounts usually in our experience are collected from the debtors at an average of about eight weeks, I should say, from the date of the invoice.

5160. *Professor Cairncross*: Is there any indication that this kind of business of turning over accounts to you is increasing, or that there is a demand for it?——In the case of my own company it has increased very substantially, but I think that that is a temporary position owing to the restricted credit available from normal sources.

5161. You mean bank credit?——Yes.

5162. *Sir John Woods*: I follow the point that the credit sale agreement has expanded because it is free of control up to nine months. Supposing that the control were to go, do you think this business would disappear, or has it any other advantages compared with hire purchase, or the ordinary rental?——I would say it is no advantage at all. It is disadvantageous, I think. It is just a method of evading the payment of deposit.

5163. *Chairman*: When you speak about the effects of these various forms of control that have been imposed on the terms of trade, do you think you could distinguish between the effects of increasing the minimum deposit and the effects of shortening the term? So far as shortening the term goes, I gather from what you say that it had very little observable effect so far as dealing in consumer goods goes, but it has an effect upon the heavier goods, plant and machinery, bought by industry. To some extent you have been able to get round that by the simple hire agreement?——*Mr. Livsey*: It does affect very much the trade in the ordinary motor car if the period is too short. My opinion is that there is a much greater restriction if the period is shortened. For instance the restriction to 18 months had a much greater effect than putting up the deposit to 33⅓ per cent. In the one case it is a matter of putting an old car in in part exchange, which very largely covers the deposit, or drawing a sum out of the bank to pay the deposit with; but when you shorten the period it is a question of how far the person's income can afford the large monthly payments necessitated by the shorter period.—*Mr. Greaves*: If there is a shortening of the period there is a tendency for people to over-commit themselves on hire purchase; they can enter into the agreement quite easily if the deposit is low, but it means that their monthly payment is high if the period is restricted. If there is an increase in the minimum down payment, our experience generally is that business slows down for a while; but gradually people accumulate deposits, or get used to the new state of affairs, and we do find that it gradually creeps back again.

5164. *Professor Cairncross*: With the higher instalments you think there is a continuing decline in the amount of business?——*Mr. Livsey*: Yes; with a shorter period it is really a permanent decline.—*Mr. Greaves*: If the thing gets too severe we then get avoidance devices coming in, and people coming to us for finance of an alternative type, such as a simple hire agreement.

5165. *Chairman*: And with your very good experience of reliability of debtors, it would not be an impossible shift?——Not impossible; but it is something we would do with reluctance. Our proper business is hire purchase, and we seek to stay in that business. If we are forced to an alternative means of giving credit, then we are prepared to consider that, but we like at all times to be the owners of the goods let out on proper hire purchase agreements.

5166. Do you think many consumers have a figure per week or per month in their mind to which they are prepared to go?——Undoubtedly.

5167. If they pay off one kind of debt they enter into a new transaction, and get back to the previous figure?——*Mr. Livsey*: An indication of that in relation to motor cars is that practically every trader tells us that the customer is not at all interested in what he is going to be charged; all that he asks is how much a month it will be. We have agreed a scale of maximum charges to the customer, and the dealers are very cross about it in the motor car trade; they say the customer is not interested in what it is going to cost him in all, but how much it is per month. I would not say that in relation to the industrial side, namely machinery, machine tools; but with the average person, the man who takes the motor car, I do not think he is a little bit interested in the capital cost; he wants a motor car, and if it is so much a month he can afford it.

5168. *Lord Harcourt*: And if you stretch the terms by an extra three months and reduce the monthly payment, that means he can buy a more expensive car without paying undue attention to it?——That is so.

5169. *Professor Cairncross*: Do you operate any kind of check on the credit standing of your customers, if they are private persons or business people, to see in what other directions they are committed?——*Mr. Livsey*: We do not get a statement as to their other liabilities. On the normal size of transaction, if the man has a bank we make the usual bank inquiry from the point of view of the amount of monthly payments. If he has not a bank we take a status report from one of the agencies which record county court judgments; but we have no detailed information. On units of machinery, contractors' plant, we have audited accounts of the company.—*Mr. Greaves*: Many companies ask on their proposal forms what other hire purchase commitments the proposer has, but we have no means of checking up on the information supplied.—*Mr. Livsey*: The Finance Houses Association have recently arranged a credit register which we will get into operation on the 1st April. Under that we shall each register with the Association's accountants customers who have more than £10,000 outstanding

with us. That should prevent them running up to what one company may feel is a reasonable limit, and then going to other companies.

5170. *Professor Sayers*: What is your had debt experience in the various fields?——*Mr. Livsey*: For my own company over the seven years since 1950 losses written off and those estimated which are not yet closed come out at 0·13 of one per cent. of turnover; but I would say that has been an abnormal experience since the war. Before the war I would say it was roughly 0·25 of one per cent.—*Mr. Greaves*: I should think that is typical.

5171. *Sir John Woods*: That is the net loss after taking credit for re-sales of re-possessed goods?——Yes.

5172. Did you have any worse experience than that during the slump in the thirties?——*Mr. Livsey*: No; we came through it very very well indeed. Even during the last war, although we all had a very large number of re-possessions when the war commenced, we mostly came through without heavy losses. It has been my experience over thirty years that generally speaking the people in this country are willing payers: they wish to pay, and if they can pay they will pay.

5173. The purport of my question was whether, in circumstances like those of 1929, 1930, and 1931, people could not pay, or whether they could and did; it seems they did?——*Mr. Greaves*: 1939-40 was a very good test. A great number of motor cars were under hire purchase then, and our losses in the long run were very small. We had a great number thrown back on our own hands, and cases where the hirer could not pay simply because he had gone into the forces, and had no earnings out of which to pay his normal rental; but in the long run our losses were very small indeed.

5174. *Lord Harcourt*: 1939/1940 was probably the time of maximum re-possessions, owing to the changed situation of individuals?——*Mr. Livsey*: Yes.

5175. *Chairman*: To conduct your businesses on this large scale do you not need a number of offices distributed all over the place?——*Mr. Greaves*: We all have offices all over the country, rather like insurance companies do; not large offices, relatively small ones.—*Mr. Livsey*: That is the meaning of the qualification "operating nationally".

5176. *Professor Sayers*: About how many offices have the twelve companies between them?——*Mr. Greaves*: 500 at a guess.—*Mr. Livsey*: I think that is quite a modest estimate.

5177. How much of the total business of the finance companies would you say was credit on motor vehicles?——I should say about 70 per cent.

5178. And a substantial part of the remaining 30 per cent. is on industrial equipment?——*Mr. Livsey*: 8 to 10 per cent.—*Mr. Greaves*: It depends whether you mean in units or money. The machinery tends to get into big figures, particularly earth moving machinery. I should say about 10 per cent.

5179. *Lord Harcourt*: What proportion of motor car sales are financed by hire purchase?——*Mr. Livsey*: Surprisingly few. The only reliable statistic we have is in relation to new vehicles, because we have our own bureau, H.P. Information Ltd., with which almost every company, whether within the Finance Houses Association or not, registers its hire purchase transactions for motor vehicles. We can compare the number of transactions registered with the number of new registrations issued by the Ministry of Transport. It was as low as 14 per cent. of registrations of all new cars a few years ago; today it is 22 per cent. for new passenger cars, and 29 per cent. for commercial vehicles.—*Mr. Greaves*: For second-hand vehicles one can only guess, because there is no information as to the number of second-hand car deals which take place in any given month. If I had to quote a figure, it would be that not less than 40 per cent of second-hand cars are bought on hire purchase, but it might quite well be much more.

5180. *Professor Sayers*. Have you noticed since the credit squeeze began a tendency for rather larger firms than before to use your facilities?——Yes.

5181. Has there been a great increase in the number of firms using you for plant and machinery?——Not a great increase yet.

5182. But a noticeable change in the kind of firm who would come to you?——I should not like to be very definite about that; I should say the trend is increasing, but it is not yet very marked.

5183. Mr. Livsey did say earlier that the expansion of business in recent years had been very much related to the squeezing of other sources of credit?——*Mr. Livsey*: I was referring to the accounts receivable, not to hire purchase.

5184. *Chairman*: Does the industrial use of hire purchase run in certain defined lines of goods? You have referred very often to earth moving machinery and heavy vehicles?——*Mr. Greaves*: Yes, it does. The restricting factor there is the period. Industrial plant cannot be satisfactorily financed over 24 months unless it is plant which, by its intrinsic nature, has a very high earning capacity in relation to its value. Earth moving equipment is ideal for that because its initial earning capacity is very great indeed. Farm tractors are another example. But for things like heavy lathes or milling machines one wants a longer period to finance them satisfactorily on a hire purchase agreement.

5185. *Professor Sayers*: It is the things that do not wear out in a month, but do wear out in less than five years?——That is the sort of thing.

5186. *Professor Cairncross*: Would you be prepared to do business where a period of more than five years was involved if there were no restriction?——Subject to our being able to get money for the requisite period. One of our main difficulties is that we cannot match the period of our borrowings with the period of our agreements.

5187. *Professor Sayers*: You do seek to do so?——*Mr. Greaves*: I would like to equate them more closely.—*Mr. Livsey*: The other factor too in the more long term agreement is the uncertainty of what money will cost us throughout. We cannot adjust our charge on our existing contracts, as a building society can on a mortgage. Take, for instance, the recent increase of 2 per cent. in Bank Rate; in relation to the business on our books at 19th September we are bearing the whole of that 2 per cent. When Bank Rate falls we have an advantage, because there is no change in the charge on current transactions. But to try and predict, certainly in these days, Bank Rate and the cost of our money for a period of five years or more ahead is quite dangerous.

5188. *Sir John Woods*: You are to a large extent borrowing short and lending medium?——It depends what you mean by medium. We are operating on six months to three years. Within that qualification, I agree. Before the restrictions were placed on hire purchase credit, we were borrowing short, because the money was always payable to the bank at call, though in practice that never happened. We knew the banks would always give us reasonable notice of any reduction. Now we are on a different basis, because we are all borrowing so much money on short term deposit on a maximum of six months' notice; so to that extent we really are borrowing short and lending medium.

5189. *Professor Sayers*: If you were free to issue debentures on a fairly big scale, could you easily do so on such terms that would allow you to go into financing of more long lasting plant?——*Mr. Greaves*: I think so. The best illustration there is that, when the wagon companies each used to run their fleets of railway wagons on hire purchase agreement for three, five and seven years, it was their practice to enter into agreements for the hire of the wagons with option to purchase in fairly big units, and then to borrow the money on terminable debentures for similar periods. These debenture issues are still extant in two wagon companies, to a total of nearly £5 million outstanding, and they go on revolving as the debentures run off they are renewed for three, five or seven years.

5190. Is there a very big field that you would like to get into?——I think there is ultimately. We should be misleading you if we said that there is an immediate very large demand for hire purchase of industrial machinery, but I think it is something which is there and will grow.

5191. *Chairman*: Where are these debenture issues renewed? Are they public issues?——*Mr. Greaves*: No, it is generally fairly private money. Both the companies concerned are up in the north, and the money generally comes from local people, introduced by local solicitors, stockbrokers, and that sort of thing. I would not

like to say it is by any means a national issue.—*Mr. Livsey*: Before these restrictions became so rigid we were developing to some extent on the basis of a five-year unsecured note, which rather covers the point you had in mind: we knew the cost of the money, and we knew the money was there for five years. But those were placed with institutions.

5192. Restrictions have put a stop to that?——*Mr. Livsey*: For over £50,000, and now over £10,000, we have to get C.I.C. permission, which they are not likely to give. In normal times it is quite a good method of financing provided that one does not have too great a proportion of resources on that basis; our business is to a great extent seasonal, and if we have fixed capital of whatever nature we are going to be paying out at one period of the year on money we are not using.

5193. What in your view is the ideal source of finance?——The joint stock banks.

5194. *Professor Sayers*: You like to borrow from them and then lend to the people who are buying the goods?——Yes. For many years we borrowed from the joint stock banks, and it was a very happy relationship; we were only paying for money as we used it, and we had a feeling of security, and the banks knew just to what extent one was credit-worthy, and how far one should go. I am quite sure that it is the most satisfactory form of borrowing for our business.

5195. *Lord Harcourt*: To what extent do you use acceptance credits?——Quite a lot. We regard them in very much the same way as joint stock banks. One has to be careful in the selection of the acceptance credit. I had a very unhappy time at the time of the Continental troubles; I had acceptances of £250,000 called in on one day, and I had to go round to the joint stock banks and ask them to take these over. Since then we have exercised great care as to which acceptance house we have used.

5196. *Professor Sayers*: I can see that the relationship with the banks and accepting houses is very happy from your side; but what is the advantage to the banks and the accepting houses that go in for this, rather than doing the business directly?——*Mr. Greaves*: I think the advantage is that we know how to do the business, and the banks, with the greatest respect, would probably not, if they had to do it themselves. There is a considerable amount of know-how in this business. And, of course, it does mean that we bear any loss ourselves and the banks do not—*Mr. Livsey*: It really means that the banks finance the hire purchase of the country, using specialised organisations for that purpose, and they have the cash and the capital reserves of the finance companies as security for their loans. When I spoke of a "happy relationship", I was not thinking of it so much from the point of view of the value of the borrowing as the fact that it really was a happy relationship; we are on excellent terms with our banks, and we can always go and discuss our problems with them and go and get advice from them. And we have the feeling that they keep us within reasonable borrowing bounds.

5197. *Chairman*: What measure of accommodation would you expect a bank to give a hire purchase company?——*Mr. Livsey*: I have always regarded round about 4½ to 5 times capital and free reserves as being a safe operating margin for a hire purchase finance company.—*Mr. Greaves*: At the risk of disagreeing with my Chairman, I would say that that should be qualified by the particular company in question as to its size, its experience and its management. If you have a small company with capital and reserves of £10,000, it would be unwise for a bank to lend that company anything like the same ratio in relation to its capital and reserves as it would for an old established company with capital reserves of £4 or £5 million.—*Mr. Livsey*: Yes. I answered in the general sense, as I am sure the Chairman wished me to do. Obviously in the case of Mr. Greaves's and my own companies our bankers would take into account our parent companies. But over the whole range of hire purchase borrowing we used to base that ratio on putting ourselves in the position that whether the customer paid us each month or not we had to pay the banks. One could reach the position that, if one put no reasonable limitation on one's borrowing, though ultimately one would collect all the money outstanding on agreements, one might reach a position with arrears such that one just could not pay the banks what was due to them each month. The basis was that we had to allow for a certain percentage of arrears to ensure each month that despite those arrears we could in effect pay off the arrears to the bank out of capital and reserves.—*Mr. Greaves*: Five times was the commonly accepted rule in the days when we were free to borrow from the banks; but I think a growing appreciation of the essential liquidity of our business might well now justify a substantial increase in the ratio.

5198. You envisage a bank supplying some measure of credit to a hire purchase concern, varying with seasonal requirements, but standing behind it and supplying credit year in year out on a certain basis?——*Mr. Livsey*: Yes. Before the war, provided that the company was being sensibly managed the credit was really fixed; unless there was a general move, or a Treasury or Bank of England suggestion or something like that, we knew the credit limit we had was there in effect permanently.

5199. *Professor Cairncross*: Do you mean a ratio of five to one in terms of bank credit or total borrowings to capital and reserves?——Total borrowings.

5200. What proportion would be from the banks, and what proportion from other lenders?——At the present time only a small proportion from the banks; at the end of our last financial year my company were borrowing just over £600,000 from the banks, and just over £2 million on short term deposits.

5201. And before the war what would the proportions have been?——It was all from the banks. We did not take deposits.

5202. *Professor Sayers*: And you would like it to be from the banks again?——I would, if we could be sure that that was going to remain. In the short period of five or six months when the restrictions were lifted I increased the limits of my own company with the banks, and undertook to give notice to repay all deposits. We gave notice to many of our depositors to repay; and then within five or six months the restriction came down again, and we had to go back to the depositors again.

5203. *Sir John Woods*: Is it right to infer from that that if you were free to borrow from the commercial banks as you used to be you would be content not to seek deposits?——*Mr. Greaves*: I would not like to say that it might not be desirable to borrow some longer term money as they do in Australia, for three, five or seven years, on debentures or on unsecured loan notes, to give a certain proportion of longer term resources at a fixed rate.—*Mr. Livsey*: I am reasonably sure that the principal companies would borrow much more heavily from the banks, as they used to do, than on short term deposit, if we could only be assured that, as soon as we had discarded the deposits, the restrictions were not going to come down.

5204. *Professor Cairncross*: Have you any figure that would allow us to judge how much bank credit you enjoy at the moment?——It is difficult to give overall figures. Taking the case of my own company the credit limits on the reduced basis amount to £1,300,000, but we have been asked to keep to our average borrowings for the year up to September 30th last, which in the case of my company only amount to £375,000. We can go up to our £1,300,000 to-morrow, but the understanding with our bankers is that, even if we did that, we would average out over the year at not more than our £375,000.

5205. *Professor Sayers*: This understanding arises from the Chancellor's request?——Yes. I accept, and I am sure we all accept, that the requests and reductions which have been made by our bankers have all been with a wish to comply with Treasury wishes. We are not blaming our bankers at all for what has happened.

5206. *Professor Cairncross*: The figures published by the Government show a total indebtedness of finance companies to the banks of £30 million?——*Mr. Greaves*: I should think £25 million of that might be to our members.

5207. And how much total credit do you have at your disposal, excluding capital and reserves: £100 millions, or much more?——Considerably more than that, including deposits and everything else; over £150 million, I should think; but I should like to confirm that.

5208. So the bank credit will be less than a quarter on that basis?——Yes.

5209. *Professor Sayers*: What sort of proportions are the other sources of credit in that total?——They vary

enormously from company to company. Some companies have taken deposits from the public for a number of years; some have only just started doing it.

5210. Would your members be willing to give us a figure aggregated for the group?——*Mr. Livsey*: I am sure we could supply the figures at any date you wish.*

5211. *Professor Cairncross*: It would be useful to the Committee to have some indication of the increase that you have been able to enjoy in deposits or other sources of funds since the contraction or the flattening out of bank credit to you. It is very difficult to judge whether it is large or small?——The restriction of credit to hire purchase companies has been operating, except for a few months, since 1947. In 1947 the Bank of England asked the banks and acceptance houses to limit their credits to the then existing limits, which, of course, were rather low in 1947, as we had not recovered from the war. That has really gone on, with two reductions, continuously from 1947, with one break of five or six months; but you have in mind the period since 1952?

5212. Since the middle of 1955, when the screw was put on a good deal tighter. In the last two or three years you have probably been more active in seeking deposits from outside sources than previously?——Very much more, yes.

5213. It is the magnitude over that period that would be of most interest to us. We should like an analysis showing the break-up between bank loans, including acceptance houses, deposits and any other sources from the middle of 1955 to the end of last year?——We will let you have that.*

5214. *Sir Reginald Verdon Smith*: With regard to the deposits themselves are there any significant characteristics of the sources from which they come: private individuals, small traders, businesses, any particular significant sources?——*Mr. Livsey*: It varies with the companies. Some companies advertise very extensively, and attract deposits from moderate people, perhaps of £500 or £1,000. In the case of my own company we do not advertise, and the deposits come from industrial sources with which the directors of my company or of the parent company are connected, though we do not usually borrow from the parent company.—*Mr. Greaves*: My company advertise, but we do not take the smaller deposits. We get quite a lot of substantial deposits from industrial sources, and quite a lot from individuals.

5215. *Lord Harcourt*: What is the smallest deposit you take?——In my own company £500.

5216. That is a fixed limit?——Yes.

5217. *Chairman*: Do you advertise varying terms upon which you will receive the deposits?——Yes. Generally speaking the commonest terms on which deposits are taken are either at six months' or three months' notice.

5218. Is that equally true when you are dealing with industrial lenders?——*Mr. Greaves*: Yes.—*Mr. Livsey*: We all offer about the same rates: Bank Rate for money at one month's call, 1 per cent. over Bank Rate for money at three months, and 1½ per cent. over Bank Rate for money at six months call, with a minimum of 4½ per cent.

5219. *Professor Sayers*: Are these deposits very volatile?——*Mr. Livsey*: Ours are, because we get monies like purchase tax or income tax monies deposited with us, and there is rather a large amount going out about the end of the year. But I imagine the smaller deposits of £500 remain.—*Mr. Greaves*: They are stable; I think in the majority of cases the smaller deposits from individuals are savings.

5220. *Lord Harcourt*: Do they stay with you for a considerable period?——Yes.

5221. *Chairman*: Have you observed any greater difficulty in obtaining the deposits you want over the last two years?——*Mr. Livsey*: No; on the contrary, my own experience has been that we really have had more funds than we require to finance the business coming in. In my own case we may have an industrial concern which has £100,000 or £150,000 on deposit with us asking us to take another £50,000 or £100,000. We do not really want it, but we are frightened that if we do not take it they will go to another company, so we take it. I have been in the position of having money on deposit at the bank at 5 per cent., and paying as much as 7 or 7½ per cent. for it to keep the good will of the depositor.

5222. If you were free to draw the bulk of your finance from the banks, it would be the least expensive way of getting your money?——It would. Of course, the banks have fixed by agreement a fairly high minimum charge for the hire purchase companies: one per cent. over Bank Rate, with a minimum of 5 per cent. We are paying the banks 8 per cent. at the present time; so our one-and-a-half per cent. over Bank Rate for money at six months call is not really very excessive.

5223. *Lord Harcourt*: In the case of the companies that take the very small deposits, does that involve a vast amount of work?——*Mr. Greaves*: It must do.

5224. And the smaller the deposits the more volatile they are?——I have not much experience of it, but I would not say that that is so. I think there is a great number of deposits of £100 or £200 that are stable and represent genuine savings.

5225. *Professor Cairncross*: Do you try to observe any proportion between cash and liquid assets and total assets?——*Mr. Livsey*: We do not have a recognised percentage, as the commercial banks do. Certainly in relation to deposit money we keep a very careful eye on the amounts payable at, say, three and six months, and the amounts we are collecting each month. We have always endeavoured to project those two figures; we assume that we get simultaneous notice to repay all the deposits on the same day, because of an international catastrophe, or something like that, and we then try to work out our graph so that the very worst that could happen would be that we should have to stop doing business for a month or two, so that our payments coming back would repay our depositors. Payments each month are ten per cent. of the total outstanding, but we have to visualise that the circumstances which caused us to receive notice simultaneously to repay all depositors would reduce that amount.—*Mr. Greaves*: I think it is true to say that we do not put cash aside specifically against excessive calls on deposits; but we all of us have regard at all times to our undrawn credit lines as reserves on call for unforeseen repayment of deposits.

5226. *Professor Sayers*: Do you hold any other form of asset than hire purchase paper, apart from a working bank balance?——Yes; a certain amount of our funds are invested in buildings for our offices, but other than that the majority, say 90 per cent., of our assets are in hire purchase agreements.

5227. No Treasury Bills?——On occasion companies in this Association have had Treasury Bills, but that has only been because they have at that date been in possession of more funds than they could use.

5228. They would not reckon to hold some Bills?——*Mr. Livsey*: We cannot afford to pay what we have to pay for our borrowing, and keep any substantial amount in Treasury Bills at a lower rate.—*Mr. Greaves*: Nor is there any necessity for it, if a company manages its affairs so that it has undrawn credit lines available.

5229. *Professor Cairncross*: What type of business do you do in the financing of exports?——*Mr. Greaves*: My own company does the export of motor vehicles to America and Canada, chiefly on three months' bills. The other companies do similar sorts of transactions; but I have not a great deal of information about what other companies do.—*Mr. Livsey*: I think it is very largely confined to the financing of motor vehicles.—*Mr. Greaves*: We do not actually act as principals, buying and selling merchandise abroad.

5230. *Chairman*: Have you got any kind of formula for the distribution of your liabilities as between short term and longer term deposits?——Generally speaking we prefer to have our deposits at six months' notice, if we can get them. Three months' notice is less desirable; and the majority of us are not very keen on taking any substantial volume of deposits at less than three months. But I do not think there is any hard and fast rule about it.

5231. Then in paragraph 21 you draw attention to the extreme flexibility of the restrictions that have been imposed upon you from time to time?——*Mr. Greaves*: Yes. I think that is a very mild way of putting it!—*Mr. Livsey*: It appears that the Board of Trade are now

* See Appendix to Minutes of Evidence.

very anxious to try and keep the present terms stable. They have been stable for quite a long period, and I think that the President of the Board of Trade wishes very much to avoid these sudden changes. It makes it very difficult, not only for the finance companies but for manufacturers and retailers.

5232. *Professor Sayers*: You have mentioned the discomfort in the restrictions of the credit you get from the banks, and there is obvious discomfort in these variations in the terms of trade control. If there is to be some way of controlling credit of this kind, which way seems to you the least evil?——The terms of trade control. It is a very useful control. America used it throughout the war on what they called the "Regulation W" plan, and it was very successful there. Its great value to the country, particularly as we now have the statistics with the Board of Trade, is that the Government can regulate the amount of hire purchase which is being transacted in any section of industry. If the Treasury see that, for instance, one month there is a tremendous increase in the sale of television and radio on hire purchase, they only have to move up the deposit or shorten the period to check that. We had an example of that during the petrol rationing period when, with the minimum deposit at 50 per cent., as it then was, and the Suez business, the motor trade was in a very bad state. To help them the Board of Trade reduced the minimum deposit on motor cars and light vehicles to 20 per cent., and there was an immediate and tremendous increase in the hire purchase of those goods.

5233. *Chairman*: If we are going to rely for this purpose on terms of trade control only, how can it help being variable and flexible?——*Mr. Livsey*: It must be flexible; it must be variable. It is the great value of the terms control that it can be so flexible. The trouble has been in our view, with great respect to the Board of Trade, that in that terrible period of constant changes they were not using it sensibly.—*Mr. Greaves*: I think that the risk of frequent changes is diminished to some extent by virtue of the increase in knowledge which the Board of Trade has gained of our business, which makes them less liable to chop and change their minds about it.

5234. *Professor Sayers*: But if that derives from a decision that this is a control that should not be regarded as a flexible one, that does not help us much. Are you not in fact putting it forward as at any rate the least undesirable of the flexible controls?——Yes. We were getting changes at one time at the rate of one a month, which is quite impossible for any industry. Obviously one could not object to a flexible control which changed perhaps once, or even in exceptional circumstances twice, a year. That would be reasonable, and we could plan our business accordingly; but we cannot conduct our business when the controls change to a marked degree in a period of a month, and then change back again.

5235. Are you speaking of manageability of your own business, or of the industrial changes that lie behind?——Of both.

5236. You think that the industries that are concerned here would be quite willing to stomach changes of once or twice a year?——*Mr. Greaves*: I do not think they would be willing, but I think they have got rather used to doing it.—*Mr. Livsey*: What is important is that when the change is made it should not be such a violent one. For instance, suddenly to make the minimum deposit 50 per cent. all round, even on machinery or on earth-moving equipment at £100,000 a unit, does tremendous damage. It is disastrous for industry.

5237. *Chairman*: Is the kind of industry whose goods you are dealing in one which needs a smooth and regular flow to be efficient?——*Mr. Greaves*: Yes.

5238. If the authorities are going to rely upon an instrument of control which by its own nature must mean that from time to time sudden alterations of pressure are imposed, must they not contemplate throwing that industry from time to time out of gear?——*Mr. Livsey*: I think that the F.B.I. have made that point very strongly; they set up a committee specially to consider it. We, of course, should like the country to be in a position where we did not have controls; I think we all accept that there must be some control in present circumstances, but we feel that the most satisfactory control is the terms of trade control because of the very fact that it is flexible. We are not suggesting that it should not be flexible: we think that is its great value; but it has not been wisely used in the past. The other trouble is that the Board of Trade do not consult with any trade association before the changes are made. For instance, we would have advised them very strongly against fixing such a low minimum deposit as 15 per cent., which they did at one time. We should have said equally that 50 per cent. would have had serious effects on a large section of industry. They consult us on intended permanent legislation, but they cannot agree to consult at all on statutory instruments.

5239. *Professor Cairncross*: Suppose you were in the same position as the commercial bankers, and had to maintain your outstanding credit at a constant level, would you choose to make use of the existing device, or would you think up some other method of securing that result?——*Mr. Greaves*: I think the main weapon we would use ourselves would be a control over minimum deposits and period of repayment.

5240. You would not, for instance, want to cut out particular lines of business?——*Mr. Greaves*: I think we would do that as well.—*Mr. Livsey*: When the credit squeeze came, and when we suffered a 15 per cent. cut in our bank credit, in or around December, 1955, some companies had to close, or did close, quite a large number of dealers' accounts without any warning at all. But I agree with Mr. Greaves that the better way from our point of view would be to achieve it by shortening the period and increasing the deposits, because we would then be maintaining our dealer connection, which is really our goodwill.

5241. *Professor Sayers*: Suppose that you were asked to put a ceiling on your outstanding credit, which you say you would do by altering the terms of payment; in that case you would be free to decide for yourselves just how you would alter the terms of payment?——Yes.

5242. This would overcome your difficulty about not being consulted?——Certainly.

5243. And would you prefer a control of this kind to one of official control of the terms of payment?——As long as there has to be control of the terms of trade I would rather it was an official control because that puts everybody in the same position.—*Mr. Greaves*: One of the great merits of the terms of trade control is that it is fair; it operates exactly the same for everybody, and the public can see that it operates in the same way for everybody. The public knows that if it goes to one company it will get the same answer as if it goes to another company.—*Mr. Livsey*: Before we had the terms of trade control and when we had the monetary control, we were in the absurd position that the Electricity Board and the Gas Board could give unlimited facilities for cookers and that kind of thing, using the country's money, and we could not compete with that because we were being cut down on our credit. The terms of trade control applies equally to the nationalised bodies as it does to the finance companies.

5244. If the circumstances demand violent changes in Government economic policy, what shape would you wish them to take?——*Mr. Greaves*: Terms of trade control.

5245. The more one concentrates the range of controls the more violent each change has to be. Do you still hold to your view, even taking account of that?——Yes. Financial controls are very difficult for us.

5246. *Lord Harcourt*: From what you have been saying, I take it that the cost of your borrowing is a minor element?——*Mr. Greaves*: Relatively.—*Mr. Livsey*: It is a minor element, because, as I have said, 70 per cent. of our business is motor business, and customers are not the least bit interested in what the cars are costing them, but only in how much a month they are going to pay. So within reason we have no difficulty in maintaining a reasonable margin in what we have to pay for money and the return we get on it.

5247. *Professor Sayers*: But there must come a point, as interest rates rise, where the difference to the monthly payments becomes significant. What point is that?——That is a very difficult question to answer, and I think the answer is probably that it is the difference between being able to buy a new car and being able to buy a second-hand car; or being able to buy a second-hand car at £800 and a second-hand car at £400.

5248. The economic conditions of the country may make it desirable that people should swing to some extent from buying an £800 car to buying a £400 car?——The Government can do that on the terms of trade control.

5249. Yes, but at what point does the rate of interest become significant?——*Mr. Greaves*: I think it would become significant at a different point for one person as compared with another. For instance, commercial users of hire purchase are decidedly rate-conscious. They will inquire from one company and another company as to what their rates for hire purchase are. The ordinary individual who goes and buys a motor cycle on hire purchase is, I think, completely unconscious of the rate; he is only interested in the weekly or monthly payment.

5250. The industrial side, including in that commercial lorries and so on, is affected appreciably before anybody else?——*Mr. Livsey*: Undoubtedly. It affects us, of course; we enter into hire purchase agreements at a fixed rate for a period, and an increase in the interest rate means that we have to finance the very considerable items we have on our books, on which we cannot put up the interest charges, out of money which is costing that much more than when we entered into the agreement.

5251. *Lord Harcourt*: That has an effect on your profit and loss account, but not to a great extent on the amount of credit available?——That is true.

5252. How do you deal with this?——*Mr. Greaves*: We take it on the chin, as it were.—*Mr. Livsey*: We get compensation, of course, when the rates go down, though we find we get the increases when things are at a peak, and reductions when they are low.

5253. *Chairman*: What has been your experience since last September with regard to new agreements?——*Mr. Greaves*: We put our charges up.

5254. Has that had any effect on the business?——It is difficult to say, because we do not know what our business would have been if our rates had not gone up.

5255. *Sir John Woods*: Was there a considerable switch between one type of customer and another?——*Mr. Greaves*: No.—*Mr. Livsey*: I would say that it has had no effect at all.

5256. *Chairman*: Can you not contrast it with 1956 and 1955?——1955 was a tremendously heavy year for turnover, probably an all-time record for all finance houses; and then 1956 was a poor year.

5257. *Professor Sayers*: But you said that the industrial user was more rate-conscious; does he ever get to the point of saying: "This is too much for me; I must wait"?——*Mr. Greaves*: I have known cases where this has happened.

5258. At what rates does it begin to happen?——People get used to fluctuations in rates. Immediately after the Bank Rate went up to 7 per cent. people were scared of paying the larger interest rates, but after a period they gradually got used to a new level of rates and came back again. It is difficult to say whether it was entirely due to the higher rate or partly due to a general check in the economy due to this shock rate.

5259. You attach some importance to the shock?——Undoubtedly.

5260. This was something quite different from a rate going up from 3 to 5 per cent.?——Yes.

5261. *Sir John Woods*: But if there was a check, whether by reason of shock or otherwise, it was temporary, as far as you can judge?——Yes. I think that is very often our experience, as when the terms of trade controls are altered. For example, if the minimum deposit is put up from 20 to 33⅓ per cent., there generally seems to be a check in business for a while; then people accumulate the necessary extra money to pay the higher deposit, and they get used to the fact that a 33⅓ per cent. deposit is the normally accepted thing, and gradually they start buying again.

5262. *Lord Harcourt*: I think the answer to the point I was enquiring about has emerged in our conversation: that if the terms of trade control, and particularly the length of the contract period, is altered, the weekly or monthly cost rises much more steeply than if the cost of money is increased, and that therefore it is a more effective check to the amount of outstanding credit than a rise in the cost of money?——Undoubtedly.

5263. *Professor Cairncross*: But your preference for the terms of trade control is not based on the fact that it limits your business more effectively; it is presumably based on a view about the embarrassments to which you are put by monetary controls and the denial of credit on which you had been counting. What puzzles me is that you do appear to have been successful in obtaining funds; you have made up what the banks used to provide, and more. The existing controls permit you to expand, where the terms of trade control might not have done this. But you still prefer to have the terms of trade control?——Yes. Monetary control seems to operate very unfairly; somebody can always find a way round it. But that is not so with the Board of Trade orders as they are at present; we all find them reasonably fair, and we operate well within them, and within the spirit of them.

5264. It is the fairness of it that appeals to you as a justification for it?——*Mr. Greaves*: Yes.—*Mr. Livsey*: I would say, not taking a selfish view at all, that from the national point of view it must be more effective, because, as I have said, with the Board of Trade now taking reliable statistics, it is possible not only to control the total volume of hire purchase, but to control it in particular sectors of industry. You cannot do that with monetary control. But why both should be required we have never understood.

5265. *Chairman*: In paragraph 26 you say in effect that you have never had any mercy from the Capital Issues Committee?——We just had that short period of about six months when we all rushed in and increased our capital.

5266. *Professor Sayers*: Have you tried lately, or do you think it is no good trying?——I do not think any of us have tried, because with the requests which the Treasury have made to the banks on hire purchase it is quite clear what would be the result.

5267. *Professor Cairncross*: Would you agree that if monetary and terms of trade controls operate side by side they do to some extent support one another? If the aim is to deprive you of access to bank credit, your financial requirements are for some time diminished because of the trade controls, so that you find you need less access to bank credit to cope with the same volume of business; is not that your experience?——Yes, it is so.

5268. Have you ever been embarrassed by this reduction in the requirements of funds? Have there been times at which the increase in the minimum deposit left you in an almost excessively liquid state?——*Mr. Livsey*: Yes, in 1956, when we had the 50 per cent. minimum deposit, none of us was using the resources we had. We had very large surplus resources, and it resulted in cut-throat competition between companies, which benefited the public.

5269. *Sir John Woods*: You say at the end of paragraph 27: "Ample evidence of this is to be found in the number of newspaper advertisements inviting deposits for little known companies having small paid-up capitals and reserves." Do you know whether the terms they offer to depositors are different from yours?——*Mr. Livsey*: Some of the small ones are offering up to 9½ per cent. I was told by one of our bankers only two weeks ago that he had seen a pamphlet issued by some small company which said that it was taking deposits at three months and six months, but that up to £500 could be withdrawn immediately on notice; then right at the end of the book, in very small print, it said that that only applied if new deposits coming in were sufficient to meet the payments going out; and that applied even on the three and six months' notice. But I would not say there is any great evidence that any of the smaller companies are acting foolishly.

5270. These companies you refer to are all in your line of business, are they?——*Mr. Greaves*: It is difficult to know from these newspaper advertisements whether some of the companies are in fact hire purchase companies at all; I think some are advertising which are not doing hire purchase business.

5271. *Professor Sayers*: What business are they doing?——*Mr. Greaves*: There are one or two companies of recent birth which have been advertising for deposits, and I do not think anybody knows what business they are doing.—*Mr. Livsey*: Questions were asked in the House of Commons about a hire purchase company in

the north-west which was advertising for deposits, and about the Corporation taking its advertisements on their 'buses. At that time this company emphasised in all their literature that they did not transact hire purchase business. What they did, I think, was to buy hotels, buildings, and all manner of industrial activities, but not hire purchase, but the Member immediately assumed, because they were asking for deposits, that they were a hire purchase company.

5272. *Chairman*: You make the point in paragraph 35: "Finance houses provide their customers with credit at a charge which is fixed at the outset and cannot be varied during the course of the transaction which may cover a period of years." How much weight are we to give to that? Is there a serious attempt to weigh the possibilities involved in having to finance over the period, whatever it is?——*Mr. Greaves*: We do make some attempt, of course.—*Mr. Livsey*: Yes, but very little. None of us ever contemplated the 2 per cent. increase last September. In a long-term contract we must take into account the possibility of increases.

5273. At the end of paragraph 35 you say that prior to the raising of the Bank Rate in September, 1957, to the exceptional rate of 7 per cent., the scales of charges operated by members of your Association were broadly speaking no higher than they were in 1938. Can you tell the Committee what your average cost of money in 1958 was, as opposed to 1938?——We were paying one per cent. over Bank Rate mostly, with no minimum; if the Bank Rate was 2 per cent. we should have been paying 3 per cent., as compared with 8 per cent. today. The reason we have been able to maintain approximately the same rates that we had before the war is that the units we finance are valued at about three times what they were, which means that we now get roughly the same charges on one transaction that we did on three transactions before the war, while the cost of handling has increased but not in the same proportion.

5274. *Professor Sayers*: But your clerks presumably want an income three times as big?——*Mr. Livsey*: It has not gone up in proportion.—*Mr. Greaves*: I think there will always be savings by increasing your physical turnover.—*Mr. Livsey*: I have recently financed quite a number of earth-moving machines at £60,000 to £65,000: that was an unthought of figure before the war, and the income on that is very substantial, but the handling cost is no greater, if as great, as on a £500 motorcar.—*Mr. Greaves*: I think competition between us has also kept rates down.

5275. Is it anything to do with the ratio of your turnover to your capital?——I should not like to answer that question without research.

5276. *Professor Cairncross*: May I come back to the terms of trade control? Some of the business that finance companies do (I do not know whether this would apply to members of your Association) involves financing stocking by motorcar dealers and others. In the case of business of that kind does the terms of trade control operate?——*Mr. Livsey*: It does; and it has brought about a rather unfortunate position, about which we are all rather worried. If a vehicle invoiced by the manufacturers is financed on a hire purchase agreement the dealer has to pay a deposit, at present one-third down. When he had to pay 50 per cent. down he just could not find it. We were then forced on to a business where we do not enter into a hire purchase agreement at all; we give the dealer an open credit. He signs a three months' bill, which we try to attach to the particular transaction; but we are really out on a limb now, with quite a large amount of money out which is in fact unsecured.

5277. *Lord Harcourt*: You are going into the acceptance business?——Rather worse than the acceptance business, I think. You do tie up your acceptances with goods; all we have is a bill which really means nothing at all except that we present it for payment. There is no security with it, and we have no underlying security because we do not own the vehicles.

5278. *Professor Cairncross*: The dealers have to make the down payment?——Yes.

5279. *Chairman*: The goods are not identifiable?——We put on the bill: "Value received, Austin (or whatever it is) motorcar chassis No. so-and-so"; but we have no security at all, and we are not at all happy with quite a lot of the money we are putting out, which is supposed to be used for stocking and is being used for different purposes. We suspect that some dealers are doing their own hire purchase with the money we put out for stocking.

5280. *Professor Sayers*: When the proportion to be paid down was increased to 50 per cent. the effect was not to force the dealer to cut his stocks of cars, but to force you and the dealer to arrange the credit differently?——That is right. The same amount of stocking went on, but outside the control order.

5281. *Sir Reginald Verdon Smith*: You said one of the possible advantages of a terms of trade control system was from the public interest that it makes it possible to deal by sectors of industry. Does this not really lead into all sorts of problems of definition, or has it been found easy to define the sort of products that you cover?——*Mr. Livsey*: The control order now has many categories but they are clearly defined. We have no difficulty in distinguishing the terms of trade control in relation to the various categories of goods. It is all set out very clearly in the order. We have one great omnibus clause at the bottom which includes anything they have not put in above.—*Mr. Greaves*: There are marginal cases, but they have not presented any difficulties at all.

5282. *Professor Cairncross*: May I ask what contact you have with the monetary authorities?——*Mr. Livsey*: We have no contact at all direct with the Bank of England. When we have wished to discuss questions generally affecting our members we have been able to discuss them with the Chairman of the Executive Officers' Committee of the Clearing Banks. We have always had access there, and we still have, and so far as they have been able they have been extremely helpful to us.

5283. Your main contact would be with the Board of Trade, not with the Treasury?——*Mr. Livsey*: The Board of Trade and the Treasury. If we wish to send a deputation to the Treasury to see the Economic Secretary or the Financial Secretary, we have no difficulty in being received there.—*Mr. Greaves*: I think that we should find, if we were received, that it would be much more at arm's length than if we went to the Board of Trade. Our relations with the Board of Trade are extremely good, and they have gone to a great deal of trouble to learn about our business and administer it in accordance with such learning.—*Mr. Livsey*: The difference is, I think, that the Board of Trade have set up a section to deal specifically with the hire purchase control orders, so that the people we see at the Board of Trade are dealing daily with the subject we are discussing. With the Treasury is it a very different position. I would say that the Executive Officers' Committee of the Clearing Banks is a far more useful source than the Treasury, because they understand our problems, and with the Treasury we are just one of many.

5284. *Chairman*: Would you regard yourselves as having a suitable working arrangement with the Board of Trade?——Very much so. And I would say that, so far as the officers of the Board of Trade are permitted, they are extremely helpful.

5285. You would not say the same about your relations with the Treasury? You could get in to them, but only if you insisted on going?——Yes. We have never been sent for by the Treasury as we have by the Board of Trade. For instance, when the Board of Trade was considering the introduction of a bill to control borrowing by finance companies, we were in constant consultation with them as the drafts were being prepared.

5286. *Lord Harcourt*: The Board of Trade is in fact your parent department?——I would say so.

5287. *Professor Sayers*: If you want to make representations about the control of the amount of bank credit you are allowed to have, do you make those representations to the Board of Trade or through the Chairman of the Committee of Executive Officers of the Clearing Banks?——Through the Chairman of the Executive Officers' Committee.

5288. And you look to him to carry the message to the Bank of England?——Yes. A rather absurd instance of that is that when the Government reduced the deposit on motorcars to 20 per cent., to stimulate hire purchase in motorcars, we saw the Chairman, and said: "The Government have achieved their objective. The business is

pouring in. Can we have back some of that 15 per cent. cut in bank credit?" The Chairman was very sympathetic, and went to the Committee; but we were not given that 15 per cent. back. But I think we have a clear channel to the Bank of England, or to the Treasury, through that Committee.

Chairman: Thank you; we have had a very interesting morning. We are much obliged to you.

(*The witnesses withdrew*)

(*Adjourned until* 2.15 *p.m.*)

R. S. DAVENPORT, ESQ., of Equity Credit Co. Ltd., J. W. HUNTRODS, ESQ., of Campbell Discount Co. Ltd., and R. G. KIRKPATRICK, ESQ., of Marlborough Finance Ltd., representing The Industrial Bankers' Association, called and examined.

5289. *Chairman*: Gentlemen, we will take the memorandum* which you have been good enough to supply to us through with you and see what questions arise out of it. You begin by giving us the composition of your Association, and the necessary qualifications for any company which seeks membership. How long had your member companies been in the business before the Association was formed? Are they all long established?——*Mr. Kirkpatrick*: The majority of these companies are post-war formations, but not all.

5290. *Professor Cairncross*: Are they public companies?——Some of them are, but I think that none of them is public in the sense of having a public quotation for its shares.

5291. The distinction will be on the basis of filing accounts; you do not know whether any company files accounts with the Registrar?——I think that some do; but the point is not very material, because all these companies without exception make their full accounts freely available to any member of the public who inquires for them. We should regard it as undesirable if any company were to decline to give the fullest possible information about its affairs in that way; it is an obligation of membership of the Association to publish accounts not more than six months from the end of the normal accounting date.

5292. *Mr. Woodcock*: Does that mean that you would expel them unless they gave a satisfactory explanation?——Definitely. There might be some special circumstance causing undue delay in the publishing, but, unless a satisfactory explanation were forthcoming, a member would be expelled.

5293. Would expulsion worry a member?——If a member were to be expelled, the Association would announce the fact, which could hardly be to the credit of the company concerned.

5294. You would announce the bare fact?——I do not think we could do more than announce the bare fact.

5295. Suppose they anticipated you by resigning, would you announce that fact?——*Mr. Kirkpatrick*: That I do not know. It is not a position that has arisen.—*Mr. Davenport*: The resignation of a member in the ordinary course would not, I think, call for any public announcement. If it were that a member had anticipated action by the Council and had resigned, then I think that we should probably make a public announcement of the resignation, and explain the reasons why we made it public.

5296. What advantage to a company is there in being in the Association?——*Mr. Kirkpatrick*: We think that membership of the Association carries with it a certain hallmark, in the sense that, if a company can announce the fact that it is a member of the Association, the public at large then knows straightaway that it complies with certain minimum requirements in certain respects that are important to the public, particularly from an investment point of view.

5297. *Chairman*: How are the requirements for membership actually brought to the mind of the public, so that there would be any significance in saying: "I am a member of the Association"?——In the first place, members are encouraged to publicise the fact that they are members. So far as the Association is concerned, we have continuous inquiries from members of the public as to what the Association is; we have literature which we make freely available, setting out the main requirements, and we accompany that by a list of the names and addresses of the member companies.

* Memoranda of Evidence Part VI No. 9.

5298. *Professor Sayers*: Have you circulated any such particulars to the financial papers?——The whole of the financial press is fully aware of the Association, of its membership requirements and of the names of the members.

5299. *Professor Cairncross*: Can you give us any impression as to the size of your companies?——Possibly an indication would be to say that the total assets of all eight member companies are approximately in the region of £5 million at the present time.

5300. And what funds do they dispose of?——That I cannot say, other than that in the aggregate it must be within the borrowing limitations that the Association lays down.

5301. *Professor Sayers*: Has any company applied for membership and been refused?——Yes.

5302. On account of non-fulfilment of the conditions stated here?——Yes.

5303. What is the significance of "inter alia" in this sentence: "Companies seeking membership . . . must, inter alia, conform", etc.?——We mention here the main requirements; one should refer to the rules to see the full requirements of membership.

5304. *Mr. Woodcock*: How were the rules drawn up?——They were drawn up at the inception of the Association by a sub-committee set up for the purpose.

5305. How can they be altered?——To alter the rules we should have to call a general meeting of the members of the Association, and propose a resolution to modify the rules in a stated manner, and have that resolution passed by a two-thirds majority.

5306. One company, one vote?——Yes.

5307. *Professor Sayers*: I gather you say there that your liquidity requirements are what they are because you have drawn a close parallel between yourselves and the clearing banks?——To a degree.

5308. You say that 10 per cent. must be in cash or Treasury Bills; the clearing banks say 8 per cent in cash. And then you call yourselves bankers. What do you mean to convey by the word "banker"? What functions do you think are appropriate to you as bankers?——Very simply I should say that the banking function in this connection is the receipt of funds from one section of the community in the form of deposits and the granting of credit facilities to other sections of the community. That seems to us a basic banking function: to borrow on the one hand and to lend on the other.

5309. Would you describe the building societies as bankers?——A building society is in rather a special position, in so far as the terms on which it borrows are quite dissimilar from the terms on which it lends, particularly in regard to period. As far as we are concerned the credit facilities which we give are mainly short term. For most of our companies the monies that are out on hire purchase agreements are liquidated at a fairly rapid rate, so that there is a high degree of liquidity.

5310. It is the shortness of your lending that you think is important?——Yes.

5311. What about your borrowing; is that like the work of the joint stock banks?——The borrowing is not quite so short as compared with joint stock banks, in so far as quite a lot of money is on notice up to six months. Most companies have a scale whereby they are prepared to repay certainly limited sums on demand, greater sums, say, on one month's notice, more still on three months and the remainder eventually perhaps on six months. That would vary from one company to another.

5312. *Chairman*: Do you regard yourselves as being under an obligation to receive deposits under your terms from anybody who offers them to you?——Yes.

5313. *Professor Sayers*: Do you receive much in deposits repayable on demand?——The most usual practice is for a company to provide that the first £100 of any sum deposited is repayable on demand.

5314. That carries interest at the agreed rate?—At the agreed rate.

5315. Is it withdrawable by cheque payable to a third party?——*Mr. Kirkpatrick*: No.—*Mr. Huntrods*: Our company has an intermediate position here; although no cheque books are issued, we find that we are quite frequently requested to make payments from accounts to third parties, and in such an event a document equivalent to a cheque is drawn up, stamped and duly signed and the remittance made in the normal way.

5316. *Chairman*: What kind of third party is that? Would they be trade accounts?——It is difficult to say. One frequently gets a request to pay £15 14s. 2d. from someone's account to John Jones or to the Charrington Coal Company or so forth, so that, although they are technically not current accounts we find they have a tendency to operate in that way.

5317. *Lord Harcourt*: What is the average size of your deposits?——*Mr. Davenport*: In the case of my company the average would be about £250.—*Mr. Huntrods*: Our average last year was about £280.—*Mr. Kirkpatrick*: I should think that is a fairly representative figure.—*Mr. Huntrods*: They fluctuate very widely from small accounts of £50 to £60 to large accounts of £4,000 and £5,000. That is the average.

5318. *Chairman*: From where do you draw these resources? Who is your typical depositor?——*Mr. Kirkpatrick*: Largely from the public.

5319. *Professor Sayers*: In advertising for or soliciting deposits from the public do you attach importance to the use of the word "banker" in describing your Association, if not your company? None of the companies uses it in its own description?——The majority of companies certainly describe themselves as industrial bankers. It is important, I think, to describe what one is in an advertisement, and it is a question of finding a term which has become accepted as describing the particular business that we carry on.

5320. For various official purposes, for instance for the purposes of the Companies Act, the Inland Revenue, the Capital Issues Committee, the Bank of England Act, you would not be described as bankers?——No. That is because we only operate in one sector of banking; in other words, we do not offer a complete banking service with current accounts, and all the normal services that a joint stock bank, for example, offers.

5321. *Lord Harcourt*: What is the average term of your deposits? Are most of them at three months' or six months' notice?——It depends upon the scale of repayment adopted by each individual company and the size of the individual deposit.

5322. The length of notice varies normally with the size of the deposit?——Broadly, but there are exceptions to that, in so far as some companies will offer a slightly higher rate of interest if the money is deposited on six months' notice as against, say, three.

5323. *Professor Cairncross*: Is there a minimum deposit?——It varies from one company to another, but most companies have a minimum. It might be anything from as low as £5; but many companies have a minimum of £50 and many also £100; purely on the basis, I think, that it costs money to administer a deposit account, and any sum less than £50 is not an economic proposition.

5324. You do not allow your customers to get into debit?——No.

5325. *Lord Harcourt*: Is there a great turnover in these deposits or do you find that in practice they stay with you?——In practice I would say they are very stable.

5326. *Professor Sayers*: What proportion of your total resources comes from deposits?——It varies considerably from one company to another, even within our own Association. Some companies have a very considerable proportion of their funds in the form of deposits; others have relatively little.

5327. Would you be prepared to tell the Committee for publication the distribution of your liabilities, either for each company or for the aggregate of the members of your Association?——I think we could supply that. We publish the aggregate deposits of our members at quarterly intervals in the financial press, but not other resources; bank loans, for instance. We also issue quarterly the total of cash and Treasury Bills, for the purpose of showing that we are maintaining the liquidity ratio. We also publish the aggregate of our total outstandings on hire purchase and other credit documents.

5328. So there are the capital, and borrowings from the banks and other sources, which are unpublished?——Except in the annual accounts.

5329. *Chairman*: Perhaps you would supply us with the aggregate figures giving the distribution of your liabilities between deposits, bank credit, your own capital, and any other sources.—*Professor Cairncross*: Perhaps you would be good enough to let us have a copy of the last balance sheet for each company; and, if possible, it might be interesting to us to see the balance sheets as they stood two or three years ago, if they are still available.—*Chairman*: We will let you have a letter after this, putting clearly down what it is we would like to have?——*Mr. Kirkpatrick*: We will do our best to supply that.*

5330. *Mr. Woodcock*: To whom do you lend money?——The bulk of the business is in the form of hire purchase and credit sale.

5331. What do you mean by the bulk; 98 per cent.?——*Mr. Davenport*: To be a member of the Association you must do at least 75 per cent. of your business in instalment trading, hire purchase, credit sale or something of that nature.

5332. What about the rest?——*Mr. Davenport*: A certain amount of business is done in other respects by way of debentures, or loans of that type, mainly to the sort of people with whom we are in business relationship on hire purchase.—*Mr. Kirkpatrick*: That is a relatively small aspect of the business; the bulk of the business is in the form of hire purchase, credit sale and other similar credit documents.

5333. I gather that this 10 per cent. that you have for cash and Treasury Bills is not necessarily the case in each company, because you say here that it may be 10 per cent. or 30 per cent.?——*Mr. Davenport*: Whether it is 10 per cent. or 30 per cent. is dependent upon the maturity of the deposits against which the reserve is kept, but in every case it must be made up of cash and Treasury Bills.

5334. On what terms do you lend? Do you lay down conditions about repayment of credits?——*Mr. Kirkpatrick*: The Government lays down conditions for us in respect of hire purchase. There is a maximum period of 24 months. As far as hire purchase agreements are concerned they are normally for 12, 18 or 24 months.

5335. Are all the loans of these companies to individuals or firms for a particular hire purchase transaction?——Yes, on hire purchase or credit sale.

5336. *Professor Sayers*: Do you do block discounts?——*Mr. Davenport*: A certain amount.

5337. *Mr. Woodcock*: Supposing you are dealing with a firm; do you lend the firm money, and they make the individual transaction?——Yes.

5338. What repayment arrangements do you make with them? That is not necessarily covered by any regulations?——It is automatic, because the resources that we make available to the firm would be tied to the period of the documents that they are providing to us. They are using those resources to give hire purchase facilities to their customers. They themselves are limited to 24 months. The resources of ours that they are going to use will therefore come back to us in that period.

5339. *Lord Harcourt*: They lodge with you the hire purchase agreements?——That is right.

5340. *Professor Cairncross*: You take over their customers' accounts?——*Mr. Davenport*: Yes, but the dealer would continue to collect on those accounts from his customers.—*Mr. Huntrods*: The normal system is for the firm concerned, to come up with a great pile of agreements; these are vetted, and we advance a percentage

* See Appendix to Minutes of Evidence.

of the nominal value of those, that is the cash price less deposit. The dealer will collect the instalments from his customers on his agreements which are left with us, and he will repay by bill of exchange or banker's order the advances made against those documents.

5341. *Mr. Woodcock*: On what terms do you lend money? The customers have to pay back on the terms laid down on the hire purchase agreement; do you lay down the terms of your loan to the dealer?——*Mr. Huntrods*: We do precisely.—*Mr. Davenport*: Take the system we use in our particular company: we take the average period of the block of agreements that the dealer has lodged with us, some at 12 months, some at 18 months, some at 24 months; that might work out at, say, 19 months. Then we say that that is the period within which he must return the resources which are made available to him.

5342. *Chairman*: It is the instalments which will be coming in under those agreements which, in fact, will provide the money to pay you off?——That is correct.

5343. *Lord Harcourt*: The dealer collects the instalments; does he pay them over to you monthly?——He pays over monthly, but what he pays may not be exactly related to the payments which he collects.

5344. *Professor Cairncross*: Is he merely an agent? ——He is an agent in so far as he is virtually collecting on behalf of the company which is giving him the discounting facility.

5345. *Sir Reginald Verdon Smith*: Who is the principal in the hire purchase agreement?——The principal would be the dealer himself. The agreement would be between him and his customer. Theoretically what the finance company does is to purchase the agreement from the dealer, and one of the terms of that purchase is that the dealer will continue to collect the instalments on behalf of the purchaser, that is the finance company, and remit what he collects or, in fact, what he should collect whether he collects or not; because he also guarantees that he will he able to collect.

5346. *Professor Cairncross*: So there is a theoretical rate of repayment on the basis of the bits of paper that he lodges with you, and he has to comply with that although the rate at which he receives money from his customers may not exactly agree?——That is correct.

5347. *Sir John Woods*: You have an agreement with him, and he has a series of agreements with individual people; your security is that second lot of agreements? ——That is right.

5348. *Chairman*: You actually buy by your discounting operation the right to enforce those agreements, and you employ the dealer as collecting agent?——That is right.

5349. Has there been in the case of your companies a shift from banking accommodation in the last three years to other sources of finance, owing to the credit squeeze? ——*Mr. Kirkpatrick*: There has been no shift in the sense that companies have done without bank facilities which were available to them; but there has been a shift, in a sense that there has been a complete freezing of the amounts that the banks can advance to companies of this kind. Therefore the companies are obliged to seek other resources elsewhere.

5350. Because your business has been growing?——Yes.

5351. *Professor Sayers*: Do you finance the increasing business entirely by going outside the banks?——Yes, because owing to Treasury directions the joint stock banks are unable, although they would be very happy from a business point of view, to increase the facilities they were giving at a certain date. In fact they had to cut them by 15 per cent.

5352. *Chairman*: From the point of view of running your own business cheaply and effectively, would you prefer to get your increased finance from the banks?——Bank facilities have certain very definite advantages. For example, if one is dealing with motor vehicles on hire purchase, the business is a seasonal one, and it is a very great convenience to be able to call on bank resources for overdrafts and so on when one needs them, and only to pay for the money when one wants it. From that point of view most companies would welcome increased reliance on bank facilities. But I think that many companies, even if banking facilities were freely available, would still want to accept money from the public on deposit as well.

5353. Because of the security of longer term or for what reason?——*Mr. Kirkpatrick*: Bank facilities are, at any rate technically, withdrawable at very short notice, although in practice no doubt a bank would be rather more sympathetic than that. With deposits we are borrowing over a wide field, and it is unlikely that at any given time more than a very low percentage of the people who have lent us money will want it back; therefore they are more stable.—*Mr. Davenport*: I think, too, that a lot of companies, given freedom, would go for a form of financing which they have not yet been able to do, at least in the post-war years, and which would enable them to obtain their finance more on the same terms on which they are placing their money out: probably by the issue of unsecured notes on one, two, three, four and five-year securities.

5354. Where would you look for that type of finance if you were free?——One would probably seek it through the medium of the Stock Exchange, trying to get it as an equity stock freely available and issued to the public.

5355. *Sir John Woods*: I understand that it is a necessary membership qualification for your Association that members must provide facilities for receipts for deposits; to use your exact words:—

"Members are required to employ not less than 75 per cent. of their assets directly in hire purchase or credit instalments financed within the United Kingdom, and to provide facilities for the receipt of deposits, loans and other forms of borrowing."

You are very firmly in the business of seeking deposits from the public; you cannot be in this Association unless you do; is that right?——The rule merely says that we are required to provide facilities for the receipt of deposits, loans and other forms of borrowing; that is fairly widely drawn. The extent to which we provide facilities is not laid down. The first part is very precise: we have to employ not less than 75 per cent. of the assets directly in hire purchase, etc.

5356. Nobody could remain a member of this Association and say he was going to rely entirely on bank credit or whatever other source he liked, and decline to accept deposits from the public; would that be right?——That would seem to be so.

5357. *Chairman*: What do you understand by the word "facilities" there? How much does it commit you to? ——I think it means no more than a willingness to accept deposits.

5358. *Professor Sayers*: That implies the establishment of at least one office. Does it imply the establishment of more than one office?——No.

5359. You simply say: "I am in Park Lane, at such and such a number, and I will receive deposits"; that is providing facilities for the receipt of deposits?——Yes.

5360. Do you, in fact, have many branch offices?——That varies very much from one company to another. One company may have one office; another company may have anything up to a dozen offices.

5361. How many offices in total have the eight members?——I am afraid I do not know; we could find that out.*

5362. You have told us that during the last two years you have been increasingly relying on deposits. Have you been opening more offices at the same time?——There is a tendency in that direction.

5363. Has the attraction of deposits been one of the factors in determining the rate at which new offices are opened?——That is hard to answer. A company does not necessarily open a branch office purely for the receipt of deposits, but it may well open a branch office for the earning of business on the other side; the two are complementary.

5364. Has the collection of deposits been regarded as a material factor?——In so far as deposits have tended steadily to increase that must mean an increase in the volume of business being done, and an increase in the size of organisation, which in itself would tend to lead to the opening of new branches.

* See Appendix to Minutes of Evidence.

5365. Yes, but when deciding whether or not to open a branch in Sheffield, for example, have you said: "If we go there we shall be in a good position to develop our business in such and such fields, and we shall be collecting rather more deposits in the West Riding than we had been doing". Does that happen at all?——I would not say that by opening a branch office you encourage deposits. Deposits are activated more by press advertising, I would say, than by having an office in a place. An office is merely the facility for the receiving of money once you have encouraged it by other means.

5366. You regard press advertising as the chief means of attracting deposits?——*Mr. Kirkpatrick*: I would think so.

5367. Is the rate of interest that you offer an attraction?——The rate of interest must obviously be a big factor when a person is deciding whether to make an investment or not.

5368. You describe press advertising as your principal means of attracting deposits: the rate of interest is therefore not the principal factor?——The rate of interest is usually featured in the press advertisement.

5369. *Professor Cairncross*: Do all your members advertise in the press?——Yes.

5370. Is this a requirement of your rules?——No.

5371. *Chairman*: What makes you feel so clearly that the rate of interest is an important element in the attraction? Do you find that members of the public who deposit with you are interest-conscious?——Yes.

5372. Is it the comparative advantage you can offer over some other favourable use of their money which you think is attractive?——I think that is an important factor.

5373. What you would regard yourselves as competitive with, from that point of view?——*Mr. Kirkpatrick*: It is hard to know where the funds that one receives have come from, but we know that some come from building societies. Some may have come from other forms of investment too.—*Mr. Davenport*: We compete surely with all other forms of short term investment where there is no risk of fluctuating capital; that excludes the Stock Exchange.

5374. *Mr. Woodcock*: You are really competing for money already saved; you are not concerned, or you do not in your answers give me the impression of being concerned, to encourage savings?——*Mr. Kirkpatrick*: That is incorrect. We find quite frequently that a member of the public will open a deposit account with a relatively small sum, say £50, and execute a banker's order for the payment to us for the credit to that account of a certain sum per month. We encourage members of the public to use the deposit accounts for savings purposes.

5375. If you were really concerned to encourage saving you would be concerned with branch offices that would help people to save?——We would not regard the mere establishment of branch offices as a very effective means of encouraging deposits. Advertising is the most effective means of doing that.

5376. Surely it is also an additional encouragement if there is some place at which people can deposit their money?——*Mr. Davenport*: A lot of them take it to a joint stock bank where they can put it to the credit of the finance company.

5377. But they have to go through what some people would consider a rather elaborate procedure by making an order on the banker to transmit it to you?——I do not think that they would be involved in very much less trouble if they actually called at one of our offices. They would have the money in cash or by way of cheque, and a lot of offices supply them with a paying-in-book. They have merely to enter the amount in the paying-in book, take it along to the bank and hand it over the counter.

5378. *Professor Sayers*: The building societies in attracting deposits have been very much concerned to develop a system of steady saving each month of regular amounts on deposit, and have given a higher rate of interest on such forms of deposits. Do you give a higher rate of interest on such regular deposits?——*Mr. Kirkpatrick*: By and large no; but it has to be remembered that this is a fairly new form of investment, and therefore time has to be given for the development of this type of facility. Various companies are thinking of that sort of thing at the moment, but it is probably early days yet to embark on a scheme of that kind. But, as I say, we do encourage the saver who wishes to accumulate from income by as far as possible giving him facilities to make that relatively easy.

5379. Another form of attracting deposits that has been common in other quarters in this country for two hundred years or so is to allow the customer the facility of drawing on it by cheque to a third party. You have stated that you do not do that. Have you, in fact, considered attracting deposits in this way?——By and large we have not, most of us, found the need. We have not found the desire on the part of our depositors for that sort of facility. The most that we get is a request from a depositor at a certain date to pay from his account to a third party a certain sum of money, and we are quite happy to arrange that for him.

5380. I am thinking not of what the customer asks you to do, but of the facility you offer to the customer in order to attract him?——*Mr. Kirkpatrick*: We do not in any way publicise a facility of that kind for the purpose of attracting deposits.—*Mr. Huntrods*: We do not generally envisage entering the commercial banking field as such, and one would be very much on the edge of it in doing that.

5381. But you do attach importance to the use of the word "banker"?——*Mr. Kirkpatrick*: Yes.—*Mr. Huntrods*: We regard ourselves as bankers of a special kind. We think that historically there has been more than one form of banking and that we have not seen the last form yet.

5382. *Professor Cairncross*: What sets a limit to your activities, a shortage of funds or a limitation of the demand for the accommodation you can give?——*Mr. Davenport*: It varies from time to time. Currently it is probably shortage of funds on the part of companies.

5383. If you attracted increased deposits, would you attract more business?——Within limitations.

5384. *Mr. Woodcock*: Does that mean that you do not have to compete with each other on the banking side?——It might seem as if that would be the effect, but it does not actually happen in that way.

5385. Do you compete with each other?——We do indeed.

5386. What form does this competition take?——It may take various forms. In the main I should say it takes the form of service to the dealer with whom one is transacting business, the manner in which one handles his business for him and the terms on which one is able to offer facilities for his customers.

5387. Do you vary your charges?——Yes indeed. The only variation we can make in these days of controls is variation of rates and charges.

5388. To what extent do they vary?——I should imagine there may be not very much more than, say, a 10 per cent. range of variation between rates; the difference might be as low as 1 per cent. on charges between particular companies.

5389. Is your own rate of interest which is charged to the borrower on hire purchase the same for everybody?——No.

5390. To what extent does it vary?——It may vary to as much as 10 per cent. of the charge; that is to say, if the charge was 10 per cent. in one case, it might be 11 per cent. in another or 9 per cent. in another.

5391. *Sir Reginald Verdon Smith*: When you were speaking of the possible growth of business, you said that it could be increased "within limitations." Is this a field in which those limitations are narrow? What has been the rate of growth, for example, over the last five years?——One of the major factors here is the Government controlling orders. However much money was placed at the disposal of the finance companies at the present time, with the present control there must be a limit to the amount of business that will be available to them.

5392. *Professor Sayers*: If those Government restrictions were removed do you think that there would be great opportunity for expansion of business of a kind that you would care to do?——I certainly think there would be room for considerable expansion.

5393. *Professor Cairncross*: Does this mean that you would extensively alter the terms of trade from those laid down by the Government?——In certain directions, yes.

5394. *Professor Sayers*: Which directions?——Probably on a number of domestic articles.

5395. *Chairman*: By allowing a longer term?——Probably a smaller initial payment rather than a longer term.

5396. A smaller initial payment, and therefore larger monthly instalments?——Yes.

5397. *Professor Cairncross*: But the bulk of your business, I take it, is in motor vehicles?——*Mr. Kirkpatrick*: That varies very considerably from one company to another.

5398. Taking the aggregate, would I be right in supposing that about half of the total business is in motor vehicles, including commercial vehicles?——*Mr. Davenport*: I would have said of this number of companies probably less than half.

5399. *Mr. Woodcock*: Do the companies tend to specialise at all?——The smaller the company the more tendency there is to specialisation.

5400. *Professor Cairncross*: What kind of terms of trade would you, left to yourselves, offer on motor vehicle business? What kind of deposit, for instance, would you ask for?——It would probably standardise itself around 25 per cent, with discretion amongst the companies to accept as low as 20 per cent. where circumstances justified it.

5401. Would you offer more than two years?——I think so. Normally, before these restrictions were heard of, it was regarded as quite normal to do a new car with 25 per cent. down payment and the balance spread over a period of three years. With plant and machinery of certain kinds one can go even further than that; one might go as high as four to five years.

5402. Which type of business do you think is most restricted by the present regulations? From what you have to say would you not think that industrial plant and equipment is more restricted relatively?——I would not myself think that. It is more logical under present conditions to restrict that class of merchandise, but I should say that domestic articles are in fact the most effectively restricted under the present terms of trade control.

5403. You are putting it to us that some of these buyers of industrial equipment would normally have been offered three to five years, where at present they are restricted to two years, so that the limitation is apparently more severe; you do not expect that any change in the terms of trade there would lead to any big increase in business?——No. Where it is necessary for a company to do so it can, and does, meet its obligations over two years. It could meet them much more adequately and much more logically if it were given three or four years in which to do so.

5404. *Chairman*: But you do not think the effect of limiting the permissible period to 24 months in the case of industrial customers has penned back business?——Yes, I do. It has done so particularly amongst those people who are not willing to commit themselves for a shorter period than that in which they feel they are able to meet the obligation; among the more careful customers, in fact.

5405. *Professor Cairncross*: And very often the smaller customers?——Yes indeed.

5406. *Mr. Woodcock*: When you are lending through a dealer and he is in a sense your agent, do you expect him to bear some part of the risk?——Yes; he selects the customer, and he carries the risk of that customer not carrying out his obligation.

5407. But you lend the money more or less directly through him as an agent?——No; we acquire the contract from him on condition that, having chosen and entered into that contract himself, he is prepared to support it.

5408. Do you lend 100 per cent. of his own outgoings?——No.

5409. What percentage?——It normally would vary between 66⅔ and 75 per cent.

5410. *Professor Sayers*: Do you lend at the same rate of interest to all your borrowers, or does it vary?——It varies.

5411. What sort of range?——Excluding where we introduce a minimum charge, which is a money charge rather than a rate per cent. charge, it would probably vary for certain companies and for certain classes of merchandise from what we should regard as a very high rate, 12½ per cent. flat, to what today would he regarded as very low, 6 per cent flat.

5412. The variation would be by classes of merchandise?——Classes of merchandise and size of transaction.

5413. Is it by size of borrower at all?——Not necessarily by size of borrower; but one would be influenced in that direction, because, generally speaking, the bigger borrower is the type of borrower who seeks more competitive quotations.

5414. You find these people are interest-conscious?——The bigger people are more interest-conscious.

5415. Did you find at all that, when the rates were raised against them steeply, as they were last autumn, they just did not do the business they were going to do?——*Mr. Kirkpatrick*: Some of them may not have; but I would not accept that generally.—*Mr. Huntrods*: When the cost of money went up for the companies on their own borrowings, at first charges were put up by a sort of general movement; but it became fairly obvious that the depressing effect of the high Bank Rate and the other measures was going to make money a little easier to get than business, and in certain cases there has been a tendency to lower charges slightly, or at any rate to get rid of the additions that were at first put on.

5416. When there was a reaction to these higher rates, was it among particular groups of customers, or was it fairly widely sprinkled over all customers?——*Mr. Davenport*: It was restricted to the commercial customer, the business man, the man who considers things of that sort; it did not affect the private domestic individual.

5417. Could you differentiate according to class of merchandise at all?——I do not think it was particular to any industry or type of person.

5418. Had you ever noticed any effects from changes in interest rates before last autumn?——Yes, we have noticed the effects of increases before; but, of course, there has been no increase so steep as that which we experienced last autumn on any previous occasion in our experience.

5419. You attach importance to the steepness of the increase?——In one step.

5420. Was that because it was a very strange occurrence, or would you suppose that an increase of equal steepness again would have the same kind of effect?——I think an increase of equal steepness taking place on top of what we have already had would always have that effect.

5421. *Sir John Woods*: Would it have that effect from whatever level the steep rise took place?——As far as finance companies are concerned, there is a minimum at which the finance company can borrow either from banks or from depositors, however low the Bank Rate goes. The minimum rate on borrowings from the banks is 5 per cent., and they probably have to pay a minimum of 5½ or 6 per cent. to their depositors. So movements of the Bank Rate between 2 per cent. and 4 per cent. have no noticeable effect on finance companies, and consequently there is no change in their charge to their customers.

5422. So the absolute level is of some importance?——Yes, in its effect upon our customers.

5423. *Lord Harcourt*: 5 per cent. to 7 per cent. is important, and 7 per cent. to 8½ per cent. would be even more noticeable?——Yes.

5424. *Chairman*: So far as you can say from experience, do you think the deterrent effect on your customers persists, or do you think that it is an immediate reaction?——My own impression is that it is an immediate one which does not persist.

5425. *Sir John Woods*: Is that true of what you call the business customer as well as the private customer?——I think so.

5426. *Mr. Woodcock*: Under the heading "The industrial bankers' function and place in the financial mechanism" you speak of credit sale agreements. I understand that in the United States there are lots of credit arrangements, including one which, if I understand it aright, is of this kind: that the customer can get from a big retail store a revolving credit, of $100 or whatever it is, which he has more or less permanently, but he has to repay the amounts of purchases to maintain it at that level. Do you finance that kind of thing? Is there anything of that sort of thing in this country?——*Mr. Davenport*: It is quite considerably done in this country, but more by retailers and people of that sort than by finance companies. I do not know of any finance company which operates that.—*Mr. Huntrods*: That is known as a budget account.

5427. What is covered by your credit sale agreement? Is it another name for hire purchase or is it something else?——*Mr. Davenport*: The reason why credit sale has developed so much over recent years is because a certain proportion of credit sale business is outside the terms of trade control orders; provided the period does not exceed nine months, there is no restriction on the amount of the initial payment. Consequently, where the initial payment is the important factor people tend to buy on credit sale and repay over nine months without having to make any high initial payment, instead of on hire purchase.

5428. *Lord Harcourt*: In whom is the ownership of the property vested?——The title passes to the customer straight away; it is just an open credit.

5429. *Chairman*: Has your experience of operating those been satisfactory in the sense of a small percentage of losses?——I think the general experience has been surprisingly satisfactory.

5430. That takes you back through the whole post war period?——Yes

5431. *Professor Cairncross*: Do I gather that you do not do any business at all in taking over accounts from retailers other than on hire purchase business?——Hire purchase or credit sale.

5432. *Mr. Woodcock*: Would you object to financing budget account business, or have you not been asked?——The difficulty is the handling of it. It is extremely difficult to handle, because one has a day to day fluctuating balance. If we could find a way of dealing with it we should probably try to do it.

5433. *Professor Cairncross*: It is done by finance companies abroad?——Yes; in America in particular.

5434. *Chairman*: Then you say:

> ". . . some industrial banking houses also discount bills of exchange related to movements of goods, and others make medium term advances available to approved applicants which are secured by debentures, mortgages and/or guarantees and indemnities."

Is this financing activity confined to particular kinds of trade?——It is not necessarily confined to any particular trades. Generally speaking the finance companies grant facilities of this sort to the dealer customers with whom they are in other relationship on their hire purchase business. A dealer may be selling motorcars or furniture, or something of that kind, and passing the finance company hire purchase business from time to time; and then he seeks a facility for his own purposes, either by way of bill discounting or debenture advance, and the finance company provides it.

5435. So it is done indirectly with the kind of business normally dealing with hire purchase goods?——Generally speaking that is so.

5436. *Professor Sayers*: Are these loans for very long periods?——So far as finance companies are concerned, they try to restrict them to the same sort of terms as for their ordinary hire purchase business; but there is no restriction on the term.

5437. *Mr. Woodcock*: Is there any restriction on the use to which they can put the money? Do you advance money for ordinary working capital, for example?——Generally speaking companies would not do that for ordinary working capital purposes; there would be some specific purpose for which the funds would be required.

5438. On your side do you make it a condition that it is for some specific purpose and not for the general purpose of the business?——*Mr. Kirkpatrick*: One example is the stocking plan facilities.—*Mr. Davenport*: Generally speaking the advance is made for a specific purpose, but I would not have thought that the finance company necessarily followed it through to ensure that it was in fact used for that purpose.

5439. *Professor Cairncross*: How do you view the application of your advances for the purposes of stocking, let us say, by motor car dealers? Is this a line of business you favour?——*Mr. Kirkpatrick*: It is not a line of business that one would seek, but it is a facility one has to give to a dealer with whom one is in normal business relationship.

5440. Because he might go to another company?——*Mr. Kirkpatrick*: That is what it amounts to.—*Mr. Davenport*: The average finance company thinks it is a great nuisance having to do it at all.

5441. *Lord Harcourt*: It is in fact the provision of working capital?——It is.

5442. If the car dealer said he wanted to build a new garage, and he asked you to lend him £3,000 or £5,000 for this purpose, would you do that?——Yes, in certain circumstances; generally speaking, provided we can be repaid on a monthly basis within the period that we normally deal with our moneys, that is about the three year period.

5443. If he says: "My wife wants me to buy a new house", would you lend money?——*Mr. Davenport*: No.—*Mr. Huntrods*: There is a minority of transactions, certainly in my own company, where we have been right outside the hire purchase field; in areas not even remotely related to it. We have financed direct import and export business, sometimes by straight bill discounting, sometimes taking the shipping documents, and in other ways.

5444. How has this business come to you? Have you sought it?——We have not sought it; it has come to us.

5445. *Professor Cairncross*: What kind of business is it? Are you thinking largely of motor car exports, or is there other business of this type?——No, we have financed aeroplanes to buyers in the Middle East on credit terms of about six weeks, and we have financed the movement of goods from, let us say, Germany to countries inside and outside the sterling area. It is something we have felt our way on.

5446. They are rather exceptional transactions, I gather?——They started as exceptional; but, within a strict limit in our own minds as to how much we are prepared to commit to it, they are tending to become habitual.

5447. *Chairman*: Would it be your impression that when this business is brought to you it is diverted from more normal channels like banking accommodation?——I can think of one case where it was, and for an interesting specific reason. In regard to one specific export of aeroplanes the financial status of the exporting company was such that their bankers would not have granted a credit by overdraft; they would have been most unwise to do so. We looked at the transaction, went into the credit with the foreign bank, and we said: "This in itself is perfectly sound; providing we have control of the transaction, we will do it."

5448. *Lord Harcourt*: When you advance money either for the provision of working capital or for the building of a garage or something else which is ancillary to your customer's normal business, do you take any contract or agreement from him that he will do all his hire purchase with you?——*Mr. Davenport*: No, we do not; but I think we hope to have that relationship with him.

5449. It is justifiable to hope that it will have that effect; but there is no formal agreement?——*Mr. Kirkpatrick*: There would be a sort of understanding, I suppose, but there is no obligation.—*Mr. Huntrods*: I know of companies who do in fact have agreements of that sort; whether they are worth anything or not I would not know.

5450. *Professor Cairncross*: Do you regard yourselves as transacting business which is in any way different from that of the larger finance houses? You call yourselves industrial bankers and the finance houses call themselves finance houses?——*Mr. Davenport*: As you will see if

you look down the list of members of the Finance Houses Association, the majority of the members describe themselves in their literature and in their advertising as industrial bankers.

5451. Then you would say that there is no difference but that of size?——Mainly size.

5452. *Professor Sayers*: Have you sought inclusion in the Bankers' Almanac?——*Mr. Davenport*: As an individual company, no. I do not know that any members of this association have.—*Mr. Huntrods*: No, certainly not.

5453. *Chairman*: You call yourselves "industrial bankers," but you are not in industry yourselves and, if I understand you aright, only a small part of your funds is devoted to supplying goods to industry. What is the idea that is supposed to be conveyed by "industrial"?——*Mr. Davenport*: The only company that could answer that would be the first company to introduce that description of its activities. Some company at some time did in fact describe what it was doing, which is the same as we are doing now, and said that it was an industrial banker carrying on an industrial banking function. Since that time it has become commonly known that those engaged in this business describe themselves as industrial bankers carrying on an industrial banker's practice, but I doubt if any one of them would be able to answer the question which you quite rightly ask. I do not think there is a logical answer to it except that it has just happened.

5454. It does not mean anything special, like supplying plant and machinery and so on?——No; there are plenty of people who call themselves industrial bankers who do nothing in plant and machinery at all.

5455. *Mr. Woodcock*: On your section on "Relations with the joint stock banks", are any of the banks shareholders in any of these companies?——Not to my knowledge.

5456. *Professor Cairncross*: Are any of your companies owned by other organisations, industrial or financial?——Not to my knowledge.

5457. *Lord Harcourt*: The Board of Trade have published an estimate that there are in existence something in the neighbourhood of 1,200 small hire purchase companies at the moment. You have eight members at the moment; the Finance Houses Association has twelve. Do you anticipate an enormous influx of people into your Association when they have the necessary trading experience to qualify under your rules?——*Mr. Kirkpatrick*: Many of these finance companies in the 1,200 are purely offshoots of other businesses with a purely restricted purpose. Many of them, for example, are purely to deal with the hire purchase business of a particular organisation. Many of them operate in very limited spheres with no ambition to go beyond those limitations. So, although no doubt with the passage of time we expect the membership of the Association to increase, the figure of 1,200 finance companies has no relationship whatever to it. One cannot envisage the I.B.A. having as many as 100 members at any time in the near future.

5458. *Chairman*: Then you deal with the arguments against direct bank participation in hire purchase.—*Professor Sayers*: Would you have any objection to greater activity by the banks in this field, if they chose to take the risks and assume the burdens?——It depends what you mean by "objection". It would be natural that we should hardly welcome competition from the banks in the field of hire purchase. Our general view in this is that hire purchase business is already being competently handled by those companies who have specialised in that field and who have acquired over a period the necessary techniques, and we do not therefore see the necessity for the banks to participate in that.

5459. The experience you have acquired gives you an advantage which must give you some protection from the incursion of new competition; but that is no reason for fearing competition?——I do not think there is any fear.

5460. You say:—"The Association opposes the possible extension" etc.; what do you mean by "opposes" there? I should have thought that you would have had faith in the advantage of the experience that you have gained and you would rather say that the Association could not care less?——*Mr. Huntrods*: As regards technique and experience I do not think it could; but there might be something to be said in the general direction that the banks are in a privileged position; they are the repositories of everybody's money, including ours.

5461. They have certain advantages that you have not. You might say they have greater facilities for collecting deposits, for instance?——I do not think that is a competitive advantage one need fear.

5462. It enables them to get the money at much lower rates than you are getting it. What are you paying now?——*Mr. Kirkpatrick*: On deposits the most common rate is 8 per cent. or 8½ per cent.

5463. And the banks get it at about 5 per cent. The banks certainly have an advantage there?——*Mr. Huntrods*: There I think you are coming to the heart of the matter. A finance company takes a special risk, operates a specialist technique, and pays the rate for the class of capital to undertake that risk. If the banks are in possession of the great bulk of the money supplied, on perhaps half or more of it they are paying no interest and they could enter this or any other business field, using their depositors' money.

5464. And taking the risks?——And taking the risks, which would be proportionately small to them though absolutely the same in the business involved. That gives them a special advantage.

5465. Are you not arguing in fact that society should welcome the extension of the banking interests? I agree that that might not be consistent with your Association "opposing"; but I am trying to find out what your Association means by saying it "opposes" this, and why?——May I put this in another way? Supposing the banks decided suddenly that they liked the look of the shoe manufacturing industry, and that shoe manufacturing industries generally had to raise capital on the market at, say, 6 or 7 per cent. There would be something to be said against the one set of institutions in the country which does not have to pay the rate for a particular class of capital entering the manufacturing market under what is essentially a false costing position.

5466. But there is no particular rate that can be labelled as the rate for shoe manufacturing, if somebody else, having assembled money from various sources, chooses to take the risk of going into that business. Why suppose that the rate for money for hire purchase business is 8 per cent. rather than 5 per cent. or 3 per cent.?——We would rather base it, generally speaking, on the same grounds as those on which we have tended to dislike the participation of the nationalised boards in hire purchase, in that they used to get money at privileged rates.

5467. What do you mean by "the Association opposes"? Do you just mean that you dislike it as individual trading concerns?——*Mr. Kirkpatrick*: We are not in favour of it.—*Mr. Davenport*: I think "opposes" is the wrong word. There is no ground for opposing it at all.

5468. *Mr. Woodcock*: I thought you were going a bit further, and saying in effect that, even if the banks could do this, they nevertheless should not do it.—*Professor Sayers*: But that is not your meaning?——The only ground for objection is that the field is already well cared for as it is at present organised, and that it is unnecessary to add further complications to that field.

5469. That is hardly an objection, is it?——One must be careful here to distinguish present conditions and conditions of complete freedom. There would be no objection under conditions of complete freedom; but there would be a lot of objection under present conditions.

5470. *Chairman*: You do not think it would threaten your reliance on the banks for finance if they went into this business themselves?——I do not think it has been the experience in America; provided that one has normal conditions where, if one is unable to get the support of the banks, one is free to seek support elsewhere.

5471. *Professor Cairncross*: I thought you were going a little further, and suggesting that there was something improper in the banks venturing their depositors' money in this way; that if the money were at call it was unwise of the banks, and perhaps in some ways a breach of faith to the depositors, if they put it into this kind of business. Are you putting forward this kind of proposition?——*Mr. Huntrods*: No, not at all.—*Mr. Kirkpatrick*: There is of course, a very large question here, and one can

develop all sort of theories about it; but, as far as the Association is concerned, our view is as stated here, and nothing more: we feel that the field is already adequately catered for by the people who are in it, and that therefore there is really no necessity for the banks to participate in it. That is broadly as is stated here, with the exception that the word "opposes" is perhaps too strong.

5472. *Professor Cairncross*: You say a little later on:—

"During 1957, although hire purchase credit made a marked recovery from the low levels of 1956, total outstandings at the end of October were still only 90 per cent. of those at the end of 1955."

Is this altogether a measure of the hire purchase business you are doing? Does it not also depend on the deposits made by those entering into hire purchase agreements?——The outstandings as far as we are concerned is a measure of the business that we are doing, of our turnover.

5473. Supposing that the initial deposit is doubled, then the total sales might go up while the outstandings went down?——*Mr. Huntrods*: They might, but they would not; because if the deposit is doubled, that undoubtedly restricts the number of sales.

5474. *Lord Harcourt*: For how long?——*Mr. Huntrods*: It depends on the general economic climate, and the movement of incomes and prices, and confidence and everything going with that.—*Mr. Davenport*: It pushes purchases forward; I do not think it stops them.

5475. It does not in fact deter business completely; it merely postpones it, and once they have time to catch up with the initial deposit then the thing goes forward exactly as it was before?——*Mr. Kirkpatrick*: Yes.—*Mr. Davenport*: That applies mainly with domestic articles. In a lot of commercial fields a machine is wanted at the time, and it is perhaps no longer of any use at a later date, or the firm has lost the opportunity at a later date.

5476. *Professor Sayers*: It appears to be your contention here that bank credit and the credit extended on hire purchase move together; but surely if you take a longer period than is covered in this paragraph, say from 1951 on, hire purchase credit has risen substantially over that period, while bank credit has not? The two things do not necessarily, over several years at least, move in parallel?——*Mr. Kirkpatrick*: The point we are trying to make is not so much that they move in parallel as that they are not directly competitive.—*Mr. Davenport*: A rise in one does not create a drop in the other.

5477. *Professor Cairncross*: I had formed a slightly different impression of your point, which seemed to me to be that, where severe restraints were placed on commercial bank credit, if these restraints were of a more extensive character and affected the terms of trade under which goods could be sold under hire purchase, there might be a reduction simultaneously in hire purchase credit outstanding. Is not that a somewhat more exact description?——*Mr. Kirkpatrick*: These figures were quoted purely to show that the expansion of one form of credit was not at the expense of the other; nothing more.

5478. But the governing phrase is surely:—"subjected to approximately equally severe restriction"; I do not know how you judge that, except by looking at the result in each case; the argument is circular?——*Mr. Davenport*: The following words are important: "neither can for long gain much benefit at the expense of the other."

5479. Is that entirely true? If you take the rather longer period between 1951 and 1956, the banks have been under considerable pressure not to extend additional advances; there has been some pressure on hire purchase, but you have surely succeeded in obtaining command over additional resources during that period and in extending credit?——That surely is covered by this, if they are "subjected to approximately equally severe restriction" over that longer period. I suppose it is fair to assume that hire purchase has suffered less severe restriction; and that the banking restriction has been more consistent over that period, whereas with hire purchase it is up and down.

5480. How do you establish whether there has been an equally severe restriction unless you look at the results in each case? If you are looking at the results, they would appear to suggest that hire purchase restrictions have not prevented an increase although restrictions on the banks have prevented an increase?——*Mr. Huntrods*: Over the 1951-56 period my colleague here was probably correct in suggesting that over the earlier part of the period hire purchase was subjected to a less efficient restriction, but in the period from February, 1956, when Mr. Macmillan's really severe restrictions came on and we were subjected to severe, and in fact discriminatory, restrictions through our bankers at the dictates of the Treasury, then I think we suffered rather more than the banks.

5481. Are you not proving too much? In that period what you had to deal with was an actual withdrawal of resources from you, and you have succeeded in making that up; the banks suffered no withdrawal of resources?——*Mr. Huntrods*: There are two sides to this. The main restriction on our business has surely been the terms control in combination with the financial restrictions, and in 1956 they were very severe. The proof of the pudding was in the eating: hire purchase outstandings fell 20 per cent.; it was a most uncomfortable year. But I am quite certain that in the state of business confidence which then prevailed, had both finance houses and banks been free to operate in their respective credit fields both would have greatly enlarged their lendings.—*Mr. Davenport*: The material thing to show is that neither gains at the expense of the other. Perhaps over the longer period hire purchase companies have expanded whereas bank advances have stayed still; but they have not expanded at the expense of the banks.

5482. It is not very clear to me. In the case of the joint stock banks it is not possible for them to compete for deposits by raising their interest rates in the way it is possible to with hire purchase. It is part of your contention, as I understand it, that the interest rates are only a limited fraction of your total costs, a much lower fraction of costs than in the case of the commercial banks. If that is so, and you find your operations are in difficulty because you have not got the necessary resources to conduct them, you can afford to put up your rates of interest in a way which the commercial banks cannot. If therefore the squeeze is operated exclusively on the monetary side you are much less vulnerable than are the commercial banks?——We say that we do not in any way compete with the joint stock banks on the taking of deposits.

5483. It is your contention that the additional funds you have had are not taken out of bank deposits. How can you establish that?——*Mr. Huntrods*: I think one establishes that from the fact that there is at any one moment roughly speaking a total supply of money, the great bulk of which is the deposits in the clearing banks. If someone writes a cheque to the finance company to place a deposit, the banks' deposits as a whole are completely untouched, because on the following morning the finance company puts it back exactly where it was, either in that bank or in another. The banking system as a whole has lost nothing; there is no variation in total bank deposits.

5484. The level of bank deposits is governed by circumstances quite different from the deposits of the industrial bankers; the resources of industrial bankers may increase in relation to the resources at the disposal of the commercial banks if customers of the banks make deposits with the industrial bankers.—*Professor Sayers*: The total liquidity of the community has increased, although the amount of the bank deposits is the same as before.—*Professor Cairncross*: What you are saying is entirely correct; but it does not mean that financial intermediaries, the industrial bankers, for instance, may not expand in relation to commercial banks while the supply of money remains constant. This is exactly what has been happening. I do not put it to you that the industrial bankers are alone in this respect; that would be quite false; nor do I put it to you that this is something which has been going on only over the past five or six years?——*Mr. Davenport*: I suppose it does have the effect, if that money comes out of a private customer's deposit at the bank into the finance company's deposit, that the money is used in a way in which it would not have been used: the banks would not have used it for hire purchase. In other words, we are

creating an additional demand for a certain class of goods. That is the effect; but we are not in fact in competition with the banks in the monetary system for deposits.

5485. You are in competition with the Government?——We may well be in competition with the Government, but the Government has ways and means of dealing with us. We are only trying to establish here that we do not compete with the banks.

5486. What would happen would be that the commercial banks would find themselves obliged to restrict their loans to the Government, and it would be that money in effect which was used?——Yes.

5487. *Chairman*: Then you come to "Restrictions on hire purchase". You do not oppose the exercise of some form of overall control of the level of hire purchase credit, given anything like the present conditions, but you think that the terms of trade control is not only the really effective way to achieve the purpose, but much more satisfactory than control of the sources of money?——*Mr. Huntrods*: Yes.

5488. *Professor Sayers*: You say that "since both rises and falls in the volume of hire purchase credit can make no direct impact on the total money supply, it follows that hire purchase controls should be regarded as a purely subsidiary monetary weapon". Is not that a *non sequitur*? It may be so, but it does not follow from the beginning of the sentence.—*Sir Oliver Franks*: While it may be true that variations in the volume of hire purchase credit do not affect the total money supply, they may affect something else, that is the level of demand?——*Mr. Davenport*: Yes.

5489. And the level of demand may be an objective of monetary policy, and therefore one cannot readily argue that this as a weapon of monetary policy is insignificant on the ground that it does not increase the money supply; the point is what it does to demand?——*Mr. Davenport*: Yes.—*Mr. Kirkpatrick*: The emphasis here is not that this is a monetary weapon which is insignificant, but rather that it is perhaps less important than a weapon to be used in a case where the total money supply has increased. In other words, we feel that perhaps too much emphasis has been placed upon the evils of hire purchase as an inflationary business, ignoring certain other factors which are a good deal more influential in that respect.

5490. *Chairman*: Then you describe how variations in the control have a disruptive effect upon the manufacturing side which lies behind the production of these goods you are interested in. How much have you seen of the upsets of manufacturing industry?——*Mr. Davenport*: The motor trade itself is a very fair example of that. At the time when the 50 per cent. deposit restriction was brought in in 1956 it had an immediate effect. The radio trade from time to time has also reacted violently to these restrictions. It has an immediate disruptive effect; that is probably caught up with later on, but the fact remains it does have that disruptive effect.

5491. *Professor Sayers*: Is this something that you have seen through your contacts with these trades?——I would not like to say we have seen that exclusively because of our contacts in particular with the trade.

5492. *Sir Oliver Franks*: It is one thing to hold a general opinion on grounds which are probably adequate; it is another thing to be able to supply direct empirical evidence from one's own trade? Can you do that?——*Mr. Davenport*: I do not think we are in sufficiently close contact with manufacturing industry to be able to say that.—*Mr. Huntrods*: I have seen two small cases. There was one small radio and electrical manufacturing business which was prospering before 1956, and then in three or four months it was driven out of business. There was no doubt that the reason for that was the restriction of sales through those hire purchase controls. I have seen another case of a business going under; it was importing, so perhaps the Government wanted it to, but it was also dependent on hire purchase for its sales and the effect of 1956 was to bankrupt it. They may be unimportant, but I have seen those two.

5493. *Chairman*: Accepting your theme about its effect, I do not see how it is to be avoided if the Government are going to use variations in the terms of trade control. The terms must be adjusted from time to time to meet the circumstances, and the new terms must be imposed, I suppose, without very much warning?——*Mr. Kirkpatrick*: There is a tendency for the terms control to be varied to too great an extent: for example, there was a move from a 20 per cent. minimum down payment to a 50 per cent. minimum. That was a very severe movement. Furthermore, these changes take place far too frequently. We feel that it is a control which should be used with far greater discrimination.

5494. With milder effects, therefore?——Yes. The motor industry is an example of this. At one time there was a 50 per cent. minimum initial payment which had quite a depressing effect on the industry, and then representations were made by the industry itself to the Government, and the control was eased down to 20 per cent.; and the whole picture immediately changed almost overnight.

5495. *Professor Cairncross*: When that happens there is presumably a repercussion on the production programmes of the motor industry, so that that industry is very much affected by changes in hire purchase terms?——Yes.

5496. *Lord Harcourt*: If the terms of trade orders are to be used as regulators, how can you avoid them being either frequent or violent? You have either to have them at infrequent intervals with rather fierce effects, or you have to put up with them being rather frequent with mild effects. If they are to be used as efficient regulators, how can you get over both those difficulties?——That may be so; but I think, particularly in the case of the motor industry, that timing is very important. The motor industry is very seasonal, with an upsurge of business normally in the spring and summer. If, for example, restrictions are eased and a considerable volume of business is done in the spring and summer such that the Government feel that it is going too far, they may then perhaps in the mid-summer put severe restrictions on, at the time when the trade is beginning to enter into its slack period anyway. The effect is very depressing, and that is not a good thing.

5497. From the point of view of hire purchase companies which is preferable? Do you prefer frequent variations of a slight degree in the terms of trade order, or less frequent but more severe?——*Mr. Davenport*: I would have thought the more frequent, less severe.

5498. You can adjust yourselves quite easily to those?——I think so. One of the other complaints of finance companies is the illogicality in the application of some of these restrictions. For instance, when the Board of Trade brought everything within the range of 50 per cent. in 1956, commercial vehicles were lumped with radio sets, private cars, and plant and machinery. It all came into the same kennel, all at the same rate. One had the impression that it was legislation against a system, or an attempt to restrict overall demand without regard to the interests of a particular demand within the overall demand.

5499. *Professor Cairncross*: It had the effect of checking investments in commercial vehicles. It was really directed against any specific things which were purchased on hire purchase, without regard to what these were?——Yes.

5500. *Sir John Woods*: If the intention of the Government is to restrict demand, is not this probably the quickest and most effective weapon at their command?——It is certainly the quickest; I would not have gone so far as to say it is the most effective weapon.

5501. It is the quickest, and it is very effective?——It is effective, in so far as hire purchase itself is a material factor in the overall demand.

5502. *Professor Sayers*: Surely if it were not effective the changes would not be disruptive?——*Mr. Davenport*: That is right.—*Mr. Huntrods*: I think at bottom we have a feeling in our hearts (I do not know how accurate I am in this, or how far my colleagues agree with me) that when it comes to a question of checking overall demand the Government says: "Hire purchase is easy; let us have a go at that", rather than taking more difficult and fundamental measures to reduce the overall level of incomes, if that is what they wish. It is as though we have too much attributed to us and too great a responsibility.—*Mr. Davenport*: I always have the impression that they make much play and publicity about restrictions on hire purchase, as though they are going to be a cure for all our ills and evils; at the same time we feel that

not enough attention is given to the individual application of their restrictions on various types of merchandise within the control. One would have thought that perhaps, if it was necessary to make a deposit of 50 per cent. for radio sets, it was not necessary to have a deposit of 50 per cent. on productive plant and machinery.

5503. Why this discrimination?——Presumably one is more essential to the country than the other. We get the impression, because there is this similarity of restriction on all types of goods that are bought on hire purchase, that it is a restriction of means of purchase rather than an attempt to channel investment in certain directions.

5504. Why not assume equally that it is an attempt to cut total demand quickly?——I think one can draw a parallel there with the directive to the banks. Surely the directive to the banks is a discretional directive; it asks the banks to do certain things. It says a complete negative to hire purchase; it presumably does not give a complete negative to things concerned with export and things of that kind. We get applications for hire purchase facilities for plant and machinery that is going to improve or increase production of goods for export, but because it is wanted on hire purchase it must come under the same restriction as buying a wireless set; the buyer must find 50 per cent. deposit and repay the balance in 24 months.

5505. But that may be because the Government thinks this is the quickest way to cut total demand, not because it has its knife into hire purchase, nor because it has its knife into either lorries or radio sets?——Would you not expect that that would be accompanied by a similar directive to the banks to stop all advances, or cut all advances by 50 per cent. or 25 per cent.?

5506. *Chairman*: I think you have made your point; that you get the impression, from the way that this is being dealt with, that the Government is striking at an activity, and you think it might strike more discriminately at the activity; on the other hand, it is an activity which does not make as large a contribution to what is troubling the Government as others?——Yes.

5507. *Professor Cairncross*: Would you rather be asked to behave as the commercial banks are asked to behave and keep within a ceiling of outstanding credit?——*Mr. Kirkpatrick*: That would be very difficult to enforce or administer. I cannot see how that could operate.—*Mr. Davenport*: I think it could, but it would be very difficult. We should be put in the same difficulty as joint stock banks are put in at the present time.

5508. *Lord Harcourt*: You prefer the terms of trade?——*Mr. Davenport*: Yes.—*Mr. Huntrods*: It would be more difficult in any case. We enter into agreements which will, we hope, be liquidated at a certain rate; it would be very difficult to enter into just so many as to make up the balance. One imagines the ordinary bank manager has a certain number of overdrawn customers, and it is fairly easy; they will probably go up to their limits anyway and he can cut one off and let another in, because the total is fluctuating, in this day to day management. But all our lendings are going down, and it is difficult to match the amount they are going down with new business.

5509. *Professor Sayers*: Does your new business come in chunks?——It tends to.

5510. *Chairman*: I think you make the point that it is not just that quantitative restrictions in the loans you make would be difficult for you to administer, but that you think the system of working through terms of control provides a fair basis among yourselves?——*Mr. Davenport*: Yes; it affects everybody equally, the big and the small.

5511. *Sir John Woods*: You say further on that the demand for hire purchase credit is little affected by variations in the short-term rate of interest. You have in the course of this afternoon qualified that a little, saying that there can be, and indeed there has been, a distinct check to the volume of business; but you think on the whole it is temporary?——That was the result of a perhaps exceptionally violent change; and it applies to the industrial customer rather than the domestic.

5512. I thought you said that you had experienced a reaction to a higher rate of interest well before Bank Rate went to 7 per cent.?——I do not think so. I do not think in my experience we have ever had to react to so large an increase ourselves.

5513. I thought you said that you had had a temporary reaction to higher interest rates at a time when we moved from, say, 3½ per cent. to 5 per cent.?——On this last occasion there was of course a more noticeable effect because of the exceptionally large increase which we had to impose at that time; but I think there always is an effect with an increase in our rates, not amongst the domestic and private users of hire purchase, but among the commercial and industrial users, the people who are interest-conscious.

5514. In other words it is customarily quite small and only temporary?——*Mr. Davenport*: Yes.—*Mr. Kirkpatrick*: Raising the rate of interest is not an effective weapon for the purposes of controlling hire purchase because the effect is not great and is likely to be temporary.

5515. *Sir Oliver Franks*: I should like to ask one rather general question which does not arise immediately from the paper before us. A recent report of the Organisation for European Economic Co-operation which was reflecting on Western Europe generally, including ourselves, foresaw a very considerable expansion of sales of consumer durables over the next decade. It foresaw more or less an approximation in our part of the world to the use of those things that is now customary in America. Do you, abstracting the interference of Governments, think that there is an indefinite expansion ahead over the next decade for your type of business, not as a theoretical view but on the basis of your actual experience of things over the last five years, or do you see a fairly early limit? This is partly a question of the social structure of our society and changes of taste and so on; but it would be very interesting to know what your quite general reflections are on that question?——*Mr. Kirkpatrick*: My own view is that, ignoring short-term fluctuations, the general trend is definitely one of continuous steady expansion over quite a long period.—*Mr. Davenport*: I would support that to this extent: I think for quite a long period there will be a steadily expanding demand for the type of goods in which we are concerned, and I think that, because of the general economic trend, there will be a greater demand for our type of facility to enable people to have the use of those goods, because they will not otherwise be able to have them; they will have so many other demands on their incomes. Possibly over the next few years incomes will not grow so quickly as in the past; for that reason there may be greater demand for our type of facilities in acquiring those goods. But I doubt very much whether in this country the nature of the people is such that they will commit themselves to the extent that the American people have already done so.

5516. *Mr. Woodcock*: Is not there something of a tendency to build the goods you would normally finance into the house itself now?——To some extent I think that is so; things like wardrobes, dressing tables, electric fires, refrigerators and so on are no longer separate articles.

5517. *Lord Harcourt*: In which case the building societies finance them?——Yes; credit sale is involved.

5518. *Sir John Woods*: Was your answer to Sir Oliver Franks related to consumer goods only or to the whole field, including plant and machinery?——I think one is probably related to the other. My own view is that demands for our type of finance for plant and machinery will also grow as people get to realise that it is the most appropriate means for acquiring plant and machinery.

5519. Do you think consumer goods business is likely to grow more than the other?——I would not have thought so. I would say that they would probably expand at about the same rate in relation to each other; but at this time plant and machinery does form a comparatively small volume of the total done on hire purchase.

5520. *Lord Harcourt*: We have got very used in our own minds to certain things being particularly susceptible to hire purchase contracts. Have you seen recently a marked tendency for hire purchase agreements to be taken out on new ranges of goods? Are you providing facilities for a wider range of goods than you have done traditionally?——I would have thought not, because of

the limitation of the resources at our disposal. Generally speaking the finance companies are not having to seek new fields in order to use their funds. If, for instance, some retailer of some type of article which he thinks is appropriate to instalment selling comes along now, he probably has some difficulty in finding a finance company who will finance him in that new field; whereas if there were more money available that probably would be encouraged.

5521. *Sir John Woods*: Do you do "durables" like travel abroad?——I think that undoubtedly will come, not as a means of trying to finance intangibles, but because if a man with a family wants to go on holiday it is a very expensive business, and he has to find a way he can provide for that out of income.

5522. Even if he has to pay for one holiday over five years?——I think he would do so each month, for the rest of his life even.

5523. *Professor Sayers*: When you were comparing America with ourselves just now you spoke of the commitment of the American as something that might be unrivalled here in the future. Were you thinking of the average proportion of a man's income that he will commit in this way?——Yes. I think the Americans are prepared to use borrowed money to a much wider extent than would be acceptable over here. There is, for instance, a good deal of what they call small loan business, where you take a small loan to pay the doctor's bill or to pay the child's school bill, or something of that kind.

5524. *Lord Harcourt*: It is largely a question of habit. You can get used to the personal loan quite easily?——I certainly think holidays will come as a matter of habit.

Chairman: I think that has brought us to the end of the questions. We are very much obliged to you.

(*Adjourned until Tuesday, 4th March*, 1958, *at* 11.00 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-SECOND DAY

Tuesday, 4th March, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., (*Chairman*)

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E. (Questions 5525 to 5621 only)
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The following witnesses, representing the Federation of British Industries, called and examined:

SIR NORMAN KIPPING, J.P., Director-General, F.B.I.
H. T. WEEKS, Esq., C.M.G., Chairman, Economic Policy Committee, F.B.I.
Deputy Chairman, The Trussed Concrete Steel Co. Ltd.
A. A. SHENFIELD, Esq., Economic Adviser, F.B.I.

5525. *Chairman*: Sir Norman, as you know, one of the members of the Committee is a member of the Council of the Federation of British Industries; I should put it on record that he has taken no part in the preparation of your memorandum.

We are very grateful not only for your memorandum* but for the work you have done in our interest in your questionnaire. Could Mr. Weeks tell us what the build-up of the memorandum itself is; in other words, how far it represents your own interpretation of the answers extracted by the questionnaire and how far it depends on experience which you have gathered elsewhere?——*Mr. Weeks*: I ought to make the obvious points on the imperfections of this sort of inquiry. It was broadcast to the whole of the membership of the F.B.I.; we got a return of about a third. We are not in a position to say whether that third is really representative of the whole membership, or how far the whole membership is representative of industry. And there is always the risk of bias: that people filled in the questionnaire because they were affected by the questions. If they were not affected, they would then possibly tend not to reply. We are not in a position to say therefore the extent to which the 1,500 or so firms are representative.

We have endeavoured in the first part of our paper to comment on the answers received; the second part was written with these replies in front of us, but has been discussed both with the Economic Policy Committee and the Grand Council and therefore brings in other points of view, and does not confine itself, in the type of comments made, to the fairly factual information in the questionnaire.

5526. You have referred to your earlier publication, entitled *Britain's Economic Problems and Policies*. To some extent, I assume, the memorandum we have here is based upon that booklet, which itself is probably based upon other research?——Based upon a similar process of internal discussion; but there was no other specific inquiry which was put out as a background to the booklet. As you say, the evidence we have given to you is consistent with, and to some extent a summary of, what we said rather more fully in the booklet.

5527. What is signified by "internal discussion"?——*Sir Norman Kipping*: It might be simplest if we refer to this booklet. The process of preparation of that was a fairly lengthy one. In the first place a small group was set up of economists who were working in business, which prepared a first draft. That was then discussed by the F.B.I.'s Economic Policy Committee at two or three meetings and one weekend meeting. In other words the booklet expressed, as far as it is possible to get, the consistent view of a number of people. Then it was again discussed at Grand Council before being finally issued. I might add that the Economic Policy Committee itself is quite a large and pretty representative group of about thirty-five or forty members. They spent a weekend on the draft prepared by the working party; it got a pretty thorough preparation before it was put to the governing body.

5528. What range of industry would be represented by the material we get from you? Is it primarily manufacturing industry?——All manufacturing and only manufacturing. I should say there are very few industries excluded; none probably of any significance.

5529. *Professor Cairncross*: When you say at the beginning of Appendix 1 to your document that the questionnaire was sent to all manufacturing members of the Federation, do you mean it was sent to all members of the Federation?——There is a single category of membership which consists not of manufacturers but of sides of commerce which are of service to the manufacturer. There are probably a dozen banks, and a few insurance companies, and a few other people: categories which associate themselves with the Federation through that group, but do not play an active part in formation of its policy.

5530. The firms who replied seem to be roughly equally divided as to size between the three groups you have used; but there would naturally be in this country a much larger number of firms employing less than 200 people than firms employing over 700 people?——Yes.

5531. So your sample is much more representative of the larger firms than it would be of the smaller firms?——*Mr. Weeks*: I am not quite sure about that. The number should not be proportionate to the number of firms but to the employment of firms in that size. Ideally we should have one reply representing 20,000 employees, whether employees in firms employing 10,000 or more, or 200 or less.

5532. Have you made a comparison from that point of view to see how representative it would be?——*Mr. Shenfield*: No; but it is true that the rate of return was much better amongst the larger firms than the smaller firms. There is a correlation between the rate of return and the size of the firms. The groups we have here do not match the sizes of the firms in our membership; in other words the rate of return amongst the small people was very bad.—*Sir Norman Kipping*: May I remind you of the distribution, in British manufacturing industry, of employment in relation to the size? There are about 10 million people working in British industry, of whom 4 million work either for themselves or in firms of less than a hundred employees; the remaining 6 million work in 15,000 establishments which employ more than a hundred people. Of these 15,000, there are 79 establishments employing more than 5,000; 407 employing more

* Memoranda of Evidence Part VII No. 8A.

than 2,000, 1,130 employing more than 1,000, and 2,800 employing more than 500. Of the 407 employing more than 2,000, 242 are in engineering and vehicles, 53 in metal manufacture, 25 in food, drink and tobacco, 28 in chemicals, 15 in textiles and 2 in clothing. These figures were correct for 1955, and there is no reason to think there has been much change. The employing power of the big firms is, of course, higher, and if you were to seek one reply for every 20,000 employees you would have to have a greater percentage of replies by bigger firms than by the smaller ones.—*Mr. Weeks*: As Mr. Shenfield has said, the relative response was greater from the larger firms; but there is the further problem that our membership is more representative of large firms, too. —*Sir Norman Kipping*: Percentagewise it is. The membership reflected in the Grand Council voting is that out of just under 8,000 firms about a half employ less than 200 people; but that is a very much smaller percentage, proportionate to the total number of firms, than all the big firms, whose representation is over 90 per cent. in membership. But the significance of that numerically large number of small firms, in relation to employing power in British industry, is not nearly as great as the figure of 15,000 I have given as the total number of firms employing more than a hundred people. It is sheer nonsense in my opinion to trot out the figure that there are 70,000 firms in British industry. It may be true; but enormous numbers of them are one-man decorators, tailors or garages. I think it is much more significant to note that there are 15,000 firms employing more than a hundred people. Those below that figure are nearly all sub-contractors and repairers and very small shops concerned only with the domestic trade and community trade very often.

5533. Were most of the firms to whom you wrote public companies?——*Mr. Shenfield*: I imagine the majority would have been; but there may have been a pretty large minority of private companies. We have never analysed the membership to see what proportion of it consists of private companies.—*Sir Norman Kipping*: It would be sheer coincidence, but I should have thought that a cross-section of our membership was typical of the structure of British industry as a whole.

5534. Looking at your tables, it may make a difference to some of the answers whether one is looking at predominantly public companies or private companies, since the public companies usually have readier access to capital?——*Mr. Shenfield*: I should say that amongst the people who made returns there was a majority of public companies; that does not necessarily mean that there was a majority of public companies amongst all the people we sent the questionnaire to.

5535. *Professor Sayers*: All this makes it rather important to know why two-thirds of the firms threw the questionnaire into the wastepaper basket. Have you any indication at all? Is there any reason to suppose that these questions have not affected these people in a serious way, or was it impatience with the questionnaires circulated by the F.B.I. and other bodies?——*Mr. Shenfield*: I am not sure that we promoted this very efficiently. We have done another exercise recently in which the rate of return was very much better than in this case; I think we promoted that a little better.—*Mr. Weeks*: It looked rather formidable as a piece of paper and, as Mr. Shenfield says, it was probably not put over as well as it might have been. On the question of why people did not reply, we have no evidence at all.—*Mr. Shenfield*: It was midsummer, and a sizeable number of people wrote to us afterwards and said that they were sorry not to have replied, but they, or the key men concerned, had been on holiday at the time.

5536. *Mr. Woodcock*: Was this rate of return of 30 per cent. below your average?——*Sir Norman Kipping*: We do not very often send out questionnaires.—*Mr. Shenfield*: In a more recent one on a different topic we sent out 750 questionnaires and received 542 replies before the deadline, and another 100 after the deadline.

5537. They were to some extent big people?——*Mr. Shenfield*: Yes.—*Sir Norman Kipping*: I think, too, that the sort of questions asked would be a bit over the head of a large number of the small companies.

5538. *Professor Cairncross*: Does the information you have had since suggest that the answers to these questions might now be modified, or a different view taken by your members?——*Mr. Shenfield*: I think not with this earlier questionnaire. I think that, if we had asked last summer the questions that we asked in our recent questionnaire, we should have got different answers from those we recently got; but, of course, the second questionnaire asked different questions.—*Sir Norman Kipping*: It might be helpful if we brought something up which is not in our official evidence at the moment. For entirely different reasons we recently launched a survey of industrial trends, which invited people to comment on their experience in the past six months on matters ranging from the trend that had been experienced in hours of work, the numbers employed, new orders, profit margins, level of output, movements of stock levels on deliveries and so forth. It was accompanied by a bit of crystal gazing for three months forward, and some questions about capital expenditure. One or two of the answers from the rather selective but not bad sample of the 542 out of the 750 invited to reply, do show one or two trends which bear upon what we have said to you. We should be happy to submit this as supplementary evidence; but we should feel some hesitancy about publication of the forecasts of future price movements and so on, which could be very harmful to the industries if published.

5539. *Chairman*: I can give you a reasonable assurance that it would not be available to the public for another year or so. Would that meet that difficulty?——We might even then not be entirely happy about publishing the crystal gazing, just because it was only crystal gazing and has not validity.

5540. It is easier for us if we do not ask you today about anything that you do not feel quite safe in saying for publication. If it is only the forecasting that you are unhappy about, I do not think it would embarrass us not to have that.——*Sir Norman Kipping*: I think we could take a decision right away to put this in, if you would like it, excising only the section that refers to forecasting. —*Mr. Shenfield*: I take it we do not mind putting in the expectations of capital expenditure?—*Sir Norman Kipping*: No.—*Chairman*: We should welcome a sight of the document on that basis.*

5541. *Professor Cairncross*: Does the information you now have suggest a reduction in capital expenditure that can in any way be traced to the increased cost of borrowing, or is it impossible to isolate the factors?——*Mr. Weeks*: We did not attempt to isolate factors. As you will see, we asked for replies to show the size of company, and the main activity (within five different groups) and then the questions, where we simply asked for "up", "same", or "down" to be marked. We had returns from 269 companies in metals, engineering and vehicles, 27 in building and building materials, 86 in textiles, clothing and footwear, 36 in food, drink and tobacco and 124 in "other manufacturing". Of the 542 replies, 146 came from companies employing more than 2,000 employees, 107 from those employing between 701 and 2,000, 157 from those employing between 200 and 700, and 132 from those employing fewer than 200. The sampling is not statistically representative; but we do not think that a more precise weighting of the replies would greatly modify the total analysis. So far as industrial representation is concerned, "building and building materials" can really be regarded as referring to building materials only since we had very few building firms in. "Food, drink and tobacco" is probably somewhat under-represented and "other manufacturing" probably somewhat over-represented, in terms of employment in those groups "Metals, engineering and vehicles" and "textile, clothing and footwear" are about right. On capital expenditure we distinguish between expected disbursements in 1958 compared with 1957 and expected authorisations for new expenditure in 1958 compared with 1957, simply as a factual statement. On plant and machinery there is a fair balance between ups and downs for disbursements, but buildings show a rather larger number of downs than ups. Those trends are very considerably strengthened for authorisations as opposed to actual disbursements, there is a very large number of downs on buildings and nearly as many on plant and machinery.—*Sir Norman Kipping*: I should like to draw attention to the last section, where this is summed up in graphic form. You will see that the pressures are obviously being felt on prices and on profits; and it gives a striking picture of the decline in capital authorisations and capital expenditure.

* See Memoranda of Evidence Part VII No. 8A, Appendix 3.

5542. Is this an inquiry you propose to conduct in future at regular intervals, or is it once for all?——*Mr. Weeks*: We have not committed ourselves, but if the results are found to be interesting I think we shall repeat it, not necessarily at regular intervals.

5543. In the same detail?——No, nor with the same questions necessarily; but on the same technique, because the recipients have found it easy to reply, and to reply quickly, which is a great advantage.

5544. In issuing this and the earlier questionnaires to your members did you take account of what the National Institute of Economic and Social Research is doing and seek to fill out the information they get, or is this all entirely independent?——We had been told the National Institute might be doing something of this sort, but we were told that in fact their work was confined mainly to analyses of balance sheets and so forth. The purpose of this was much more an immediate quick picture of the current atmosphere than anything else.

5545. The analysis of balance sheets provides results that are extremely interesting taken in conjunction with your questionnaire. For instance, the degree to which companies run an overdraft is one of the matters on which you comment here; and you point out that industry has been very liquid over the past few years. This would also appear from a balance sheet analysis; but there is, as far as I can judge, some inconsistency between the replies you have received and the evidence of the balance sheets, which seems to point towards a much larger proportion of companies having no overdraft. Your figures suggest that about 86 firms out of the 1,595 had no overdraft during the period 1950 to 1956; the National Institute analysis suggests a very much higher proportion?——*Mr. Shenfield*: It might very well be, because our sample is not representative. Only one-third of those invited replied; and it was biased in favour of size. I think that both of those factors would tend to make for a smaller proportion of companies not having an overdraft; but it is very hard to say.—*Mr. Weeks*: I think that figure comes from paragraph 10 (i) of our appendix. We did not ask a question about that, of course; this was merely the number of people who chose to add this information.

5546. *Professor Sayers*: If one thinks of the boom as running at any rate from 1955 to 1957, one would expect a large number of long scale capital plans to be made during the years 1956 and 1957, plans that would involve expansions and replacements and so on over a considerable period, and that, without any decline in the intention to add to capital, the level of authorisations would decline pretty steeply after that. Is the big decline in "authorisations expected" shown here to be accounted for at all in that way, or is there a genuine expectation that plans to be implemented fairly soon are going to come down?——*Mr. Weeks*: I should have thought that in part, certainly, without anything happening one would expect to find a decline; but this is comparing 1958 and 1957, and I should have thought the authorisation boom, so to speak, was in 1955, and that already in 1957 the new intentions were falling off. But there are no figures to support this.

5547. *Chairman*: How far do your replies to this recent questionnaire run in line with the Board of Trade's recent publication about plans for industrial expansion?——*Mr. Weeks*: As far as I remember, the Board of Trade figures are on expected expenditure and not on authorisations.—*Mr. Shenfield*: If we are to place very much credence in these figures, ours show a rather gloomier picture; but of course they are not expressed quantitatively in the sense of amounts of money; they only give the number of people going down and up, and that can have very many different interpretations.—*Sir Norman Kipping*: Nevertheless, on a pretty big sample fairly carefully selected, disbursements on balance are not expected to fall this year but authorisations are; so I think that to some extent supports Professor Sayers's thought that authorisations still working themselves out and having to be paid for in both buildings and plant were made at rates higher than new authorisations expected.—*Mr. Weeks*: Obviously expenditure on buildings could be expected to fall off before expenditure on plant, because buildings are for the most part paid for before the plant comes in.—*Sir Norman Kipping*: There are some surprises in the record of stock movements, in answer to question 7, where rises during the past six months are reported rather more frequently than we should have guessed.

5548. *Professor Cairncross*: There is a disparity between raw materials and final products?——*Sir Norman Kipping*: Yes.—*Mr. Weeks*: I think perhaps that we might have expected that six months ago, by last August (this was sent out in February) to find stocks of raw materials going down, but one must remember that raw materials have been brought forward, and I think that in many cases deliveries have come forward rather more rapidly than expected.

5549. *Professor Sayers*: Has the rise in stocks of finished goods resulted from inability to sell?——*Sir Norman Kipping*: We find it extremely hard to be sure of the explanation. It is probably a mixture of various things. One does know that the retailer and wholesaler are ordering much shorter and forcing stock holding back on the manufacturer and producer industries. Whether that is because the retailer is being squeezed for credit, or because he is taking a gloomy view of the market, is something one can only guess at this stage. In this connection you have asked us if we can collect information on the comparison between trade credit and bank credit. That will involve us in another questionnaire of some sort, and when we get answers to that I think we might be able to sort out the explanation for this greater holding of stocks of finished goods. It is rather surprising, though, to find that in the metals, engineering and vehicles field the holding of stocks and finished goods has been rising; that is not so characteristically liable to suffer from the retailers' attitudes.—*Mr. Shenfield*: It suggests that it is getting harder to sell even in the intermediate ranges of industry.—*Mr. Weeks*: It is surprising to find a comparative consistency in the "up" to "down" ratio between textiles and clothing, which is essentially retail distribution, and metals, engineering and vehicles.

5550. *Professor Cairncross*: You have already collected some information in your earlier questionnaire, where you show the changes over the past three years in the proportion of trade debtors to turnover. This suggests that there has been an expansion in trade credit over the past three years, though it is not clear from these figures whether it has gone up steadily throughout the period or rose less in 1957 than in previous years. This appears to be true of firms in each group. Is it possible to look at the figures and say whether the bigger firms were net givers or takers of credit?——*Mr. Shenfield*: We had a number of covering letters with the answer to this earlier questionnaire, a goodly number of which dealt with this point on the lines: "although we say trade credit has lengthened, we do not say it has lengthened by much." I then personally interviewed a few people, and I found the same kind of view: that trade credit was lengthening but the degree of lengthening was not very significant. I cannot say, however, that that was a very representative sample in either case.

5551. Are you speaking of recent events or nine months ago?——Nine months ago.

5552. Is there any evidence that it is still lengthening?——We do not know.

5553. It may be useful if we make available to the F.B.I. witnesses the data with which the Central Statistical Office has provided us on this, indicating from balance sheets what has been happening to the trade debtor and trade creditor items, and ask for their comments on the figures. We are chiefly anxious to establish whether there has been in the past few years a tendency for trade credit to expand when bank credit has been limited, whether we can expect that the two will in future move together. We should like to know whether you have formed any judgment as to whether the normal pattern is one in which trade credit and bank credit expand simultaneously, or whether a new pattern has been introduced in the past five or six years?—*Professor Sayers*: And whether the pattern differs after September 1957 from immediately before September 1957?——*Mr. Shenfield*: It would be impossible for us to pronounce upon that at this stage, but it is a matter we could certainly look into.

5554. *Professor Cairncross*: Another point put to us is that there is a pronounced tendency for the burden of carrying stocks to be pushed back towards the manufacturer from the retailing end. Sir Norman was commenting on this earlier. Have you any indications of a movement of that kind?——*Sir Norman Kipping*: I cannot answer that statistically, but in many dozens of contacts with

manufacturers I hear that so often as to be sure it is real.

5555. *Professor Sayers*: Is it because retailers are not able to get credit as easily as they were?——*Sir Norman Kipping*: I cannot give the reasons. It may be a mixture of what outlays the retailer has had, probably coupled with credit restrictions, which have resulted in his forcing back stock holding to the manufacturer; but it is quite marked.—*Mr. Weeks*: The same point is made in a few covering letters to this last questionnaire, that the retailers and wholesalers were holding off somewhat; but it is very difficult for a manufacturer to say whether that is because the retailer is not selling or whether he is deliberately reducing stocks.—*Sir Norman Kipping*: This is the worst month of the year in which to judge this point, both because it is always a sticky month just after the Christmas boom, and also because of the quite large proportion of products affected by purchase tax and the anticipation of possible Budget changes.

5556. *Mr. Woodcock*: Would you not have expected that since the war, at least till comparatively recently, retailers would have held more than their normal pre-war stocks, with shortages and possibilities of price rises?——*Mr. Shenfield*: That would be countered to a considerable extent in the consumer field by purchase tax regulations; that is quite important.—*Mr. Weeks*: I should have thought that that influence disappeared two or three years ago.

5557. *Professor Cairncross*: Would it be possible for you to analyse the answers to questions already put on trade credit, so as to show whether there is any tendency for particular industries or for the large companies to be showing an increase?——*Mr. Weeks*: There is a bit of a clue here on the large and small company question, although we are showing as larger companies here those with over 700 employees: the "up" and "down" ratio does not seem to be very much different.—*Sir Norman Kipping*: If the Committee would care to suggest the exact type of question it would like answered, we should be pleased to see if we could incorporate that in a questionnaire.

5558. *Chairman*: I think we could evolve some questions, and send them to you later. May we now run through the appendix to your memorandum and see what questions arise on it? In paragraph 4 you are dealing with sources of funds; you say there are marked differences in the extent of recourse to share issues. Are we to concentrate on the words "share issues" there, or does that mean raising capital in the market generally?——*Mr. Shenfield*: The share issue is what was asked.—*Mr. Weeks*: That was simply a comment on the replies to that question.

5559. *Professor Cairncross*: The word "share" here includes debentures?——*Mr. Weeks*: No; equity shares. —*Mr. Shenfield*: Again these figures only indicate frequencies, not amounts.

5560. *Lord Harcourt*: In the last two sentences on paragraph 4 you talk about the smaller companies and then you say: "It is likely that in some cases this may be the result of lack of knowledge of the machinery available for raising funds". Do you find there is still a great ignorance among smaller people as to how they may raise capital?——There is some ignorance; I do not know whether you could call it great. A lot would not come to our knowledge, because the person concerned would probably go to his banker and the banker would tell him. But we are not without evidence of small firms who have somehow not got that information.

5561. Who are still in difficulties?——*Mr. Shenfield*: Yes, certainly in recent months.—*Sir Norman Kipping*: And that applies to medium term credit as well.

5562. *Professor Sayers*: Is it because they have been unable to raise money in their accustomed ways?——To some extent.

5563. And their ignorance is not on how to raise money in general but how to raise money in ways different from the channels to which they have been used?——Yes; or, in the present circumstances of stringency, without giving up control. That is a very important matter in the case of a small man.

5564. *Professor Cairncross*: Were you surprised by the results obtained from the questionnaire showing the influence of the cost of borrowing on the willingness to borrow?——*Mr. Weeks*: I do not think so.

5565. You would have expected figures of this kind? ——*Mr. Shenfield*: Something like that, yes.

5566. *Sir John Woods*: In paragraph 13 you indicate that quite a considerable proportion of firms are affected by interest rates; but you say that only 179 out of a total of 1,595 were affected by the rises in early 1955, as though you thought that was small?——The difference is between interest rates as a *major* factor and interest rates as a factor. A large number of people treat interest rates as a factor, but on those two historical occasions very few regarded the changes as a major factor.

5567. *Professor Sayers*: But the 179 refers to the major factor?——Yes; that is a very small proportion of the 1,595. It is about 12 per cent.

5568. When you say this is the kind of figure that you would have expected, do you mean that it is what you would expect, given the talk you had heard from business men during this period, or do you mean that it is much what you would have expected in relation to what you believe would have happened in previous periods?——It was partly the result of what one heard orally from people concerned, and partly from known matters such as the blunting influences on the effect of a rise in interest rates, some of which we set out in our evidence; adding all those together, I think one would not have been surprised that the rise of 1½ per cent. did not affect the great majority of business decisions.

5569. Do you not find this figure of 179 out of 1,595 astonishingly high? This is the most surprising thing to me in the whole of the papers you have put before us. ——*Mr. Weeks*: It is very difficult to throw one's mind back to what one expected. Certainly at the time we saw this there was no great surprise. It is, of course, difficult to know how people are going to interpret "major factor"; I think one has to assume that they read the following questions as well: "did it cause you to modify market expectations? to defer or reduce an investment project? to modify your views about stocks?" If they did any of those things, even if they decided not to raise stocks quite as much as they had previously, then it may be suggested that that was regarded as a major factor.

5570. *Professor Sayers*: And, therefore, they would be in the 179?—*Chairman*: We can regard the people shown under (ii), (b), (c), (d) and (e), in the section about interest rates as those who because of the rise of 1½ per cent. in Bank Rate in early 1955 took an adverse decision with regard to investment, either fixed or in stocks?——Yes; but to what extent we are not able to say. We were trying to get at the extent to which it was a general red light, and something which affected a particular decision, which might therefore be said to follow from the change in the rate of interest.

5571. *Professor Cairncross*: But you also found that more people reduced their investment because of the rise in cost than because of any danger signal that they attributed to the rise in rates?——*Mr. Shenfield*: It is difficult to interpret because some of these are duplications: some firms might appear in (b) and (c) and also perhaps in (d). And then the difficult question arises for the person making the return to decide which was the major factor in his own mind. Still, the figures, as far as they go, show what you are suggesting.

5572. But the material question is the one the Chairman was formulating: how many of the 179 firms did in fact reduce their investment, either fixed or in stocks?——*Mr. Weeks*: Yes. It is a question of reducing investment which before that they were on the point of deciding to undertake.

5573. How many firms are under either (b), (c), (d) or (e) without duplication?——*Mr. Weeks*: We cannot tell you without running the cards through.—*Chairman*: Could you do that for us. It may only be a very small duplication involved, but it might turn out to be quite substantial.——*Mr. Weeks*: Yes.*—*Sir Norman Kipping*: The impression reaching me at that time was that the factors listed in paragraph 18 of the main paper were of the greatest importance; it was hard to know whether the interest rate had been an isolated factor in the

* See Memoranda of Evidence Part VII No. 8A, Appendix 2

decisions that were reached, or the possibly changing attitude towards the expectation that inflation would continue. As this paragraph points out, if people were expecting a 5 per cent. a year inflation, then the relation of that to the cost of borrowing becomes an extremely important consideration.

5574. *Professor Sayers*: This was in January and February, 1955. If in fact the expectation of inflation was strengthening at that time, it makes this figure of 179 all the more surprising?——*Sir Norman Kipping*: Yes, it does.—*Mr. Shenfield*: But it might have been something of this kind: that the general atmosphere in which that change was made might have been effective for a very short time, that is to say, a person having to take a decision might have been impressed by what was said in public for a few weeks and his decision might then have been affected; and then, very shortly after, he might have decided that the Government's measures were not going to be as successful as they thought. The whole influence might be very transitory.

5575. He is being asked this question two years later; would that not tend to discount any transient influence?——Yes.

5576. *Professor Cairncross*: I took this question in conjunction with another one that surprised me; the answers to the questions in the questionnaire on the influence of taxation appear to show that higher taxation since the war has not caused the majority of firms to want a higher rate of return on investment. This would seem to suggest that they were not very interest conscious. Do you find that a surprising answer?——*Mr. Weeks*: One might have expected to find a higher proportion of them saying: "Yes" than we got.

5577. Would you think that firms, if asked to say what they regarded as a reasonable gross rate of return before the war, would have given rather similar rates, and shown an average rate of return of 15 to 20 per cent.?——*Sir Norman Kipping*: It is frightfully hard to generalise. If you asked a typical cotton manufacturer whether higher taxation since the war had caused him to require a higher gross rate of return, he would say sourly that it was no good hoping for a higher return; it could not be bad anyhow. In other words, market considerations would come in here, and it would perhaps only be those who could exercise some choice in the matter who would reply to the question at all.—*Mr. Shenfield*: It is very hard to judge the reliability of the answers to that question, where we are asking people to cast their minds back twenty years or so.

5578. You do not think they were thinking in terms of the rate of return on turnover rather than on capital?——No. I think the next question would have cleared their minds of any doubt about that.

5579. Is it clear from the analyses you have done whether the firms that did show some response to the rise in the Bank Rate were firms that normally expected a low return on new investment or firms that normally expected a high return?——*Mr. Shenfield*: No. These are cross-analyses which we did not do. We did not think the questionnaire was worth it at that stage.—*Mr. Weeks*: It could be done, of course.—*Professor Sayers*: It would be of great use to us if we could have a very considerable analysis of these 179 firms who regarded the rise in Bank Rate early in 1955 as a major factor; showing what kind of firms they were, and in what branch of industry; and if that could be related to the answers those firms gave to the questions on the influence of taxation that would be very helpful.*

5580. *Professor Cairncross*: From the replies to the later questions which you put about the fall in Bank Rate in February, 1957, it seems that that did not have any great effect on expectations or on investment decisions?——Yes.

5581. *Professor Sayers*: Have you any impressions at all as to what happened as a result of September, 1957? You have no questionnaire covering this?——*Mr. Weeks*: No, we had no questionnaire to deal with that. My impression would be, first of all, that some of the decisions to postpone investment had been taken before that. I do not think that the feeling was that there was a weakening of the market, so to speak, for investment before September. The immediate effect was not, I think, a sudden decision to postpone something which was just about to be decided upon; things went through for a time. In a sense the effects have rather more recently begun to accelerate. That is based on my impression of what is happening in the building industry; the first reaction was not a sudden postponement of orders about to be placed, as one might expect, but a later reaction has been that further schemes have not come forward. Looking back, it is difficult to tell how far it was simply the 7 per cent. alone, or how far it was a sort of general atmosphere for a time; how far it was technical, so to speak, and how far psychological. But my impression is that the effect on investment in particular was very much greater than the previous 1½ per cent. rise in January and February, 1955.—*Sir Norman Kipping*: I should like to add one or two impressions to that. I think people made up their minds that the September measures were likely to work, that they were determined enough; so they began to forecast the ending, or the rapid slowing down, of inflation. Then I think that in several important commodities world production began for the first time for many years to overtake the demand, and they ceased to become scarce. Of course, it is well known that, with commodities like steel, in times of scarcity people commit themselves for a long time ahead to ensure a supply. We can see in this later questionnaire that they were still having to take delivery of materials at the rates they had committed themselves for; but these old commitments are running out, and new orders placed with steel mills and in other commodity markets are falling, enabling people for reasons quite apart from the 7 per cent. Bank Rate to reduce their stock commitments. This de-stocking, what the Americans call an "inventory shake-out", is very characteristic of what seems to be going on at the moment. These factors, in other words market trends generally, may have had far more to do with it, I would have thought, than the technical effects of interest rates, although there is a complex interaction between the two. Psychologically, with what seems now to be happening, I believe that the most important factor of all is what opinions are about the future of inflation: if people really feel that this is at an end then the interest rate becomes a very much more important element in decisions than if there is a forecast of continued inflation.

5582. What was their view on the future of inflation in the period January/February, 1955?——That it would continue, I would say. I think that in January and February, 1958, there is a much more hopeful view that it will be mastered. Of course, everybody is watching what happens on the wage front which might send it off again, but there is a more hopeful view of it.

5583. Are you not again underlining the surprising size of this figure of 179?——I do not think we have seen it that way, but it is a very interesting point.

5584. *Sir John Woods*: Would the 7 per cent. Bank Rate itself make a good many people think there was going to be a rapid slowing down in inflation?——It would, of course, play its part, very largely psychological, in their estimate of the future of inflation.

5585. From that point of view it is one of your major factors?——*Sir Norman Kipping*: I think that must be admitted.—*Mr. Weeks*: It would be very difficult to say what would be the effect if in 1955, instead of going up by two jumps, from 4 to 5½ per cent., Bank Rate had gone in one jump from 4 to 6 per cent. I think that that one jump might possibly have been more of a shock, and caused people to think again, than the two successive increases. Again, 7 per cent. is a high figure; it is an alarming figure and the point at which a man begins seriously to think about the cost of borrowing, and the cost of over-stocking.

5586. *Chairman*: Would it follow from what you have said that before 1957 there have never been conditions ruling or expectations present which would enable interest rates to have an effect?——Not interest rates as they were, I would have thought.

5587. *Sir John Woods*: There are two factors, as Mr. Weeks said: it may be the substantial jump, as it might be from 4 to 6 per cent., or it may be a jump to an absolutely high level. If in January/February, 1955, the Bank Rate had gone from 4 to 6 per cent. in one go, would that have had a materially greater effect than what in fact happened? If there were 179 firms who did take notice of what actually happened, is it possible that a dramatic jump would have had a proportionately greater

* See Memoranda of Evidence Part VII No. 8A, Appendix 2.

effect? Have you any views about that?——*Mr. Weeks*: The absolute size of the jump must be of considerable importance, particularly as we are talking about gross rates of interest and what after all we are also thinking of is net after tax.—*Sir Norman Kipping*: I think most people thought of the Bank Rate as having more to do with the flight from sterling than the curbing of investment at home.—*Mr. Weeks*: It is difficult to say, because February, 1955, was not long after the cessation of building controls, and there was clearly, as soon as the building control ceased, a very large pent-up desire to have fresh building investment. That certainly came out, and it might have gone forward even against a 2 per cent. sudden rise, because 1955 was a fairly boom year for industrial development.

5588. *Professor Sayers*: You have spoken of the difference between going from 4 to 6 per cent. and going from 5 to 7 per cent.; you indicated that, when the Bank Rate gets up to 6 or 7 per cent., it is a much more serious business than when it is down at 3 or 4½ per cent. At what point would you say that it becomes a matter which businessmen would take more notice of? Is the critical level 5 per cent. nowadays, or higher or lower?——I do not think it is possible to say. The figure is different according to whether there is an expectation that inflation will continue or not. It certainly seemed to me before the increase to 7 per cent., in the first place that it must be a 2 per cent. rise to have any serious effect in itself, and secondly, that it would not be impossible that, if 7 per cent. was combined with the expectation of a continuing 5 per cent. inflation, after a time even 7 per cent. might be absorbed as part of the pattern of the post-war economy.

5589. Had we been talking in 1952 or 1953 most people would have regarded a 4½ or 5 per cent. Bank Rate as high; is it important if they become used to higher rates?——I think it must be a factor but how far absolute and how far relative it is very difficult to say.

5590. You keep coming back to the expectations of inflation. Surely, they must be of a very limited kind? If people really based their businesses on a belief that prices were going to rise 5 per cent. a year, there would be no way of holding back capital development, would there?——*Sir Norman Kipping*: I think that is true. The sort of remark one heard far too often from people in control of very large companies was an admission that many a boardroom decision to go ahead was ultimately swayed by some such consideration as: "If we put it off, it will only cost us another 5 per cent. at the end of the year; so we will lean in the direction of doing the thing now"; a very demoralising basis for reaching decisions, which was recognised increasingly as the years went on, until finally that attitude and belief is reflected very much in the problems examined in our booklet.

5591. And that has occurred a number of times within your experience?——*Sir Norman Kipping*: Yes; I heard a lot of that, and undoubtedly there was reality in it; and it increasingly came to be recognised that that was so and that it was a very bad thing.—*Mr. Weeks*: And an expression of regret that the money had not been spent a couple of years sooner.—*Mr. Shenfield*: It is not so much a case of a firm belief that there will be a continuation of inflation at so much per cent. a year as a vague feeling that there will be some continuation which throws the decision into the balance, and determines that in fact there will be expansion where otherwise there might have been caution.

5592. Looking back over the fifties, at what stage do you think that that argument became an important one in swaying decisions?——*Sir Norman Kipping*: I was tempted to say 1956 or 1957, but Suez had some queer temporary contorting effects on attitudes and opinions, and I would have to think it over before being sure whether it was 1956 or not.

5593. You are inclined to put it as late as 1956?——*Mr. Weeks*: I should have thought that in 1955 people were certainly thinking that way. As I said, with building investment there was also the effect of the removal of controls, which was obviously an important factor.

5594. *Mr. Woodcock*: From your answers it sounded as though the consideration was the cost of the investment; that is to say the prices for capital goods, not the profitability of the investment?——*Sir Norman Kipping*: When a company looks at a project there are so many factors influencing the timing of it: raw material availabilities, market prospects, cost, and hundreds of factors which all weigh. I should like my comment to be taken as meaning that when the decision to move and the timing of the move were in any doubt boards tended to go ahead on the inflationary argument, rather than defer the matter for six months for another thought.

5595. Yes, but what is the inflationary argument? Is it just that the cost to them of the new investment will rise? Is there not the other side too, that it is going in money terms to be worthwhile?——*Mr. Shenfield*: That must be assumed. If it was not so, they would not make the investment at all.

5596. *Chairman*: Is there not a great deal of purely competitive investment, not conceived on the basis of a pure calculation about the cost or profitability of investment, but really forced upon firms by a vague uneasiness about what their competitors are doing?——*Sir Norman Kipping*: I find that difficult to answer. One of the characteristics of the post-war period has been the enormously rapid technical change, and a very great deal of new industrial investment has reflected the absolute need to be up-to-date and in the van with a new product. That might be an answer to your question if you are thinking in those terms. But take for example the development of the petro-chemical industry: I do not know if you could say that those developments were forced upon companies by the knowledge that if they did not do it someone else would (to some extent that would be so) or by the belief that when, say, polyethylene sheet is developed it will find world markets and be profitable in its own right regardless of any other considerations. I think it is very hard to distinguish between these things.

5597. *Professor Cairncross*: Do you not agree that a large part of the investment was conditioned by the size of the order books of the firms making the investment, technical advance almost inevitably being incorporated in the new buildings?——I think those two things interact. Take the advance in the size of electric generating equipment: there might be full order books or not, but the sheer technical advance in the size of the equipment would involve new buildings capable of handling the bigger manufacture. It would, incidentally, increase the capacity of the company. So there is a complex of the two considerations every time. In regard to the expansion of a new product one cannot talk about the size of order books: for example, with things like petro-chemical developments there is no order book; the product is unimagined by the customer. It is only when the firm offers it to him that they know he is going to buy, for instance, terylene, or some new product. The faith of the company has to be a judge of whether the market can or cannot be developed.

5598. *Mr. Woodcock*: Would there not be assumed order books?——There would be market research, but I think there is a distinction between that kind of case and, shall we say, the case of a machine tool builder who has a standard product that does not change very much.

5599. I am not sure the distinction is quite as sharp; I think it is still relevant to Professor Cairncross's question that they would have a conception in mind, not that they necessarily had orders; as you say, they could not when the product was not produced.—*Professor Cairncross*: The point is surely that investment depends to some extent on sheer animal spirits, as was once said. If people feel a tide is running with them they will try out the new ideas, and there is a high level of investment; whereas in other circumstances there may be just as many interesting ideas but less investment. But this is not, I think, purely a question of expectation about prices; it is relevant to the influence of interest rates. As I understand what you are saying, it is that some investment was brought forward in effect because it would cost more if deferred. Now, if it is brought forward in response ultimately to long order books, and if it has the effect only of extending the order books of the firms making the plant, then that marginal influence may not affect the level of employment at all. It may leave an inflationary pressure on the economy but not be the determining factor.——*Mr. Weeks*: I am not sure that I quite follow the point: but one factor which determined the timing of the decision to invest must have been the

length of delivery for machine tools and plant and equipment: if one knew it was on eighteen months' or two years' delivery one would naturally have to take a very long view, and would also tend to take an earlier decision, if one believed that future demand was strong enough to justify the investment in question.—*Sir Norman Kipping*: Perhaps I can make a shot at answering Professor Cairncross's point, if you will not mind my arguing from the particular to the general by taking this sort of case: a company manufacturing industrial solvents, which are not peculiarly liable to rapid technical change, is going to gauge its requirements for the future on its forecast of the demand from other industries or from the export markets. It can see the rising curve, and realises that at a certain point it will have to provide additional facilities. Now, in doing so it will, of course, modernise and adopt new methods, and the new plant will be quite different from the one before. That company, I think, has to make a judgment how far it will allow its own technical developments to progress before it takes the decision to build in order to meet this new rising market. In that sort of case the decision to build would be made much earlier than otherwise if there was an expectation of inflation, because the advantage of waiting for more research and development before making a decision to build would be offset by the disadvantage of the higher cost of the development if there is going to be continual inflation. There are a lot of things of that sort, where the moment to reach a decision to build is flexible within twelve or twenty-four months.

5600. If that is so, would any increase in interest rates by itself be likely to influence the investments? I think you are laying stress on expectations about inflation rather than on interest rates?——*Sir Norman Kipping*: Is it not the relationship of the one to the other? Paragraph 18 of our main paper points out that, if the one practically offsets the other, then the interest rate is not very prominent in the mind of the board taking the decision. If the interest rate is very high and clearly not only adds to costs but also affects the estimate of the likelihood of inflation being defeated, then it has a bearing in those two ways, I should have thought.—*Mr. Weeks*: One may be expecting, so to speak, an over-refinement in analysis. Inflation is not considered apart from the buoyancy which we have come to associate with an inflationary period. From the point of view of the decision to invest I do not think people say: "Shall we do this if we have inflation and buoyancy, or not if we have inflation but no increase in effective demand"? The two things, quite naturally, come to be very closely associated.

5601. We are usually thinking of changes in interest rates alongside other measures, and it may on occasion be these other measures which are responsible for changing the general atmosphere and making people think inflation is coming to an end. Suppose that we abstract from these other measures and what has been happening in the world in the past year; do you think the Bank Rate at 7 per cent. would have checked the inflationary forces that were at work if that had been the only measure taken?——*Mr. Shenfield*: Extremely unlikely just by itself.

5602. *Chairman*: Can you isolate the factor in that way? What ground have you to go on that would cause you to form a view?——If you take the interest rate *simpliciter*, then it becomes just a case of making a calculation—the cost of the investment and the expected return; as there is always such a considerable margin of safety in calculations of the expected return it is unlikely that a rise in interest rates of 2 per cent. or even 3 per cent. and perhaps more, or a level of interest rates of, say, 7 per cent. could, after allowing for taxation, materially affect the decision. But, of course, if all the other factors are present, then it becomes another matter.

5603. *Professor Sayers*: You speak of calculations. Are calculations made in which the interest rate is taken as a factor before investment is made?——*Mr. Weeks*: Yes; I think that 5 per cent. is taken as the rate of interest. Perhaps that is an exaggeration; but perhaps it has an element of truth: I do not think that the actual rate is taken with any precision.—*Mr. Shenfield*: If it was done on borrowed capital it would be.—*Sir Norman Kipping*: I have read a lot of project reports in my time, examining the pros and cons in all their many-sided aspects which companies look over before they reach a decision. This element in the calculation of the validity of the whole project is there on paper, but it does not figure as a principal consideration in the average project. There is far more estimating of costs of production related to probable selling prices and demand trends and all that kind of thing which determines the validity or otherwise of a project.

5604. 179 firms have said they took notice of it at this particular juncture. In what form does it appear there? Does a Finance Director ever say in looking at these projects: "But you have based this on the wrong rate of interest. You must re-calculate"?——I do not think we are competent to answer that.

5605. Perhaps you cannot be expected to answer the question in that form. Has it occurred within your experience? I am trying to find how this became a major factor with 179 firms?——*Sir Norman Kipping*: I am becoming nervous about how well the question was understood by these 179 people.—*Mr. Shenfield*: I do not think the 179 merely took account of the rise in interest rates alone; they took it in the context of the other measures. It is not explicit in the answers.—*Sir Norman Kipping*: We could go back to these 179 firms, and cross-question them about this, and perhaps get more information.

5606. It is rather vital to our discussions. We have had so many people tell us over so many years that, at any rate in the manufacturing industries, the rate of interest hardly affects these decisions at all, and one has come to think that whatever else Bank Rate changes can do they cannot do anything much about investment in the manufacturing industries. But you are providing us with evidence to the contrary, and it is important to us to check just what that evidence amounts to?——*Mr. Weeks*: Ought we not to make a distinction between decisions on fixed investment and decisions on stocks? After all, stock decisions can be very short term decisions; it is the fixed investment decisions with which you are concerned.

5607. *Chairman*: There must be quite a lot of overlapping in these figures; a lot of people must have answered "yes" on more than one of the subsidiary questions here?——*Mr. Shenfield*: Yes; and furthermore, a man might have said "yes" to the main question if he had regarded the rise in the Bank Rate as a red light of a general character, without having any particular effect on any calculations he made. I would suspect that a large number, perhaps most, of the 179 said "yes" not because of any calculations but because they regarded Bank Rate as a red light.

5608. *Professor Sayers*: We want to know whether it is the red light element that matters, or whether there is a serious cost element in their reaction to changes in the Bank Rate?——*Mr. Weeks*: You are really interested in the 69 who deferred or reduced a project because of the effect of the increased interest rate on costs, are you not? On stocks, the reaction shown is a very natural and proper one.

5609. Even that we want to know about. After all, a very eminent person in this field thought thirty years ago that he had exploded the idea that interest rate changes had any effect on stocks?——*Sir Norman Kipping*: I should think that there is a very strong overlapping element; in the answers to (*a*) and (*d*) we can find that out, of course.*

5610. *Chairman*: You were speaking about investment projects in which the various factors that make it a question of whether or not a project is profitable are laid down on paper. I suppose that at that stage a company is not faced with the question by what process it is going to raise money for the project, whether to borrow on long term debentures at the current rate of interest, or to do it out of its own resources and hope to borrow later, or to borrow short term for the moment and borrow later on more favourable terms. That all comes later?——*Sir Norman Kipping*: There is all the difference between the investment of £5,000 by a small firm, and the kind of money that a large oil company has to find. The latter must take very much into consideration the cost of borrowing, but I should have thought that the former probably does not. Lying in between are many different kinds of factors. The amount of self-financing that goes on in industry probably blunts the effect of borrowing rates in the case of all those companies who can deal with a high proportion of their expansions from their own resources. That was certainly in the early post-war period a very big factor. One so often heard people say: "We have the

* See Memoranda of Evidence Part VII No. 8A, Appendix 2.

money and have just been waiting for the chance of carrying out the developments we wanted to carry out". So I should have thought that the interest rate might be one that was coming increasingly into importance as the stored-up savings had been spent.

5611. *Professor Sayers*: This would suggest that it is very important indeed for people responsible for economic policy to be fully informed of the liquidity position of industrial concerns?——Yes; we have tried to help them to come by that knowledge in connection with Board of Trade inquiries and so on.

5612. *Chairman*: If at the time the really important decision was being made on a project the company was not concerned with the actual worry of raising the money it would be forced to bring in a more or less conventional rate of interest, of the kind that Mr. Weeks spoke of?——I think that there is a lot in what Mr. Weeks said, although it is imprecise.

5613. *Professor Sayers*: Is it conventional?——*Mr. Weeks*: The company might look either at the interest on the capital or at the expected gross return on investment. If it looks at interest on capital, say, of 5 per cent., it really makes very little difference to the decision whether to go ahead or not, whether it says 5 per cent., 4 per cent. or 6 per cent. Alternatively, if it ignores interest on capital and looks for a gross return on the investment of, say, 25 per cent., it does not matter whether it is paying 4, 5 or 6 per cent; it is well within. The real uncertainty is not that, but what the capital cost of the project is going to be, future price levels, demand and so on.

5614. That is exactly what the university lecturer says when he is lecturing. He is describing the position correctly when he says that?——*Mr. Weeks*: In my limited experience, yes.—*Sir Norman Kipping*: I agree; I think that is broadly true.

5615. You will see why, after having had years of that, one finds these figures so surprising?——One must come back to the other factors. To attempt to isolate this point as if it really determines things is, in my opinion, unwise. It is a complex of factors, and this expectation of inflation has, I am sure, been a very prominent consideration in that complex.

5616. *Lord Harcourt*: My experience as a partner in an issuing house is relevant to what Professor Sayers was saying. I cannot remember a case where a company has come to my firm, and asked what the cost of money would be, or how it could be raised, until long after they had a plan in existence. I think that the plan is drawn up first, and then they go to their financial advisers who tell them what is the most economical way of raising money at that moment and how it can be done. I think that one of the reasons for that is that the drawing up of these plans takes such a time that to ask what the cost of money was before starting to plan would have little meaning. —*Professor Sayers*: Does a shift from one range of interest rates that has prevailed over the years to another range that prevails over a further period of years still leave the rate of interest ineffective?——I should like to draw attention to the very different cost build-up in different sides of industry. There are very many in which labour cost is 25 per cent. of total cost; there are some in which labour cost is 2 per cent. of the total cost. In those cases the cost of the plant and the buildings to house it becomes a very much more significant factor in the total cost. Flour milling is that sort of case. I should have thought, without being able to speak of it as a known fact, that the cost of raising money might be very much more important to the flour milling type of case than it would be to the generality of manufacturing industry. I should think too that in the building of new ships the same consideration would be much more prominent. We are only talking here of the generality of manufacturing industry. That ought to be realised, because it might be quite an important distinction.

5617. *Sir Reginald Verdon Smith*: Is there not another aspect to this? A great deal of capital expenditure so classified is in fact a total of a very large number of small decisions taken throughout the period; in relation to those decisions all sorts of practical considerations of the market such as have been mentioned are really far more relevant and major considerations than the cost of money?——Yes.

5618. *Professor Cairncross*: In paragraph 35 of your main paper you rather toy with the idea of establishing a fund, or seeing a fund established, to help men starting in industry without any financial resources. Can you tell us exactly what you have in mind here? Is it something akin to the Nuffield money that was available immediately before the war?——*Mr. Shenfield*: We have to admit that this is rather nebulous. Quite what the constitution of this fund would be I do not think we really decided. We think that it would be something worthy of consideration by industry or by city houses, but we really have not developed it.

5619. What do you regard as the magnitude of this problem? Do you think it is a serious one, or are there only a small number of people involved?——*Mr. Weeks*: As far as I recall, this really sprang from the feeling that in the past a lot of promising young men had been given a "kick-off" by friends or other people who before the war would have had some money which they were prepared to invest. They were prepared to give that type of rather personal support, and take a chance on expectation of quick profit. This had produced some very good enterprises and very good people. That type of support is now lacking. It was felt as something which had been in the past personal, and possibly had to be institutionalised to give the same opportunities for people of that type to start.—*Sir Norman Kipping*: Yes. This is the problem of the disappearance of the personal backer. One finds a largish number of individuals, whom one could probably describe as inventors, a proportion of whom have got something good, which they develop with the help of their own resources to a point where one can see what it is. They then want backing, and they used to be able to find backers. It is a risky type of investment, because one is dependent upon one single man, quite apart from the ability to judge the project, and the one single man can get run over by a bus. Whether we can ever, therefore, replace the old personal backer by an institutional backer I should have thought was a point of the greatest doubt. What in fact happens to these men in the end, when they find they cannot make their way on the basis of private backing, is that they are absorbed by bigger companies who are willing to say: "I like the look of your thing. I offer you a job, and you can come and develop it in the company". That is a course which these men do not like, because they think they are going to be swamped and will lose control of the thing. They would prefer a private backer, or some institution that would back them. It was knowledge of that, and the belief that there might be an institutional solution, that led people to make these suggestions.

5620. *Sir John Woods*: Is there really any factual evidence of the existence of such people?——Yes, I think so. I have come across quite a few personally that had been drawn to my attention, and I have spoken to the chairmen of companies of the sort that would be likely to take on that kind of a risk, and I have heard a lot more about it through doing so. I could quote cases; I could even name companies who have had experience of this kind and who have backed such men. I will quote one case: a man devoted his thinking to the control of the flow of liquids, and he hit upon methods of measuring with great precision the volume or weight of a liquid being fed into a receptacle. Its practical use would be the filling of ampoules with dangerous drugs, or something of that kind. It was a clever development, backed by one or two reasonable-looking patents, and he got to the stage of getting orders to fill millions and millions of capsules with anti-toxic drugs,, and that sort of thing. Then he began to spread out into other sides of industry which would benefit from a strictly controlled liquid measurement; for instance, he made experimental and successful apparatus for coating television tubes by his methods. Obviously he wanted much more backing, to the tune of a 10,000 sq. ft. building and a bit of working capital, and so forth. He struck the greatest difficulty in getting it by any other means than absorption by one of probably half a dozen companies whose business it could be to get into that field. He very much wanted to run his own show and not be absorbed into a big company, and there was a great search for a possible backer, that led to ultimate failure. The backer, after all, would have been dependent on the life and health of the one man. He was absorbed by a bigger company. I have evidence of quite a stream of

that sort of thing coming up every year; probably twenty or thirty cases.

5621. *Lord Harcourt*: You talk in this paragraph about the ability to keep the man with the bright idea, in this country; is it your positive experience that there is more opportunity for this sort of man abroad?——*Sir Norman Kipping*: I could not say that; I do not know how that came to be there.—*Mr. Shenfield*: Well, it was vaguely linked with the temptations of North America.

Chairman: We will break off now. I understand that we shall not see you after lunch, Sir Norman; I am sorry, but we understand.

(Sir Norman Kipping withdrew)

(Adjourned until 2.15 p.m.)

MR. H. T. WEEKS, C.M.G., and MR. A. A. SHENFIELD further examined.

5622. *Chairman*: I think we bad covered paragraphs 6 and 7 of the appendix to your memorandum. May we come to your next heading, the influence of taxation, and see what the answers you got amounted to on that? You say that only 23 per cent. of the firms stated that their investment decisions since 1951 had been materially affected by favourable changes in investment allowances and 15 per cent. by unfavourable changes. About 600 firms answered these questions; 369 had been materially affected by favourable trends and 230 by unfavourable ones. There were no answers, I take it, from the rest?——*Mr. Weeks*: That is right. Even those figures include some double counting of people who replied "yes" to both questions and said that they had been materially affected by both favourable and unfavourable changes.—*Mr. Shenfield*: Changes took place at different times, of course. The majority of the returns were silent on this.

5623. A very considerable majority must have been silent. What is your impression of the amount of influence on investment or investment plans these changes in initial allowances are capable of making?——*Mr. Weeks*: I was rather surprised with the size of the figures. They were much more than I expected to see.

5624. *Professor Sayers*: Is it not a question of timing: whether or not investment decisions were deferred or brought forward by changes in allowances?——*Mr. Weeks*: It is a question of timing essentially, but even so I think I would not have expected the figure to be quite so high.—*Mr. Shenfield*: Nor would I. I have not enough first hand knowledge, but I have found it very rare to discover an industrialist who will say that he made an investment decision because of the investment allowances, still less because of the initial allowances.

5625. Would the efficacy of these changes be much affected by the liquidity position of firms? Supposing that by various devices British industry were made much less liquid, would it then be more sensitive to this kind of change?——*Mr. Weeks*: I would have thought so, but that is purely personal speculation.

5626. Looking back over the actual experience, would you say that the changes were more effective as the liquidity of English industry declined?——*Mr. Weeks*: We have no evidence bearing on that.—*Mr. Shenfield*: It would be very hard to test, even if in the future we had annual changes in investment allowances, for example, and could make a running comparison with liquidity changes; but as we had only two changes in investment allowances it would be a most difficult exercise.—*Mr. Weeks*: It might be possible to do a cross analysis on these questions with others at the moment of time we are talking about.

5627. *Chairman*: Then may we go through your main paper? At the end of paragraph 3 you say: "As might be expected, in so far as rises in interest rates did have a direct influence on the business decisions of those who returned the questionnaire, its effect was greater in the field of stocks than in that of fixed investment." What are the reasons which led to it having a more direct impact, if that is your experience, on stocks than on fixed investment?——*Mr. Weeks*: It is more easy to vary expenditure on stocks than on fixed investment; expenditure on fixed investment is already determined by previous conditions, and by a whole programme.—*Mr. Shenfield*: Stock decisions turn on taking a short-term view, as opposed to a long-term view.

5628. *Professor Cairncross*: You do not attach importance to the fact that the rate of interest would be a substantial proportion of the cost of holding stock?——*Mr. Weeks*: One would consider that, too.

5629. *Chairman*: We are speaking of manufacturers' stocks in this connection?——Yes.

5630. And you think that the interest element involved in that part of the firm's business is a matter of calculation as to what they intend to do?——Yes; my own personal experience was that it was only when we bad a Bank Rate of 7 per cent. that I really began to consider what an expense it was to hold the stock level in steel which I had regarded as being traditionally necessary.

5631. *Professor Cairncross*: In the case of steel, have you any idea what proportion interest is of the total cost? Is it 50 per cent.?——I would not like to say. It depends on the varieties carried. There are too many other factors.

5632. Would it not be a high proportion?——It can be a considerable item, and one which, if one feels that the forthcoming supplies are going to be adequate, can be avoided. A reduction of stocks is also the quickest and easiest way to reduce an overdraft position; and, if one wishes to carry on with alternative investment, one can finance that temporarily on lower stocks.

5633. *Chairman*: It is no good planning for an expansion of your works if you are going to reduce your stocks?——*Mr. Weeks*: The amount of stock one has held for so many years has not really been entirely a logical decision. In steel, in particular, it is a question of getting deliveries when one can. The moment there is a change in climate, one then begins to think what reserve one should normally allow, and the answer is, perhaps, 10 weeks' stock. In a scarcity position, one does not like to forego deliveries.—*Mr. Shenfield*: In 1956 manufacturers bought all the steel they could, regardless of price or cost. But steel is an exceptional case; if the stock figures here related to steel only they would give a very different picture.

5634. The impact is on those who are running an overdraft; it is not a notional calculation?——*Mr. Shenfield*: I should not have thought so.—*Mr. Weeks*: No.

5635. *Sir Reginald Verdon Smith*: I should think that it also included work in progress, and therefore was relevant to the whole volume of one's manufacturing programme, rather than simply to one period?——I think in this case it has been pretty well interpreted in that way; but materials can be adjusted more easily than work in progress.

5636. *Chairman*: Then you say: "Little is known to the Federation about the effects of the decisions of the Capital Issues Committee. However, of the companies which returned the questionnaire none was refused permission to issue capital by the Capital Issues Committee during 1951-1955, and only a tiny number were refused in 1956-1957. A slightly greater number of companies were deterred by the expectation of refusal from attempting to issue capital, but the number was still extremely small, even in 1956-1957."—*Professor Cairncross*: You do not show the ratio between these two. There is no way of judging from what you tell us what the proportion is of companies who would like to apply and are deterred from applying for permission to make an issue?——*Mr. Weeks*: We cannot go beyond the figures here.—*Mr. Shenfield*: We gave the very small numbers who replied to this question.

5637. *Chairman*: Are not the numbers of refusals or expectations of refusal almost negligible?——Yes.

5638. *Professor Sayers*: Even taking into account those who were deterred by the expectation of refusal, does it not seem that the effect of the existence of the Capital Issues Committee has been very slight indeed in this field?——*Mr. Weeks*: That would be our impression from the figures.—*Mr. Shenfield*: Until midsummer 1957.

5639. In paragraph 9 you say: "There is some evidence that the London bill market is increasingly being used

instead of bank overdrafts for short-term finance." Is that not a credit squeeze phenomenon?——It has certainly happened recently. It applies only, so far as I know, to a very small number of very large firms, whose bills are acceptable to the market.

5640. Are they confined to particular trades?——As they are very large firms, they are not really, because they have a very wide spread of interests.

5641. *Chairman*: Oil is the one that generally crops up in this connection. Is that your experience?——*Mr. Shenfield*: I think I can mention the Dunlop Rubber Company Ltd. as an example; that, of course, has a very wide spread of manufacturing processes.—*Mr. Weeks*: This was brought in because one or two people said they were doing this, and therefore we thought we should refer to it. We certainly could not quantify it.

5642. *Professor Sayers*: Is it a credit squeeze phenomenon; from the date does it not seem so?——*Mr. Shenfield*: I guess it is.

5643. Do you expect it to go much further?——It is hard to say. It depends on the relative advantages of borrowing from the banks.

5644. *Lord Harcourt*: You are talking about the trade bill here, I imagine, and not the bank acceptance?——*Mr. Weeks*: That is right.

5645. Do you see any evidence or any tendency for companies to hold Treasury Bills?——No.

5646. I understand that in the United States a proportion of Treasury Bills is held by quite a large number of manufacturing companies. Have you any idea why here the tendency should be retarded, or so little in evidence?——*Mr. Weeks*: No.—*Mr. Shenfield*: Until fairly recently it would not have paid to hold any short-term funds liquid in the form of Treasury Bills, but it is true that in the last twelve months, or perhaps more, it might have done. I think there is a great deal to be attributed to habit here. It is a strange thing for British manufacturing enterprise to consider.

5647. *Professor Cairncross*: The holding of Treasury Bills and short bonds by non-banking companies makes a substantial difference to the authorities' grip of the money supply. Do you think this might be developed further?——It is not impossible.

5648. *Professor Sayers*: The holding of Treasury Bills by industrial concerns is, in the main, a new thing since 1954; if they have taken to Treasury Bills, why should they not go on to trade bills? Is there any reason for them to stop experimenting in ways of holding their assets?——There are circumstances in which I think it might be attractive to them; and the barrier of the habit of holding money in other ways could be overcome. But we have no evidence of anybody actually holding Treasury Bills at the moment.

5649. *Chairman*: Then I think we have covered your views on the effectiveness of monetary measures and the problems of inflation. Are there any more questions on that?—*Professor Sayers*: In paragraph 17 you say, ". . . the possibility must be taken into account that it [the raising of interest rates] may have undesirable side-effects". What have you in mind there?——Mainly the effect on the cost of servicing the Government Debt.

5650. In paragraph 19 you say, "Moreover, the effectiveness of a high Bank Rate depends very much on the firmness with which long-term yields are made to conform to it." What had you in mind there?——Such action taken by the monetary authorities as will bring the whole structure into line with a higher Bank Rate.

5651. What kind of action do you think they should take?——*Mr. Shenfield*: That is not so easy. I think we should say that that is what we would like to hear from you in due course!—*Mr. Weeks*: I would suggest that the wording should be changed to "would conform" rather than "made to conform".

5652. *Chairman*: We are very much interested in this. We wondered if you could contribute anything as to just what considerations could he involved?——*Mr. Shenfield*: I would not like to commit myself offhand.

5653. *Professor Sayers*: This is an aspiration but not a plan?——Yes.

5654. *Professor Cairncross*: In paragraph 20 you say: "Thirdly, the loss of productive capacity which very high interest rates force upon the economy by choking back investment may be very heavy." This is in line with the view that high interest rates have, by themselves, a marked effect on productive investment?——Yes. It is defectively stated. It really means "the whole policy of dear money and bank directives, of which the central part may be a rise in interest rates".

5655. You mean measures to put up interest rates would choke back investment more than the other elements in demand?——We say, of course, "*may* be very heavy".

5656. *Professor Sayers*: When you talk about "choking back investment", do you not mean choking back investment plans?——Choking back investment plans is right, yes.

5657. We want high interest rates because we want a high level of investment to be maintained, not because we want it choked back; is that not right?——Yes; but the operation of the high interest rate is to prevent some investment from taking place which otherwise would have taken place.

5658. Yes, but if you talk about investment in this way do you not mean total investment?—*Professor Cairncross*: The figures you showed us this morning did not suggest that investment had yet been choked off too much; on the other hand it suggested that authorisations had been cut?——*Mr. Weeks*: It simply confirms the point. In very simple terms, the figures suggest that up to or just before September, the rate of interest, whether or not accompanied by other things, was not very effective, and that since then the rate of interest plus other things (and who can say how much is due to one thing and how much to another) has had some effect. At least that is a judgment one can make from the figures.

5659. *Professor Sayers*: I cannot follow this sentence, if you substitute "investment plans" for "investment"; and if you do not substitute "investment plans" for "investment", then I still cannot follow the sentence?——I am not quite sure what your distinction is between investment and investment plans. What do you mean?

5660. That the boom goes at too high a pace because people are trying to do too many things at once; that the way of checking the demand is to make people come into the market for less goods; but you do not, unless you reduce the total employment of resources, reduce the level of investment; in fact it may have the effect of increasing it?——Yes, but I would have thought that the indication at the moment was that, certainly in the building industry, the total resources of industry were likely to be greatly under-employed next year and later this year.

5661. You are doing as Mr. Shenfield did: you are taking a particular part of investment. Is not what is relevant here the trend of total investment?——*Mr. Shenfield*: I am not sure that we would persist in that third statement, on reflection.—*Professor Sayers*: It is an argument that is commonly used, and we find it here.

5662. *Professor Cairncross*: In paragraph 21 you correlate inflation with Government expenditure, not with the size of the Budget deficit. Is it your view, taking this paragraph with some others in the document, that a reduction of Government expenditure will reduce inflation, but that an increase in taxation might have the opposite effect?——The two are not necessarily the same, of course: a reduction in Government expenditure might not reduce inflation; it depends on the circumstances in which it takes place and on what else has been done in the economy. But we think that, if all other things remain equal, then a reduction of Government expenditure would reduce inflation.

5663. I am looking forward to paragraph 30, where you seem to dismiss the usefulness of Budgetary manipulation?——We did not take paragraph 29 and 30 as far as we might have done, because we came across some extremely difficult matters which we preferred not to pronounce upon at that stage. If we were asked to give our view on the relation of the Budget deficit or surplus to the inflationary problem it would be very difficult, because there is a conflict of views. I think the preponderant view among us is that a budgetary surplus, obtained by a higher level of taxation than is necessary to pay for the current Government expenditure, is both inflationary and

deflationary, and that in some circumstances it can be more inflationary than deflationary; though we readily admit that there are circumstances in which it may be more deflationary than inflationary.

5664. *Sir John Woods*: You are talking of above-the-line surpluses?——Yes; but there we come to the difficult question of financing below the line in regard to nationalised industry and other types of national expenditure, which make it difficult to make prescriptions for the future of the surplus.

5665. *Professor Cairncross*: At any rate you are more certain that a reduction in Government expenditure would have a moderating effect than you are that an increase in the size of the Budget surplus would have?——Yes.

5666. Then in paragraph 22 you refer to finding workable criteria to govern public investment. Have you any suggestions as to what criteria they might be?——*Mr. Weeks*: I am afraid the answer is no.—*Mr. Shenfield*: One might personally suggest some, but we have no authority to suggest anything on behalf of the Federation.

5667. *Professor Sayers*: Why do you say in paragraph 23: "It is now probably too late to look to funding for an immediate attack on the credit base"?——We were thinking of the high cost of funding at the moment, with short-term rates being as high as they are and long-term rates having been made, to some extent, to approximate to them.

5668. But then you contemplate that the rate of interest should be put up to an unprecedented level, if this is the method necessary to control investment?——*Mr. Weeks*: We do not see a necessary contradiction there. As a means of dealing with a temporary inflationary situation, it need not be a very long-lived affair, in which case one might delay funding in the hope that rates might come down.

5669. This seems to come back to the disputed sentence about making long-term rates of interest conform to the movement of short-term rates?——*Mr. Shenfield*: Yes, there is to some extent a contradiction there, because that does pre-suppose that the remedy will have to take some considerable time. Nevertheless, it is a matter of judgment, one would say. It may take some considerable time and yet it may still be justifiable to delay funding on the score of expenditure. That would be a very difficult matter to assess.

5670. You think, in other words, that one can choke off inflation by putting up rates to a point at which people still do not regard long-term bonds as a good buy?——*Mr. Shenfield*: It is possible.—*Mr. Weeks*: If you go through the stage of high Bank Rate in which long-term rates will be more or less in sympathy, you are causing yourself budgetary problems in the future, but you may find you have a succeeding situation in which funding becomes more attractive, assuming in the meantime that there are other measures to avoid inflation.—*Mr. Shenfield*: It might turn out that the true long-term rate of interest might be probably higher, in which case it would be expedient; but it would require some pretty good crystal gazing.

5671. But you are crystal gazing here in pre-supposing that the long-term rates are likely to fall. I am afraid you cannot have it both ways. To come now to your paragraphs on directives on bank advances, I would like to ask whether your members feel that they have been at all hurt by the restriction of bank competition implicit in the latest phase of the credit squeeze?——*Mr. Weeks*: There is nothing to suggest they have.—*Mr. Shenfield*: Not much: a small minority of cases.

5672. *Chairman*: Then you refer to the control of new issues in paragraph 26; you say: ". . . the criteria applied by the Capital Issues Committee are not made public". But you know the directions under which they operate; those are all published?——For the outside observer it is difficult to see how they are in fact applied.

5673. When you say "criteria" you mean what led them to deal in a particular way with a particular case; you are really saying: "Let us have statements available to the parties"?——*Mr. Weeks*: Yes.

5674. Have you heard much dissatisfaction?——Everybody who is turned down is irritated by the fact that no reason is given.

5675. Does that apply to capitalisation issues, which is rather a separate branch of the Committee's activity, or does it apply generally to people who want to raise capital?——*Mr. Shenfield*: As far as the evidence we have is concerned, it is general; but of course we have so little.

5676. *Sir Reginald Verdon Smith*: Is it implicit in what you say in paragraphs 27 and 28 that you feel that the operation of hire purchase controls can be extremely damaging to particular sectors of industry, and that that impression has been derived from a great deal of evidence within the Federation?——*Mr. Weeks*: The sudden and unpredictable impact, yes.—*Mr. Shenfield*: That is the view which has been repeatedly put to us by the representatives of the industries concerned. I cannot say we have checked it; but there seems to be no dissent amongst them.

5677. *Chairman*: Do you categorise them as light engineering, or do you include things like furniture in that?——Yes, the furniture people have said the same thing as the refrigerator and washing machine manufacturers.

5678. *Professor Cairncross*: Are not these to some extent marginal items in consumer demand, and therefore very liable to fluctuate?——Yes; but the complaints relate to the difficulties that are thus created in manufacture as regards forward planning, and so on. They are not just complaints about lack of demand at a particular moment.

5679. There is a general issue which I would like to put to you on paragraph 33. Is it your feeling that the high level of investment in industry in the last few years has used up a number of opportunities for investment that will not continue at the same rate in the future, and that therefore, if the rate of interest does rise, the demand for capital for investment may show a substantial and continuing reduction? Has there been a "once and for all" element in the investment boom in the last few years?——*Mr. Weeks*: There must have been something of that, I think; it would be a question of how much and how important.—*Mr. Shenfield*: I could easily believe that there has been, but I do not know of any evidence to show that there has been.

5680. Would it be your view that a large part of the investment in the last few years has been a direct product of the inflation that has been going on, and the expansion in the order books of firms making these goods? If demand, as measured in terms of orders on industrial books, was increasing, were firms not then tempted to make extensions of a capital character that were based on an illusion that demand, in real terms, could extend to the level it had reached in money terms? To that extent, would not that element in investment be pressed out once inflation disappears?——*Mr. Weeks*: I would have thought the decision to invest, in real terms, would depend very much on the expectation of things in five year's time, or in ten years.—*Mr. Shenfield*: But some of it will turn out to be illusion if we end inflation: that must happen. Some of the decisions taken under the influence of inflation must prove wrong; but we have not yet succeeded in stopping inflation, so we do not yet know which decisions will prove to be false.

5681. It is very relevant to our inquiry to form some judgment of what the continuing level of investment is likely to be at a given level of interest. Do you think it is likely to be in line roughly with the level running in the last few years?——*Mr. Shenfield*: I think that it would be possible for it, as a percentage of the gross national product, to be brought near the level it has been, even if we ended inflation, unless the end of inflation took the form of a deep recession; and then clearly there would be an immediate change. But if one could imagine (it is perhaps far too optimistic to be envisaged at all) that we eased ourselves out of inflation and into a nice, pleasant plateau which would enable real expansion to take place, I see no reason why the proportion of the gross national product going into fixed investment should fall very much, if at all. I think it may well fall initially.—*Mr. Weeks*: With fairly stable prices, I should have thought that even with a moderately high rate of interest a good deal of investment could and would be undertaken.

5682. *Professor Sayers*: Putting Professor Cairncross's question in another way, are industrial firms still feeling

that there are many developments of their plant and buildings that they hope to make over the next few years?——I should have thought that there are a very large number of people round industrial England, who believe that new plant is desirable within a reasonably short time.

5683. And you think that would remain true?——Yes.

5684. *Chairman*: Is that in the field where technological invention is going rapidly ahead?——Partly that, but partly also where technological invention is not going ahead so fast but where the buildings are old, badly lit, inconvenient, or badly laid out, in which case, without the expectation of a very great return on capital, a firm could nevertheless justify scrapping the old buildings and re-building because of the operating economies it would get in the process.

5685. You think that people are very conscious of the need to rearrange the work, quite apart from new building?——*Mr. Weeks*: Yes.—*Mr. Shenfield*: I would not say that there is anything startling about that; I should have thought that was a natural thing to expect, except in days of depression.

5686. *Professor Cairncross*: Is not the rate of industrial investment very high in this country in relation to pre-war experience?——*Mr. Shenfield*: Yes; but so is the level of employment. If one is talking about a plateau in which we have 3 or 4 per cent. unemployment, it would be vastly superior to anything we had between the wars, and would have some influence on the rate of investment.—*Mr. Weeks*: I think also there has been some investment (it is impossible to say how much) which has directly followed from the shortage of labour and the desire to have better working conditions in one's buildings, because one can thereby attract labour.

5687. Many of these factors which arise in conditions of more intense employment would not appear in conditions of less intense employment?——They would be less strong.

5688. *Professor Sayers*: We are trying to discover, I think, how much of the old-fashioned trade cycle there is in the present situation. How far is the nature of the recent investment and its motives such that there must be a down-turn in investment demand at current rates of interest?——It is difficult to go beyond the fact that in 1959, under present possibilities, there will be a lowish level of investment.

5689. Will that be by way of a repercussion of the American situation, or will it be something inherent in our own current internal situation?——*Mr. Weeks*: I should have thought it was something inherent in our own current internal situation.—*Mr. Shenfield*: I do not see how you can tell how much of investment is of a true cyclical character; at least I do not see how you can do it except by probing into each investment.

5690. *Chairman*: I think that brings us to the end of your main paper. There are one or two questions of further analysis and information which we will tidy up with you afterwards, if we may?——We will proceed with the further analysis on these figures and let you have the results in due course.

The following additional witnesses, also representing the Federation of British Industries, called and examined:

J. L. S. STEEL, ESQ., Chairman, Overseas Trade Policy Committee, F.B.I., and a Director, Imperial Chemical Industries Ltd.
M. A. FIENNES, ESQ., Managing Director, Davy and United Engineering Co. Ltd.
NORMAN HINTON, ESQ., a Director, Simon-Carves Ltd.
A. L. PLEASE, ESQ., Overseas Director, F.B.I.

5691. *Chairman*: May we now turn to your paper on exports*, and run through it paragraph by paragraph and see what questions arise on it? First you begin by dealing with the adequacy of the finance of short-term exports. In your view no real problem is raised in regard to that. What is the factoring service you refer to in paragraph 3?——*Mr. Steel*: That is a common practice in the United States. I have not first hand experience of how it works, but, as I understand it, manufacturers sell to factors who buy outright and proceed to sell. They are not wholesalers, in the sense of selling on a commission basis; they are outright purchasers who in effect finance a proportion of the sales of the manufacturer.—*Mr. Hinton*: It is in the domestic market of the United States, and not for exports.

5692. Then we pass on to medium-term credit. Here you say in paragraph 4: "there is again no lack of sources of finance. In order to tap these sources, however, it is essential to the manufacturer that he should be able to insure the credit risks"; and so we pass on to the Export Credits Guarantee Department. Accepting that it is E.C.G.D. policy not to cover the whole risk but to cover various percentages between 80 and 95 per cent., is it not possible for the manufacturer to insure to cover the balance?——No.

5693. Why?——*Mr. Hinton*: I do not think it is the normal thing for insurance companies to deal in this kind of risk.—*Mr. Fiennes*: I remember a case when it was tried: insurance companies were tried and Lloyds too, but nobody was prepared to insure the balance.

5694. *Lord Harcourt*: Was that because of the existence of E.C.G.D.?——I should think that probably had a good deal to do with it. In the particular case I had in mind we wanted to know if somebody would take the balance, and the answer was no. We did not have the opportunity to go back and ask why not; that was not quite the object.

5695. If the E.C.G.D. did not exist, would Lloyds be prepared to underwrite 100 per cent. of the risk?——I do not think so.

5696. *Chairman*: Has the E.C.G.D. been doing this sort of business ever since this kind of risk, political trouble or the transfer difficulty, has been involved?——*Mr. Fiennes*: Certainly since the war; I do not know to what extent it was doing it before the war.—*Mr. Hinton*: E.C.G.D. was certainly in existence before; my own company effected a Russian contract for heavy capital goods in the early thirties, and I think we had a 90 per cent. cover on it.—*Mr. Please*: Ever since 1929 they have insured this kind of risk, as a result of the recommendations of the MacMahon Committee. That is when they took this type of cover, although the cover has been extended in various directions.

5697. In effect this type of cover has always been in their hands and not in those of the insurance market?——Yes.

5698. *Professor Sayers*: There used to be risks of this kind before 1929; I suppose they were then taken by the merchants?——*Mr. Please*: It was taken after 1921 in an entirely different shape and form. There was the Trade Facilities Act, and the old E.C.G.D. before that; according to the reports made at the time the risk was so large that the E.C.G.D. was being run more or less at a loss, and it looked as if it was an indirect subsidy to exports.—*Mr. Hinton*: You appreciate we are not interested in this insurance for all countries; not, for instance, for Australia, Africa or America. It is only where there is a genuine risk, or we feel there is a risk, that we need the insurance.

5699. *Professor Cairncross*: In domestic credit insurance is it possible to obtain 100 per cent. cover?——In the only type of business I know, which is capital goods, we have never even considered it for the domestic market.

5700. The Trade Indemnity Corporation Ltd. covers a large portion of the mainly domestic market; do they offer 100 per cent. cover in practice?——*Mr. Hinton*: I have no experience of that.—*Mr. Fiennes*: In the capital goods trade in this country one is generally dealing with substantial concerns; it has never even occurred to me that it would be necessary to insure credit risk on the sort of business with which we are concerned.

5701. *Chairman*: You rather indicate that it is a matter of policy with E.C.G.D. to leave some margin uncovered?——*Mr. Steel*: That is our impression. It has been suggested that the reason for this is that it is considered that it would be unfair to ask E.C.G.D. to insure the manufacturers' profit, and the figure of 85 per cent. has apparently been chosen to some extent as an approximation of the difference between the actual cost to the manu-

* Memoranda of Evidence Part VII No. 8B.

facturer and the amount of money he hopes to get at the completion of his contract. If that be the case, our view is, first, that on many occasions it would be unreasonable to expect the manufacturer to get as much as 15 per cent. profit in the face of the competition which he is likely to encounter from other countries; and secondly, that the manufacturer still has a substantial interest in carrying out the contract satisfactorily, quite apart from being at hazard himself for 15 per cent. of the total sum involved. A large proportion of the kind of business we are talking about is going into the relatively under-developed countries, where this type of business is increasing, where the difficulties of estimating the exact cost of the job are substantial, and where a whole lot of unforeseen changes may occur in the course of completing the contract. Those have to be borne as a matter of ordinary commercial and technical practice by the manufacturer, and the manufacturer, so far as he has represented to the F.B.I., regards that as for him a sufficient stake to make him take a real and proper interest in the business, and considers that it is consequently not necessary to put him at hazard for 15 per cent. of the total value of the contract in order to make him take a real and satisfactory interest in the completion of the job.

5702. *Sir John Woods*: The ordinary manufacturer would say that he had his own risks with regard to his manufacturing methods, and so on, and that in the "good old days" before the war it was no part of the manufacturer's job to shoulder these financial risks, whether arising from political trouble or insolvency, or anything of that kind?——That is so.

5703. I suppose the E.C.G.D. answer is that that may be true, but that is not any reason for saying that the whole of this risk should be borne by the taxpayer?——*Mr. Steel*: I do not know what the official answer of the E.C.G.D. is; all we know is that in practice they are not prepared to insure more than 85 per cent. of the risk. —*Mr. Hinton*: Apart from the risk on what we call the f.o.b. sterling side, we cannot insure the local currency expenditure, which in the type of contract I am interested in, such as coking plant and power stations, is quite a substantial part, perhaps 25 per cent. on a £5 million contract. We take all the risks on that; the only insurance we get is the 85 per cent. on the sterling costs.

5704. *Lord Harcourt*: If you want to insure a large contract against these risks, do the E.C.G.D. insist on insuring all your exports?——No. They have what is called a blanket policy, which really covers what is described here as medium-term exports; a blanket policy means that one insures everything which comes within a certain range of export credit. If one enters into that, one insures everything and one gets more competitive rates, and certainly there are other advantages. It is limited to contracts under £1 million, and extending to about four years. Over that it is an *ad hoc* arrangement. But the E.C.G.D. do not compel one to take out a blanket policy as a condition for covering one particular contract.

5705. Any manufacturer exporting from this country is at liberty to insure or not insure with E.C.G.D. as he likes?——Yes.

5706. *Professor Cairncross*: Is this true of short-term insurance?——I am not very conversant with short-term, but I am pretty certain it is the same: that one has no need to insure, but also one can take out a blanket policy which does cover all one's exports in that range.

5707. *Lord Harcourt*: I understood that in return for this service of insurance you were required to put anyway a proportion of all your risks through E.C.G.D.?——*Mr. Hinton*: No, there is no compulsion at all; it is a voluntary arrangement with E.C.G.D.—*Mr. Fiennes*: If one insures *ad hoc*, the cost per cent. is more than if one insures all one's export contracts; that is to enable E.C.G.D. to take the rough with the smooth.

5708. *Chairman*: That in itself would not be an unreasonable situation?——No, I would not regard that as unreasonable; one cannot expect to go and insure only the bad risks and get just the same rate as one would if one was insuring all of them. I wonder if I might make a point on the subject of E.C.G.D.'s cover. I am the managing director of a medium sized engineering company, and it is a feature of the business that in a lot of these cases we have a contract which is very large in relation to our turnover; therefore, when we are putting 15 per cent. of our contract price at risk, we are also putting what may be regarded as a very large proportion of one year's profit under risk. When any of these propositions occurs, we have to look at it, to weigh up the risk which exists, and what we stand to gain and what we can lose if we do lose. Without going into a lot of calculation, I think it would be right to say that the fact that we can only normally cover 85 per cent. with the E.C.G.D. leads us to quote a higher price than we should otherwise do; and in the process we undoubtedly lose a proportion of business. The fact that we have to give a higher price arises from cold business calculation; I understand that E.C.G.D. regard it as naughty that we should do that, but we have to get the right sort of return for our company without involving ourselves in unjustified risks. In general I would say that the price becomes a higher price by reason of the fact that we can only insure 85 per cent.

5709. *Chairman*: You have to shift on to the purchaser the additional premium which would be required?——Yes; it varies from case to case, but I can recollect a recent case of a contract which we lost to the Germans, where we reckoned that over the whole of the credit period we were really at risk for an average of 8 per cent. of our total contract price. My own company considered that 8 per cent. was too much risk, and we quite frankly put up the price, so that if the banks exercised their right of recourse against us in respect of the uninsured 15 per cent. we had something in the kitty to pay that. But our sacrifice would have been more than our profit. That was a cold commercial calculation we took, but it resulted in the loss of the contract.

5710. *Professor Cairncross*: When you seek to have 100 per cent. cover, are you thinking exclusively of the transfer risk or are you thinking also of the insolvency risk?——*Mr. Hinton*: We are really thinking of the risk which we do not like to take, or should not take, which is the political risk; that is completely outside our control. As to insolvency, if we lost on that account it would be because we had chosen a bad customer; but we feel rather strongly about the political risk. It is difficult to say what we think the percentage should go up to; all I would say is that we think it should be higher than 85 per cent. at this stage.

5711. Even on insolvency?——On insolvency it should be more.

5712. Do you not think that firms should have some incentive to choose good customers?——Before we get any E.C.G.D. insurance at all, the E.C.G.D. themselves vet the customer and decide whether he is a good risk; so they take some of the responsibility there. They will not give the insurance unless they are satisfied.

5713. Bearing 85 per cent. of the risk as they do, is it not a natural thing that they should want to vet him?——I agree.

5714. Is it not equally natural, if they are offering favourable terms of insurance, that they should want to offer an indemnity on rather less than 100 per cent. of the contract?——*Mr. Hinton*: I could agree with you that it should not be 100 per cent. All that I say is that it should be more than 85 per cent. The 15 per cent. contingency is spread over a number of years where a large capital project is involved, whilst the position is aggravated where there is an accumulation of such contingencies.—*Mr. Fiennes*: It is part of our job to satisfy ourselves as to the credit-worthiness of our customers. Where we are dealing with a simple business where we are going to be paid 90 per cent. by the time we ship the goods and the remaining 10 per cent. later, I do not think 85 per cent. is unreasonable; but where the period of payment and the risk extends over a number of years after completion, I feel we need greater protection against the credit risk. I think most of us engaged in this field would regard the real protection needed as being against the political and transfer risks, against foreign exchange going wrong, against devaluation of sterling, against dictatorships, and all those things which can happen.

5715 *Sir John Woods*: Have the F.B.I. considered, instead of taking 90 per cent. of the total risk, the possibility of having a contract insured 100 per cent. excluding profit?——*Mr. Steel*: We have not given official consideration to that; but from conversations I have had that

would meet to a very substantial extent the desires of many members. It is the political hazard which is incalculable from the point of view of the average exporter of this type of goods, and on which he does want 100 per cent. cover. He would, I think, in many cases be prepared quite willingly to shoulder a balance of the commercial risk attached in connection with the possible insolvency of the customer. I do not know whether it is possible in practice to have two kinds of policy, or whether it is better to merge the premium for the political risk and the commercial risk and cover only 90 per cent. or 95 per cent.; that is a matter of technical scope in connection with E.C.G.D. The main underlying business is that the exporter from this country cannot help the political hazard, and he may not have a sufficient disposition of his export orders to spread his risk.

5716. *Lord Harcourt*: I suppose the bulk of this medium-term credit is required for the export of capital goods, and those capital goods, when going to under-developed countries, as most of them do, are being sold to a public body of some kind, or a semi-Government agency; and that therefore from your point of view you consider the political risk greater than if you were selling to a private customer; is that so?——Not necessarily; the political risk we have been referring to is primarily the risk of our inability to get sterling for the payment, even if the ultimate buyer has got all the necessary local cash in the till to meet his commitments.

5717. That is what I would call the primary political risk; but when dealing with the under-developed countries, do you not also enter into a secondary political risk, that you are selling to a Government or semi-Government agency who may have their policy radically altered?——That is always a possibility, and one that must be in the mind of anybody selling to a Government or semi-Government agency overseas: but whether the hazard in that case is greater in total than the hazard of selling to a private company is a matter which would have to be decided in each particular instance.

5718. *Sir Reginald Verdon Smith*: As Mr. Steel was saying, the lack of anything greater than 85 per cent. cover puts a manufacturing exporter from this country at a disadvantage with a foreign competitor. Is it within your knowledge that all foreign competitors have an advantage in this particular respect?——*Mr. Fiennes*: I have heard it said that the insurance the Germans get is less than 85 per cent. I went over to Germany last year, and talked about it to some of them; they were rather cagey and did not say very much, but they tried to give me the impression that the insurance they got was less. But when we get to the facilities given by the American Export-Import Bank, one understands that the credit is advanced without any recourse to manufacturers at all, and of course for a very much longer term.

5719. *Chairman*: That is credit advanced at the other end?——*Mr. Fiennes*: Yes, advanced to the customers.—*Lord Harcourt*: That is the traditional way it used to happen.

5720. *Professor Cairncross*: Do I understand you are saying that 85 or 100 per cent. credit is advanced in that way?——*Mr. Hinton*: Less than 100 per cent.; 60 per cent., I believe, as a loan to the customer. If we had a similar arrangement here we could insure the whole contract with E.C.G.D. The E.C.G.D. has two types of policy; the ordinary contract works policy, when a credit is not visualised, and the banker's guarantee policy, an unconditional guarantee policy which is absolutely essential for long-term credit, if one wishes to have a credit of seven to eight years. It has been acknowledged that you can get a better cover for political risk on a manufacturer's policy; but in the case of the unconditional guarantee there is a flat insurance cover of only 85 per cent.; that is where we feel there is some hardship thrown on the manufacturer. After all, the 15 per cent. is spread over, in lessening amount, a period of possibly eight years. I do not think there is worry about the ordinary straightforward contract policy.

5721. We are speaking now about long-term or medium-term?——There is hardly any difference; E.C.G.D. has only one division, the medium-term division, which deals with the whole lot.

5722. There is a difference in the type of contract, a difference between the construction of a steel works and a shipbuilding contract. One might have a division, and call one long-term and the other medium-term?——They overlap a lot in my own case; we do entirely capital goods, and we build small plants which take two or three years, and large ones which take five years. Where the division is I do not know.

5723. I asked the question because I had in mind a particular issue, which is the pre-shipment risk involved in some of these contracts. Is it not right to say that E.C.G.D. cannot give pre-shipment insurance on constructional contracts?——That is rather a sweeping statement. I have come across it, but under very strange circumstances. Without boring you I would say that it is where we put up a proposal that we should have part of the sterling side of the contract paid in local currency; in that case E.C.G.D. did say they could not give pre-shipment insurance, why I do not know.

5724. I may have been misinformed, but I gathered E.C.G.D. had stiffened quite considerably on this in the last few months?——*Mr. Fiennes*: They have stiffened in respect of the term.—*Mr. Steel*: There is a point, in relation to paragraph 4, about the minimum sum of £250,000 which the E.C.G.D. will at present guarantee. We have had substantial representation from our membership that that figure is unreasonably high in a number of special cases; such things as earth moving equipment and heavier transport vehicles. I have had it mentioned by Mr. Hinton on my right in connection with the type of business his company does from time to time, the erection of small sulphuric acid plants; it is quite possible that in the course of a year or less there may be a series of orders, none of them approaching the £250,000 mark, but in aggregate substantially exceeding it. It is extremely difficult for the companies involved to finance that business in the absence of the guarantee from E.C.G.D., and our membership feel there is a substantial case for a reduction in this sum of £250,000 to cover this other type of business. It would not necessarily be desirable to do it in every case, but they would like to see a more flexible attitude.

5725. *Chairman*: What information had you gathered from the representations which have been made about the reasons for this minimum?——We have not any definite information, except in so far as we understand that it limits the number of special cases with which E.C.G.D. has to deal, and consequently it limits the range of investigations and work they have to undertake. We have not heard, as far as I know, any reason other than that; with the possible exception that it might be necessary to have greater discrimination among the potential customers of E.C.G.D., because it would perhaps tend to bring into the system a number of manufacturers of less weight and importance than those who already avail themselves of these facilities.

5726. Then we come to long-term credit in paragraph 5; it is in this sphere, you say, that "a re-appraisal of the methods of export finance and an appreciation of future requirements are most needed." Then you make the point that in the United Kingdom's export trade "the proportion of more specialised engineering goods is steadily increasing."—*Professor Cairncross*: If a British firm undertakes a contract overseas for construction, does it require more capital than if it accepts a similar contract at home, in the sense that a larger proportion of the value of the contract would be outstanding at any one time?——*Mr. Fiennes*: It is more a question of long-term credit. Substantially there would be no very great difference, because it is an almost universal practice of heavy capital goods manufacturers to require the customer to contribute very substantially to the financing of the work in progress, financing the construction of the job. It is a fairly common practice for home orders for these large contracts (steel works equipment would be a good example) to ask the customer to pay about 80 per cent. of the contract value of the work done each month or each quarter; then he is expected to pay 10 per cent. on delivery and the 10 per cent. outstanding 12 months or so later, at the end of the retention period. The ideal kind of export contract we hope to get without any credit terms, and we rather improve on that: we expect an overseas customer to put down 10 or 20 per cent. when he signs the contract. But we should still expect 90 per cent. in total by shipment f.o.b. and the remaining

10 per cent. outstanding after the retention period. In terms of financing the execution of projects, I do not think any more working capital is required for an export contract than at home. The thing only becomes greatly complicated where credit terms are involved, in the light of some recent development.

5727. *Lord Harcourt*: As I understand it, E.C.G.D. have a limit of time beyond which they are not prepared to insure what you might call long-term credit. A great part of the goods which we are discussing this afternoon are goods which one could not expect to be amortised in that period; therefore the E.C.G.D. cover does not really meet the importer's problem, which stems from a lack of development of the capital market in his own country, which prevents him from borrowing there. Is that right?——*Mr. Steel*: That is very largely the case.—*Mr. Hinton*: And he cannot borrow on this market either.

5728. He used to borrow in this market; now he cannot, and he is thrown back on his own capital market?——*Mr Steel*: Or on loans from the World Bank, or similar institutions; but clearly E.C.G.D. goes in no sense towards the point of financing the payment by instalments of the plant which is exported from this country. The type of plant which is specially under consideration at this moment is the kind of plant which could only be amortised out of profits over a substantial period of time, fifteen or twenty years in the ordinary course of events; and the problem is really the financing of the construction of that plant from the customer's end.—*Mr. Fiennes*: Two conditions may arise: the customer in the under-developed country may want outright the capital to finance the construction of a project; or the customer may have the capital in his own currency but does not have the sterling which the British manufacturer wants it paid in. As to the first, no facility which has recently been offered will enable finance to be provided from this country over a period which is necessary to amortise a large capital project. On the other hand, the kind of cover which is offered will in some circumstances enable the customer to find the sterling that we want the contract sum paid in. For example, he may have seven years to find the sterling instead of three years. It is important to make that distinction.

5729. *Chairman*: You have eliminated in paragraph 6 the classic possibility that the loan was raised in the capital market here, and the manufacturer had no trouble about it from the point of view of credit. Now you have eliminated, under present E.C.G.D. policy cover, anything like as long as the period of time involved for the purchaser to pay out of his own resources. Are there no institutions in this country, forgetting E.C.G.D., who are prepared to provide the finance required?——*Mr. Steel*: Although banks, and possibly insurance companies and such institutional investors, might be prepared in certain circumstances to advance money or make loans, in fact on long-term no one, as far as we know, would be prepared to do it on this type of business without the guarantee through E.C.G.D. or some other Government institution that they would be paid on the due date.

5730. *Professor Sayers*: Why must it be by a Government institution?——*Chairman*: What is the difference between this and the tanker finance arrangement under which the banks drop out first, the insurance companies come next, and the pension funds take the latest slice?——The distinction is that the payment, in the case of the steel works or the coke oven plant in South America, has to come from Brazil, the Argentine or another South American country; whereas the payment for the tanker fleet is not dependent on the conditions in a specific overseas territory with all the political and financial hazards attached.

5731. *Sir John Woods*: There have been one or two cases where a bank has been willing to lend for a period to finance an export to, for example, Australia, without export credit?——I have no personal knowledge of that, but I should think it is very probable.

5732. I have; but in that case I understand that the bank themselves, for their own reasons, would not be prepared to lend beyond seven years at most. Do you have any view on that?——*Mr. Hinton*: The banks usually limit their lending for medium or long term to seven and a half years, and insurance companies do not like to come in on shorter than ten years. There is that gap of 2½ years at least.

5733. *Chairman*: That is a gap in the suitability of credit to particular lenders?——That is one of the problems. But, even if we could cover the gap, we should still have to persuade E.C.G.D. to give the insurance; they limit their insurance to five years from the date of completion, which is usually a period of seven and a half to eight years at most from the date of contract.

5734. I am trying to make out whether, without the assistance of a Government agency, it would be possible to find motive forces in our own economy that would face this, and whether that is due in fact to an unwillingness to take the risk, or whether it is a term of credit we are not interested in providing?——*Mr. Steel*: There are two things: first, there is this gap of two or three years in relation to the term of credit, because the shorter term is attractive to the banks for technical reasons and the longer term attractive to insurance companies or other institutions for internal reasons. But, irrespective of that gap, we have no reason to believe from our experience that there is any number of institutions willing to loan money for this period without cover from E.C.G.D. That is the second point. At the moment E.C.G.D. cover from the date of signing of the contract to five years after completion is about seven and a half years, which happens to coincide, to the best of our information, with the period for which the banks are prepared to lend. We have no knowledge or experience, as far as I know, what would happen if E.C.G.D. would guarantee beyond five years after completion, and we had then to go to institutions and see if we could raise the money.

5735. *Sir John Woods*: Are not E.C.G.D. obligated on that limit on export credits to five years from shipment by agreement with other credit institutions in Western Europe?——Yes, that is so.

5736. If it could be shown that purely from the point of view of British manufacturers exporting heavy capital goods it was a good idea to extend the term, all the other credit insurance people would do the same. Do you think that in those circumstances there would be any net gain to this country?——*Mr. Hinton*: Not all the countries are members of the Berne Union. Countries like Japan and America are outside it, and I think Belgium as well. Our main difficulty on this extended credit over a period of 7½ years comes from contracts backed by the Ex-Im Banks which go up to ten or twelve years. We have got a case in point; the Japanese Ex-Im Bank financing textile machinery for India. These people are outside the Berne Union, and it is a matter of competing against them.

5737. How seriously do you think this has affected the export market?——*Mr. Fiennes*: There are very substantial works which might be available to this country if the credit were available.

5738. *Professor Cairncross*: Is it your suggestion that capital would be forthcoming from this country?——Quite frankly I do not know.

5739. Does not there underlie these questions the issue of how much capital this country can provide to foreign countries?——*Mr. Steel*: We have been trying to state the practical position from the point of view of the exporter from this country. We are of the opinion that more business overseas would be available if the British manufacturer by one means or other were enabled to give longer credit terms. At the same time we are very conscious of the undesirability of entering into a competitive race in credit terms with the other main manufacturing countries of the world. In addition, too, we fully realise that the amount of credit which this country can afford to extend in the form in effect of unrequited exports for a substantial period of time must be limited. We cannot assess the importance of that in the national economy; all we can do is to point out that there are these practical difficulties from the point of view of a member selling overseas, and that in our opinion manufacturers would be able to get a larger volume of export business of the type we are discussing if it were possible to give somewhat extended credit terms.

5740. *Chairman*: A good deal of the force of that seems to depend upon your theme that the future level

of exports in this country depends increasingly upon this kind of export. How much can you enlarge on that?——Not substantially. It is already an important part of British exports; and it is also, I think, a matter which is not disputed that certain of the conventional type of exports from this country of consumer or near-consumer goods are certainly not expanding, and in many cases are diminishing. We see no likelihood of a change in that trend. The obvious example is the cotton textile industry of the non-specialised type. There may be other examples in some of the more old-established forms of chemical products, merely because of continuing increase in local manufacture overseas and the gradual filling of the market by local products. On the other hand, we see prospects of increase, perhaps substantial increase, in novel products, and in those engineering products where the specialised and traditional skills of this country still give a substantial advantage over any local manufacturer in the under-developed countries. What we have therefore to consider is our competitive position in that type of manufacture in relation to manufacturers in Germany, France, the United States and so on. It is in that connection where possible competition in credit terms as one of the elements in competition arises. We feel, although we have no means of checking this definitely, that there is a chance of a substantial increase in the volume of this type of export.

5741. *Professor Cairncross*: Would it also be possible that a number of contracts have gone to other countries even at higher tender prices because better credit terms have been offered; in South America, for example?——*Mr. Fiennes*: I have heard it said that that has obtained in South America. I was discussing a case this morning where quite a substantial contract was placed abroad at a higher price than the British manufacturers quoted, because credit facilities were available. But I must admit my information on that subject has not been extensive.—*Mr. Hinton*: A very good example of what we have been talking about is the case of India and the three large steel works which were to be built. The first one went to Germany with good credit terms; the second went to Russia on probably better credit terms; and we had a very big struggle to get the third, which fortunately we did. If we had not been able to give good credit terms, and on that not only E.C.G.D. helped us, but the Government itself, we should probably have been out of India for a long time in steel works. There is going to be a fourth steel works in the next five year plan; there will be extensions to these others. We are at least competitive now in that we are in the country. If we had not got that third steel works, we should probably have been out for good.

5742. *Professor Sayers*: In the case of the first and second which went to other people, was the British price lower?——*Mr. Hinton*: We were not even approached; they were selected contracts.—*Mr. Fiennes*: In the case of the Russian credit terms there are presumably political implications, but it would be wrong to ignore them, because they are likely to be with us for some time and we may have to consider what to do about it. What we know about the Russian terms for this steel works as compared with the kind of terms given in this country really adds up to this: the Russians asked for no down payments at all, and on each consignment of machinery delivered c.i.f. Indian port credit was raised for the value of that machinery, repayable in twelve annual instalments carrying interest at the rate of 2½ per cent. There is no reason to doubt that that is substantially true. On our side, on the other hand, on a total f.o.b. sterling value of roughly £50 million, Her Majesty's Government gave a direct loan of £15 million and a consortium of London banks gave a seven year credit for another £11½ million, making £26½ million altogether. Thus roughly half the value was able to be financed over seven years (as opposed to twelve) with interest at 1 per cent. above Bank Rate, as compared with 2½ per cent. I think that kind of comparison should be noted, though I am not suggesting we should put ourselves into a position to beat the Russian terms.

5743. *Sir John Woods*: You have been discussing this rather in terms of competitive advantage as against other people, and particularly in terms of getting nearer to matching the sort of terms which the Export-Import Banks give. Do you think there is anything in the argument that, if credit terms for these long-life capital goods were extended to something like fifteen years, or ten years which would be better than nothing, there would be advantage all round, in that more schemes would come from other under-developed countries which would otherwise not come forward at all?——*Mr. Steel*: Yes, I think that there would be a greater rate of economic development in the under-developed territories if they were able in effect to raise money more readily. To a certain extent at least the rate of their development must depend on the availability of finance and not by any means exclusively on the availability of technical help or technical skills in the countries concerned. We do feel, therefore, that to some extent at least the more rapid development of these countries, added and sustained in this way, would be of medium and long-term benefit to the exporters of other goods from this country. There must be in many cases instances where the installation of certain forms of primary plant, whether they happen to be power stations, glass-works, or anything like that, will give rise in a very short period of time to exports from this country of the materials that those factories will require. In addition, too, we get at least the steady flow of spare part orders and replacements, and through standardisation of equipment a certain likelihood of continuing business in the same line of country.

5744. You said that some advantage of this kind would come from their being able to borrow more readily. It is not only being able to borrow more readily but being able to borrow on terms which enable them to amortise the money they raise over the real life of the asset?——Yes.

5745. *Professor Cairncross*: Cannot all of these countries borrow from the International Bank for Reconstruction and Development on terms more favourable than they could from us?——*Mr. Steel*: I think that the International Bank does not make loans to individual companies or private enterprises, but only to governments and with a government guarantee.—*Mr. Fiennes*: And contracts have to be put out to tender, I think.—*Lord Harcourt*: To competitive tender. The International Bank will lend to the individual company, but requires a government guarantee.

5746. *Professor Cairncross*: The rate of interest may now be rather an important factor then?——Yes.

5747. Do you find that at current rates, even where the credit could be made available, this has some influence on the source of country of supply?——*Mr. Hinton*: I have not had any direct experience of that; but my own company was tendering for a very big plant in Italy and our terms of credit were at the time quite attractive, based on 7½ years, but we did hear that lower rates of interest were quoted. Unfortunately the Bank Rate went up to 7 per cent. during the negotiations and the rate of interest was geared to Bank Rate; the contract is in abeyance.—*Mr. Fiennes*: From my experience I think that we probably lost more jobs due to the credit term being a little bit shorter than the Germans can offer than to their rates of interest being lower; in one way or another the Germans' usual arrangements were more flexible. We lost a large job in Portugal recently because of the seven year limit on the credit guarantee (seven years from the signing of contracts); there is a lot of evidence to show that the German arrangements in fact added up to ten years, and that was more decisive in the minds of the Portuguese than the rate of interest. It was said that in this particular case the Germans were associated with a Belgian concern; the Belgians are not parties to the Berne Union. We endeavoured to counter it by splitting the contract into two stages, but without success. We regarded the credit arrangements there as rather inflexible in the circumstances.

5748. *Professor Sayers*: You have just given a German example; but the Germans, like us, have had rather high interest rates and interest rates would not be a factor making strong difference in competition. If you took a comparison with, say, the United States, would you answer the question a bit differently?——Yes; but I think it would not be a comprehensive answer; in the particular case I have in mind, the Tata Iron and Steel Company, which went to an American concern on an International World Bank loan, the interest rates were similar, but in fairness we should say the term was very much longer; and the Americans offered to do this job

very quickly indeed, far more quickly than we could in the circumstances. The answer to your question is not clear cut, I am afraid, because there are often other factors.

5749. *Chairman*: In paragraph 9 I think the main theme is that you want a common policy among the banks in dealing with finance in this way.—*Professor Sayers*: Do you dislike competition in banking?——*Mr. Hinton*: This kind of business is comparatively new, I think, in banking circles. In the last three or four years several banks (one in particular and others following) have been rather enlightened, from the manufacturers' point of view, and have given all the assistance necessary. Other banks have not seen their way to view it in the same light; possibly they feel that they can make as much money by investing money elsewhere. If there is going to be an increase in this form of credit given by the joint stock banks it seems to us that there may come a point where it may be the enlightened banks who have to go on increasing credit. We felt that it would be better if there were some common policy amongst joint stock banks, so that they would share the business proportionately, or if there was some means of getting together on some kind of common policy. We can see the day arising when no more money will be available to us, even though one or two banks have been willing to lend us the money.

5750. *Chairman*: A common policy might drag you back rather than push you forward?——*Mr. Fiennes*: Only in so far as there was a common policy not to lend.

5751. *Professor Cairncross*: This is really a pious hope that all banks will catch up with the enlightened ones?—*Chairman*: You have found sympathetic help from certain banks but have not found other banks ready to come into this field?——*Mr. Hinton*: I do not think that the element of competition comes into it, because interest rates must be geared to the bank rate; there cannot be much adjustment there.

5752. *Professor Sayers*: If the banks were free from the present governmental control of their running, would you not expect your ends to be served better by competitive banks, with a willingness on your part to transfer your custom to the bank which showed the greatest disposition to be enterprising in this field? I find it awfully difficult to swallow from you these complaints against private enterprise?——*Mr. Hinton*: I think that the enlightened banks are at an advantage, in that they are more likely to attract other types of business.—*Mr. Fiennes*: I think that the point is really this: sometimes in the commercial world one is asked at rather short notice whether credit could be provided. One does not want to be in a position where one has to go round the city hat in hand finding out if anybody will produce the money. One wants to know whether there is a policy, and whether the banks are willing to lend money, without having to go round to find it.

5753. The banks told us in evidence that it is open to business men to transfer their accounts from one to the other. It would seem from their evidence that, apart from the recent credit squeeze conditions, an industrialist was perfectly free to switch his custom to the bank that by and large gave him the best service. Is not that so?——*Mr. Hinton*: In theory, yes; but there are practical difficulties. If you have been used to one bank for a long time and they know your system it is not quite as easy to switch from that bank to another.

5754. *Sir Reginald Verdon Smith*: In paragraph 9 you refer in rather complimentary terms to Air Finance Ltd. Does that provide a precedent that you regard as desirable in other directions?——I do not know the actual workings of it, but in theory I think something like that would be very useful. But to be of any use a consortium or corporation like that would have to be well capitalised; it would run into many tens of millions. It would have to have large funds or guarantees available, which would ultimately have to come from the insurance companies or joint stock banks.

5755. You say that "the manufacturer is entitled to expect that raising finance for exports should be expeditious", and so on, and "should not prejudice his ability to quote firm prices to his customers." What point had you in mind there?——*Mr. Hinton*: By firm prices we mean fixed prices plus escalation clauses, based on statutory increases in labour and material costs. We cannot quote a firm price because we do not know what is going to be the rate of interest right through the contract period, since the interest rate chargeable would be tied to Bank Rate.—*Mr. Steel*: We cannot offer a definite rate of interest for credit; we are obliged to quote a rate of interest which is tied to Bank Rate.

5756. *Sir Oliver Franks*: That could readily be altered, but might be more expensive?——*Mr. Hinton*: I have had the experience of trying a bank on a fixed rate of interest over a period: they would not play.—*Professor Sayers*: You want more time to go to another bank that will play.

5757. *Chairman*: The representatives of the Discount Market Association said to us that they would be in this business of long-term financing quite readily, if the outstanding debts created produced a negotiable instrument. Have you given thought to that?——*Mr. Steel*: We have not entered into the technicalities of the banking position, because we had no one in a position to advise us on the points at issue. There is one other point which has been represented to us: that, whereas many years ago a customer was financed by a loan from this country and had all the money required to pay his bills on the due dates, we have now got away from that to the point where in certain cases the customer is financed from this end by accepting houses or others who are prepared to guarantee his payments subject to E.C.G.D. background guarantees. We are informed that there has been a tendency recently for the E.C.G.D. so to conduct their business as to make the manufacturer here the real borrower, and not the customer overseas. That is a point which has given rise to substantial difficulty in many cases, because of the limitation of the borrowing powers of the manufacturer. His financial position might be excellent, he might be wholly reputable; but he might have some previous loan charge which limited the total amount of his borrowings from other sources. In a case like this he may well be faced with an opportunity of doing business; he may get cover from the E.C.G.D.; he could go to a bank, but he himself has to borrow and it would take him outside his borrowing powers; so he has regretfully to abandon the project completely.

5758. *Professor Sayers*: When the purchaser used to do the borrowing, he often had to pay very high rates of interest indeed, and he could sometimes get no more money at any price. What you seem to be conveying is that it is sometimes difficult to get more capital for these purposes, and that a high price has to be paid in this country for that capital. Is that not what it comes to?——*Mr. Hinton*: No, I do not think so. Suppose that some companies are quite willing to undertake to carry out a contract for a job in Brazil; if the only way in which they can be financed for that job is by borrowing themselves, with background guarantee from E.C.G.D., then they may well go beyond the limit of their borrowing powers.

5759. *Professor Cairncross*: This goes back to the question I put to you much earlier when I asked if more capital was required by British firms in meeting a foreign contract. Are you not now putting to us that the firm is put to the limit of its borrowing capacity?——*Mr. Fiennes*: That is what I meant to try to answer, when I said that in normal times it did not, subject to things which had been happening very recently. To quote an actual case: my company have a contract at the moment in Spain with a firm which said it wanted some credit, not because it had not money in pesetas, but because it could not raise the sterling in time. With the help of an E.C.G.D. guarantee a cash advance facility was arranged. The terms of this are in effect that the manufacturer sends his claims for payment to the lender, and the customer repays over a period of years. E.C.G.D. guarantees that to the extent of 85 per cent., the banks having recourse to us for the 15 per cent. of the credit outstanding at any time. That has been operating quite satisfactorily; similar contracts have been done in many countries. E.C.G.D. have now suddenly reversed this. We have another inquiry from Spain at the moment from a very big, substantial company for a similar large contract worth £1 million. We went to E.C.G.D. and said: "Will you insure a cash advance facility similar to these other cases?" They said: "No; we will not do that now; you have to borrow the money this time. The way

in which it will work is this: you must ask the customer for promissory notes, and we will guarantee them to the extent of 85 per cent.; but our guarantee will not be effective until the goods have been shipped and accepted by the customer." As to what acceptance means in this context, I do not know; on strict interpretation it possibly means "when the goods are erected and ready for work." It means in any event that we shall not be able to discount these promissory notes until the goods are shipped, and possibly not until a year later. So we said to E.C.G.D.: "We cannot do this contract without progress payments, our financial structure is set up on the basis that the customer pays as we incur expenditure." So E.C.G.D. says "We will give you a pre-shipment payment policy in addition to the credit policy; you take that to the bank and they will advance you the money you want." We went to the bank; the bank said: "We are sorry; we are short at the moment." In fact, if we are paid 25 per cent before shipment and, say, 10 per cent. is left till the end of the retention period, we are going to want £650,000, which we have got to borrow to execute that contract. We cannot do it, because we should greatly exceed our borrowing powers if we did; it would be impossible for us to borrow that money from the bank. So the thing goes round and round. I have had to say: "If we cannot go back to a cash advance facility we shall simply have to write to the customer and say we cannot do it." We have tried to find different conditions, but we still cannot get it. I think this is almost the most important thing that has happened recently in regard to finance for exports. Seven year credits on capital goods contracts which represent a high proportion of a company's annual turnover just cannot be undertaken, because the finance cannot be dealt with in that way.—*Mr. Hinton*: I entirely agree. I think this is a most important and distressing change in E.C.G.D. policy. It seems to have arisen in 1957. We cannot understand why they have changed over from the cash advance facility, which was very simple to operate, and cheap from the borrower's point of view, because he only paid interest on his day to day balances. We do not understand why they have changed the principle. They have given an odd reason: something to do with the fact that under the banker's unconditional guarantee they are not allowed to withdraw their insurance at any time. If they can withdraw their insurance on the promissory notes, that in itself is rather disturbing from the manufacturer's point of view; he after all is the borrower in this case.—*Mr. Fiennes*: We take the view that it is not our business to borrow this money; we are in business as engineers, not as finance bouses. We have had to take a financial risk and accept some recourse. We have accepted that to a reasonable extent. But to be asked to pledge your company to borrow these enormous sums of money is quite out of proportion to the size of the business, and is rendering export business of this kind impracticable.

5760 *Chairman*: This means that you guarantee the customer over this period. I am not quite clear whether that is a deliberate change which E.C.G.D. wants to bring about?——*Mr. Hinton*: When you come to the point of shipment, which is probably where acceptance will take place, you can discount your promissory notes without recourse to yourself up to 85 per cent.

5761 *Professor Cairncross*: If you were building a steel works in this country, probably acceptance would take place as soon as payments were made, with no outstanding obligations?——I should expect in more cases that acceptance would be on delivery itself. The problem does not arise when building plants in this country as no long term credit or E.C.G.D. cover is involved.

5762. *Chairman*: Is "acceptance" really quite an appropriate phrase? You get progress payments on certificates, and then you get agreed retention money at the end, released only a year after the thing has been working satisfactorily. There is not a moment of acceptance, is there?——*Mr. Fiennes*: It may well be that a device could be introduced in a contract document, but the E.C.G.D. guarantee is not operative until the goods are shipped.—*Mr. Hinton*: I do not know whether that happens in the case of progress payments.

5763. *Sir John Woods*. Did Mr. Hinton say that under an unconditional banker's guarantee the E.C.G.D. cannot withdraw their cover, but under a manufacturer's policy they can?——Yes. They can tell us, say, to stop shipments under a manufacturer's policy.

5764. For any reason which pleases them?——*Mr. Hinton*: Yes, absolutely at their discretion.—*Mr. Fiennes*: They put it into each contract, but I have never known it happen. Presumably they could only do it in the event either of the customer geting insolvent or there being difficulties limiting it.—*Mr. Hinton*: Those would probably be the reasons; we have had this very problem.

5765. *Sir John Woods*: You say at the end of paragraph 9: "the trend of the country's export trade seems increasingly likely to require some new initiative". I take it that that refers to the general considerations mentioned in paragraph 5; you are not thinking of some special initiative to look after pressures on the export trade that may arise in 1958?——*Mr. Steel*: No; that refers to the long term trends.

5766. *Chairman*: You are dealing in paragraph 10 with the special situation of the civil engineering contractor?——Yes. Since this was written we have been informed that the special position of the civil engineering contractor is being put forward in separate evidence. We had no chance of excluding it from this document, but we feel that it would be much better for the specialists in that rather unusual industry to make their own case; we have not a specialised knowledge of it.

5767. Are there any other questions on this export paper?——*Lord Harcourt*: At the end of paragraph 8 are you there making a positive recommendation for the institution in this country of an Ex-Im bank?——*Mr. Steel*: No. A number of members of the F.B.I. feel it desirable to mention the existence of the Export-Import Banks in this connection, and some of the possible implications; but there is a wide variation of opinion. There is no common view as to the desirability or otherwise of a similar institution in this country. It would be not unfair to say that a substantial view is that it would be better to utilise existing facilities more fully and to improve those existing facilities, rather than at this time to start a new institution. I am speaking without any statistical background on this, but that is my impression of the majority view.—*Mr. Hinton*: The only advantage of something similar to that would be to cover this gap of 2½ years to which we referred [cf. Qns 5732-34]. There does not seem any other means of covering it at the moment.

Chairman: Then I think that completes our questions on your memoranda. We are much obliged to you for the help you have given us.

(Adjourned until Thursday, 20th March, 1958, at 11 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-THIRD DAY

Thursday, 20th March, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E., (Questions 5851 to 6086 only).
PROFESSOR R. S. SAYERS, F.B.A.
GEORGE WOODCOCK, ESQ., C.B.E. (Questions 5768 to 5922 only).
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR EDWARD REID, BT., O.B.E., Chairman, Accepting Houses Committee, and a Managing Director, Baring Brothers & Co. Ltd., ANGUS MACKINNON, ESQ., D.S.O., M.C., T.D., Deputy Chairman, Accepting Houses Committee, and Chairman, Brown Shipley & Co. Ltd., and J. V. MACARTNEY-FILGATE, ESQ., M.C., T.D., a Managing Director, Lazard Brothers & Co. Ltd., representing the Accepting Houses Committee, called and examined.

5768. *Chairman*: We have all read your memorandum*, and are most grateful to you for the careful preparation that has gone into it. I should like to work through it, taking the questions as they arise. I would like you to enlarge, if you would, on the Committee itself and how it came to be formed. There are seventeen members. Is the qualification for membership really determined by the fact that a member's acceptances are available for discount at the Bank of England?——*Sir Edward Reid*: Yes; their acceptances can then be discounted at fine rates in the market.

5769. Has it always consisted of the same seventeen members?——No. It started on the 5th August, 1914. A meeting was called rather hurriedly in the office of Frederick Huth & Co. and the representatives of twenty accepting houses met in order to agree on a uniform procedure for handling the problems of the moratorium that had just been declared. A committee of six was formed then to deal with that; it was called the Accepting Houses Committee, and out of that the present Committee has developed. It continued to deal with the practical problems of such things as Trading with the Enemy Regulations and matters of that kind in the early part of the 1914-18 war, and it continued in existence in a rather informal and desultory way, now and then handling one matter or another which was of interest to accepting houses.

It was not really until 1936 that two things happened which gave it a more positive existence. The first thing that happened was that the British Government instituted a clearing for trade and payments between this country and Spain. In 1934 the Government had introduced legislation giving itself the power to introduce clearing arrangements. The reason why that was introduced was that Germany had declared a transfer moratorium and the British Government had intervened to try to get justice for British creditors and traders; the negotiations were then going very badly, and it was thought that they might break down in which case a clearing would have been instituted. As it turned out that proved unnecessary; but two years later a clearing was introduced for Spain. The essence of a clearing is, of course, that the proceeds of imports from the country in question to this country get put into an account and used to pay debts or to pay our exporters to that country. For that it is necessary to know what the debts are. There were a certain number of banking claims on Spain, and the Accepting Houses Committee represented the accepting houses for providing information about those claims. It was found that the banking claims could not be dealt with in the framework of the trade clearing, and special arrangements had to be made. The Accepting Houses Committee became officially the liaison between the Government and the accepting houses for this purpose. I had been appointed a member of the Clearing Offices Advisory Committee when the Act was passed, and so I became involved in these Spanish arrangements, and accordingly it was on that occasion that I was invited to become a member of the Accepting Houses Committee.

The other thing that happened was that this Committee had had a more or less informal existence in the office of Frederick Huth & Co., and a member of the staff of Frederick Huth had been its secretary. In 1936 Frederick Huth gave up business and the Committee had then to take an office of its own and engage staff. Thus it became a body with a separate organisation, and Mr. Houseman, who had been the secretary since its inception when on the staff of Frederick Huth, became the secretary.

Then there came the outbreak of war and the bringing in of exchange control regulations. A great deal of the day to day administration of the exchange regulations was entrusted to the banking community and to the accepting houses. What came out of that was that membership of the Accepting Houses Committee meant that one was automatically an authorised dealer in foreign exchange, and the stamping of Form E.1 relating to sterling transfers, which was an important part of the exchange control regulations, was entrusted to us as well as to the clearing banks. At that time and for that purpose the list of members was revised; some houses which had given up or practically given up active business dropped out, and one or two other houses, who had never joined the Committee before because they had not happened to be involved in any of the problems handled by the Committee, joined it. That was in 1940, so that then the Committee became fully representative of all the accepting houses doing active business.

When we took an office, engaged staff and all the rest there were discussions as to whether we ought not to draw up some rules or a constitution. After discussion we came to the conclusion we could get on very well without any, and so we have no written rules at all.

5770. Have any firms joined since 1940?——Yes. Antony Gibbs & Sons in 1946, Arbuthnot Latham & Co. Ltd. and S. Japhet & Co. Ltd. in 1952, and most recently S. G. Warburg & Co. Ltd. a year ago; when they took over Seligman Bros. who are already members, but they themselves had to be elected as members.

5771. Is there any system for a regular review of membership? I suppose it would be very important for any one doing or wanting to do accepting business that his acceptances should be taken by the Bank of England?——One does not join the Committee in order to have one's acceptances taken by the Bank of England. It happens the other way round: the acceptances have to be taken by the Bank of England before there is any question of joining the Committee.

5772. If they are taken, is one automatically eligible to join the Committee?——No; we are our own masters. I should think that the two would go together, but nobody can become a member of the Accepting Houses Committee unless we elect him. I have no doubt that we and the Bank of England would feel the same way.

* Memoranda of Evidence Part VI No. 1.

5773. Are there any firms doing acceptance business whose acceptances are taken by the Bank but who do not belong to your Committee?——You would have to ask the Bank of England whose acceptances they take; I would not necessarily know that. But there are many other houses who accept bills. There are some very well known and highly regarded merchant firms accepting bills to finance their own business. There is no restriction on accepting bills; the question is whether one can find somebody to discount them.

5774. I rather had the impression from the opening of your memorandum that in fact any accepting house whose acceptances are taken by the Bank would be more or less automatically a member of the Committee?——Naturally we would want them in because we want our Committee to be representative; but before any new members come in there are private talks with the Bank of England. Are you really asking whether we might hold a view different from the Bank of England?

5775. I was asking to see whether such a situation had ever arisen?——It never has; and I should say that conditions would have to change very materially before that ever did happen. But in fact we should have to sit round the table, and elect a new member; we always have done that.

5776. In paragraph 3 you refer to "duties or responsibilities entrusted to the clearing banks (with the privileges which those duties or responsibilities may carry with them)" being equally entrusted to members of the Accepting Houses Committee. What have you in mind on that: the helping with exchange control regulations?——There are three things: (1) we are authorised dealers in foreign exchange; (2) we are authorised depositories of bearer bonds; and (3) we are exempted dealers under the Prevention of Frauds Act. Those three privileges come automatically to members of the Accepting Houses Committee, but at present none of those really means anything, because the list of authorised depositories and exempted dealers is far wider than the membership of our Committee. At the outbreak of war it meant something, but with the general liberalisation of the administration of exchange control the list has become very much wider, and any house which might qualify to join the Committee in future would undoubtedly be all these things already.

5777. How do you categorise the duties?——As authorised dealers in foreign exchange we have to see that the rules are kept. One is enabled to authorise this, that or the other; but we have to be quite sure that we are in fact authorised to authorise anything we do authorise. In the foreign exchange field there has to be the least possible dislocation and business has to be decentralised; the banking community has to be trusted to see that the control is carried out, and carried out efficiently. The members of the Accepting Houses Committee have those duties.

5778. *Professor Sayers*: You draw our attention to the fact that accepting houses are not by any means the only people accepting. Taking all the bills that are held in London, what proportion do you think are acceptances of your members?——The chart in our paper gives the total bills drawn and our acceptances outstanding. For the purpose of this chart each house made a return to the Bank of England, who added up the totals and gave them to the Committee; that is the basis of that figure of our acceptances. The figure of bills drawn is an estimate based on stamp duty takings.

5779. Could you give us any idea who are the people who account for the gap between those two figures, and in what sort of proportion they are responsible?——*Sir Edward Reid*: There are many trade acceptances by firms who accept bills to finance their own trade. Then a good many trade bills are discounted by the exchange banks. There is a great deal of Eastern trade, for instance, that gets dealt with in a slightly different way: the exporter draws upon the importer, the importer being a client of the exchange bank, and the exchange bank buys the bill.

5780. *Chairman*: Before we go on, for the purposes of record would you give us a definition of the trade bill?——A bill accepted by a trader.

5781. Without any other name on it?——It can have other names as it passes. Then the clearing banks do quite an acceptance business.

5782. *Professor Sayers*: Would that be bigger than yours?——They do not show their acceptances separately from various other things; but my guess is that the total of their acceptances is smaller than ours.

5783. *Professor Cairncross*: The clearing banks show a total of £500 million for "acceptances, endorsements, etc." Your view would be that the bulk of that is not acceptances?——I think you must ask the clearing banks that.

5784. The view put forward here is that your members' acceptances form about a fifth of the total bills existing at any one time; four-fifths must therefore be accepted elsewhere. Do you think the trade bills you have been referring to represent the bulk of the difference?——I should think probably; but it is very difficult to say. Bills are used for all sort of purposes. The discount market could tell you that far better than we could.

5785. One discount house gives particulars of the sources of acceptance of the bills which it holds; and in this case the proportion of the acceptances by the members of your Committee is very high, about three-quarters of the total. Would it be true that much the larger proportion of the bills held by the discount houses are bills accepted by members of your Committee?——A great many trade bills negotiated by the exchange banks, that is to say the banks with branches abroad, never come into the discount market at all; they are held by the banks. A certain amount of our bills are drawn by traders abroad and are negotiated by the exchange banks and do not come under this type of thing, but I should think that a larger proportion of our acceptances find their way directly to the discount market than of trade bills; and of course they prefer them.

5786. *Professor Sayers*: Are any of your acceptances held by your own members; not by the acceptor himself but by another accepting house?——Yes; we keep accounts for banks abroad who negotiate bills and send them to us. We may bold bills on other accepting houses in a term remittance account for the client abroad; or they may ask us to discount them.

5787. *Professor Cairncross*: Is this a practice that varies between one house and another? Does any house specialise in holding bills to any extent?——*Sir Edward Reid*: It is not primarily our business to discount bank acceptances. I would think that as a general rule we would only hold bills for banks abroad who send them to us to hold them for them.—*Mr. Macartney-Filgate*: We might buy a parcel of bills in the market; if we bought £50,000 or £100,000 bills in the market that parcel might well include acceptances of other houses, or it might turn out that they were acceptances of joint stock banks; they would be one or the other.

5788. *Chairman*: You would be buying them as an investment of your own assets?——We would buy them as a form of liquidity.

5789. *Professor Cairncross*: This is not, however, a preferred investment? You would prefer to buy Treasury Bills rather than bills arising in that way?——*Sir Edward Reid*: Our bill holdings are very largely Treasury Bills.

5790. *Professor Sayers*: In paragraph 5 there are references to the general current banking business of the accepting houses What are the sources of deposits held at the accepting houses? Do they come from people who are having bills accepted by you?——A substantial part of the deposits of most of us, perhaps of all of us, would come from banks or other companies abroad. An industrial company in this country would not keep an account for drawing its wage cheques and so on with us. It would keep it with the clearing banks. As we have said here, to some extent the banking that we do is ancillary to other services that we render to our customers. It may be in connection with acceptance credits, with foreign exchange business, with issue business, with looking after pension funds; there is a variety of specialised services that we render, and our customers may keep accounts with us for that.

5791. It is not predominantly any particular one of these? The position used to be, I believe (certainly it was said to be), that the accepting houses required customers who had drawn bills on them to deposit with them before the maturing of the bill sufficient money to meet the bill, and that this was the origin of a large part of the deposits. This was stated, for instance, in the various accounts of the 1914 crisis. Has this ceased to be so?——I do not think that this is so at all. Take the case of a bank abroad keeping an account with one of us: we may accept bills for account of that bank; we may also, and probably would, have a lot of business of paying cash under sight credits. For meeting these sight bills they would have to keep a balance, but not for the term bills.

5792. They are not tied up with the accepting business?——*Sir Edward Reid*: No, not at all.—*Mr. Mackinnon*: We all have a certain number of private clients, who are just ordinary users on an ordinary current account basis; but that is a very small side of our business.

5793. *Professor Cairncross*: Is it possible to give any impression of the proportion of your business which is on foreign account? Is it of the order of half, or a much smaller proportion?——*Sir Edward Reid*: I do not know what the proportion is. I should think it would vary very much, not only among houses but from time to time. Family businesses very often keep family accounts, and if it is a large family there are a lot of accounts, in which private investments and other matters are looked after.

5794. *Chairman*: The holders of these private accounts treat you as ordinary bankers?——Yes.

5795. *Sir John Woods*: Do you accept time deposits?——Yes.

5796. *Professor Sayers*: On the same terms as clearing bankers? Are you tied by the clearing bankers' rule of seven days only?——We were; but there has been a lot of correspondence between us and the clearing banks on that over a period of years. Before 1955 the clearing banks had a minimum period of twenty-one days. We had put to the clearing bankers that that was too long a period, but they stuck to it and we went along with them in order to keep in line. In 1955 we returned to the charge; they recognised that our arguments were reasonable, and the period was reduced to seven days. In 1956 we told them that we were embarrassed at having to refuse interest for shorter periods to our foreign clients who could easily get it elsewhere. We agreed with the banks to maintain the principle, to which they attached great importance, of no interest on current accounts, but our rule now is that deposit accounts may be for any period and that interest rates on deposit accounts are to be at the discretion of the accepting house concerned. So we can have call deposits just as the Eastern banks do. The clearing banks took note of this, but said that they would not change their own rules. Our attitude to these is of necessity rather different from that of the clearing banks. We work with them, and keep in line with them when we can, but as our business is not stereotyped we always reserve to ourselves the liberty to treat exceptional cases in exceptional ways; at the same time they have our assurance that that liberty will not be abused.

5797. You indicated as a reason for your breaking away from the clearing bank rule that you were noticing that other people were not bound by the seven day rule. Who were those people?——The discount market, for instance. They were paying interest from day to day to our clients, and we were precluded from doing that, until we altered it.

5798. Was it the rising level of rates in the discount rates that forced this?——*Sir Edward Reid*: No, not the rising level; it was the fact that this was happening. Rates were not so high in those days. It was the fact that the discount market were able to take deposits on a call basis.—*Mr. Mackinnon*: And some of them were actively seeking them, too, on the Continent and elsewhere.

5799. What is your general rate for deposits now? Have you anything that you would call a fairly stable level of rates in the last six months?——*Sir Edward Reid*: The ordinary rate is the same as that of the clearing banks.

5800. Does that apply to a large proportion of your deposits?——Yes, that is more or less a standard rate.

5801. *Professor Cairncross*: You refer in paragraph 6 to an "active trustee business". How large is this trustee business? Does it involve extensive dealing in bonds, for instance?——Yes. There are two kinds of trustee business: one is to act as executors of wills, trustees of settlements, and custodian trustees of pension funds and things of that kind; the other is in the field of industrial trusteeship, trustees for debenture stocks and so on. The trustee for a debenture stock has the mortgaged properties mortgaged to him, and there is no question as a rule of dealing in securities there. The other business (the wills, the settlements and so on) does involve the handling of investments.

5802. *Chairman*: You must have a lot of sinking funds to look after?——Yes. We have to purchase debenture stocks or arrange for drawings when the trust deed provides for that.

5803. *Professor Cairncross*: If you take that part of the business that involves actually holding securities, would it run to several hundred millions of pounds, or is it much less?——*Mr. Macartney-Filgate*: I think several hundred millions is too high.

5804. *Lord Harcourt*: With the very rapid growth of pension funds, this business must be increasing quite considerably in volume?——*Sir Edward Reid*: Very much. In the last few years it has increased a great deal. We are not always necessarily acting as trustees but often as investment advisers.

5805. *Professor Cairncross*: Are you under any obligation to provide information about your trustee business to anyone?——No. It is very strictly confidential; we could not disclose it.

5806. I meant the aggregate amount of investments you hold as trustees?——We have never been asked for it

5807. *Chairman*: In paragraph 13 you are giving a typical instance of the provision for facilities at the request of an importer to open a letter of credit in favour of a foreign shipper. The customer in that case is the importer, I take it?——Yes.

5808. And therefore the charge for commission is a charge that you make to him?——Yes.

5809. So although it is a credit in favour of the foreign shipper, no foreign exchange is collected by way of an invisible earning by that kind of operation?——Not when it is for account of a British importer.

5810. *Professor Cairncross*: On the other hand the value of our imports measured c.i.f. would include the value of the commission?——No; cost, insurance and freight does not include the acceptance commission provided for the importer.

5811. *Chairman*: In paragraph 17 you say:

> "When the credits are granted for foreign account the remuneration attaching thereto swells the invisible exports of this country."

Does that cover the case where the commission charged for the provision of the accepting house's name is a charge to a foreign customer?——Yes.

5812. *Professor Cairncross*: Is it possible to indicate anything about the magnitude of your credits for foreign account?——I think that the bulk of our term draft business is done for British accounts, but I do not know what the proportion is. Much of what we call "credit business" consists of paying cash against documents and does not involve actually giving any credit; a great deal of this is done for foreign account. I should say that we do more sight business for foreign account than term business at the moment, particularly now that exchange restrictions have stopped documentary credits on a term draft basis for account of one country outside the sterling area in favour of another country outside the sterling area.

5813. But even before that there would have been a big drop in relation to what had been customary in the twenties?——An enormous drop.

5814. At that time most of your business appeared to involve credit for foreign account?——The demand for domestic credit really only grew up in the thirties on the large scale at which it is now going. The proportion of foreign to domestic has changed very much.

5815. *Chairman*: How and why is that?——The hazards of dealing in some parts of the world are greater than they used to be; and there are all sorts of exchange restrictions and difficulties. Those, I think, are the two reasons which have reduced the foreign business.

5816. *Professor Cairncross*: Does not the foreigner now obtain credit more readily locally than in London? Is he not under less pressure to come to London to finance his trade?——Quite often that is so; but he has to pay for his import in a currency which the shipper is willing to receive. To take a theoretical case which may or may not actually have happened: if Finland wants to import coffee from Brazil, the Brazilians might not particularly want finnmarks and the Finns might not have any cruzeiros; such business would normally be financed by opening a sterling credit in London. It may be opened on a sight basis or on a term draft basis. It depends partly on the custom of the trade, and partly on the relative cost. In some countries local finance is very expensive, and the fact that there has been a discount on forward sterling has from time to time reduced the cost of sterling credit for foreign account.

5817. There has also presumably been a decline in the amount of credit offered to members of the sterling area in relation to what would have been typical in the twenties. Surely there must have been a rise in banking facilities in the sterling area?——*Sir Edward Reid*: It has changed. There used to be, for instance, a very large business done in London accepting term drafts for imports into the United States of Australian wool. So far as I know, that has practically all gone, though there is some of it still.—*Mr. Macartney-Filgate*: The post-war foreign exchange restrictions, which prevented a lot of this credit work being done here, drove foreigners to other sources, and it is difficult to get people back when they have found other working methods. I think we have lost a lot of foreign business through the immediate post-war exchange regulations.

5818. *Sir John Woods*: You explained that various hazards reduced the credit available for foreign borrowers, but you say in paragraph 20: "Simultaneously with this the demand for credit by domestic borrowers increased substantially." What were the reasons for that?——*Sir Edward Reid*: The main reason was a long period of cheap money which made acceptance credits for the time being appreciably cheaper than a bank overdraft. Bank Rate remained at 2 per cent. from June 1932 until August 1939. A bank overdraft is usually given on the basis of so much above Bank Rate with a minimum of so much: 1 per cent. above Bank Rate, with a minimum of 5 per cent. is a well known condition. It means that, whenever Bank Rate is 4 per cent. or less, the overdraft rate is 5 per cent. But when Bank Rate is 2 per cent. our bills go at 1 per cent. or sometimes less, and even with our acceptance commission an acceptance credit is considerably cheaper than a bank overdraft; so where the underlying business is suitable for an acceptance credit, which is by no means in every case where a bank overdraft is given, it becomes advantageous to take an acceptance credit. During that long period of a 2 per cent. Bank Rate domestic borrowers became aware of it and accustomed to the bill. That was the main factor which brought that business up just at that time.—*Mr. Macartney-Filgate*: There was a period in the thirties when the discount rate was $\frac{3}{16}$ths per cent. while Bank Rate was 2 per cent.

5819. Would you say in respect of transactions which lend themselves to acceptance credit that there is periodically a swing between that and bank advances, according to the relative cheapness of the two ways?——*Sir Edward Reid*: Certainly.

5820. *Mr. Woodcock*: Is your commission always the same whatever the amount or the source of the borrowing?——No; it varies.

5821. Does it vary a lot?——No, it becomes fairly standard. We are not a rate-fixing body in any way; everybody is at liberty to charge whatever he likes. But there are certain large credits given to industrial borrowers in this country in which most of us participate, so that we all know what the commission is in those cases. There is rather a tendency to say: "If so-and-so pays so much, this other client should not pay less", or: "If so-and-so pays so much, we cannot expect somebody else to pay more". That tends to standardise the charge for first class British credit takers; but the charge does vary according to the nature of the business done and to some extent according to the demand. If we are all rather full up, we may need a little more tempting to take a new client than if we are not.

5822. Is the size of the undertaking a factor too?——*Mr. Mackinnon*: The size of the individual firm would be a factor.

5823. I meant the size of the demand on you?——*Sir Edward Reid*: That would not make any difference to the rate. But a small firm might have to pay a little bit more than a large firm.

5824. *Professor Cairncross*: What is the normal range of your accepting commission?——For a first class borrower $1\frac{1}{4}$ to $1\frac{1}{2}$ per cent., I should say.

5825. But rising above that for business involving perhaps larger risks?——*Sir Edward Reid*: Yes.—*Mr. Mackinnon*: I should think 3 per cent. would be about the top.

5826. *Mr. Woodcock*: So the range is $1\frac{1}{4}$ to 3 per cent.?——*Mr. Macartney-Filgate*: I think that 3 per cent. would be exceptional.—*Mr. Mackinnon*: I have seen 3 per cent.

5827. *Professor Sayers*: Over the last thirty years you must have had a great deal of experience of the swing according to the relative rates between bills and bank advances for home trade. I imagine that there is some business that is done by bank overdraft that never comes to the bill at all, other business that has throughout that period normally been done by bills, and some that has been swinging according to the relative rates. Could you tell us in what trades the bill has held its ground fairly firmly all the time and in what trades it swings?——*Sir Edward Reid*: In the merchanting business generally the bill has held its own, but the average merchant (I can speak, for instance, with experience of business with the Liverpool cotton merchants over a period) will have an account with a clearing bank and facilities from an accepting house. In the days when cotton from America used to be paid for by a 60-day sterling bill, the accepting house or the bank would accept those bills. When it came to holding cotton in store until the mills wanted it, the merchant would use either a bank overdraft or an acceptance credit according to which was cheaper. In that type of merchanting business is cut very fine, and they are always looking at the odd sixteenth per cent. In some other businesses the reliability of the facilities is more important than the odd sixteenth per cent. The merchanting business generally is one where bills have continued and where it is customary to pay for an import by opening a commercial credit; and that tends to go on unless it becomes unduly expensive for a long period.

5828. What are the commodities that have swung quite decidedly from bill finance to overdraft finance in the last thirty years? Is bill finance used much in petroleum importing?——It is used not necessarily only for imports of petroleum into this country but also for shipments of petroleum elsewhere. I have seen bills used for petroleum quite a lot.

5829. Is that trade that would swing between the overdraft and the bill?——Yes, I should think it would.

5830. What about tobacco?——Yes, quite a lot of bills are used in the tobacco trade.

5831. Is that financing that swings between bills and overdrafts?——Imports of tobacco tend to be financed by bills, and the work in progress, when the tobacco is already here and the cigarettes are being made, more by overdraft.

5832. What about sugar?——There have been a lot of bills used for sugar.

5833. Is that a trade that swings?——I should think it is.

5834. When there is a swing in favour of the use of bills consequent upon a change in relative rates, are the accepting houses able to face that demand with equanimity? Are they able to cope with the demand fully, or do they sometimes feel that they are being over-extended?——I have never yet known a period when the accepting houses as a whole have been full up. There have been occasional times when one house which happens to have had heavy demands and has a large amount outstanding has had enough for the moment, and decides to stand aside; but the accepting houses as a whole have

been well able to cope with all the demands that have been made on them up to now.

5835. *Mr. Woodcock*: Are you speaking of the accepting houses as a whole, or just of your members?——Of the seventeen members.

5836. *Professor Sayers*: When a particular house feels full up in a particular direction, it would respond to the situation simply by declining to do as much business in that particular line; it would not respond by putting up its rate?——That is right.

5837. Do the total amounts of your acceptances in fact vary a great deal according to how cheap your finance is as compared with bank overdraft?——That is one of the factors, no doubt; but I think that it is probably the general price level that is the biggest influence.

5838. *Professor Cairncross*: You show over the period for 1956 to 1957 a big increase in acceptances, and a big increase in bills drawn. Is there any special explanation of this?——I do not think there is. There are so many different factors.

5839. *Professor Sayers*: It was at a time when commodity prices were on the whole falling?——The demand for credit was at that time very great. A few days ago I got the figure for the end of December, 1957, and our acceptances are reduced by about 10 per cent.; the figure has gone down from £130 6mn. to £119·4mn.

5840. It is still above the level of two years ago?——Yes.

5841. *Professor Cairncross*: Is it possible for you to say whether the demand came from sources within the United Kingdom or from sources outside the United Kingdom?——From both. There was certainly a demand within the United Kingdom, and in the latter part of last year there was a fairly large demand from the Continent, I think largely because they could buy three months forward sterling so cheaply that the cost of obtaining sterling credit was cheap. But I should think that the domestic demand was the greater contributor to the increase.

5842. Do you think that there was some association with the credit squeeze on the domestic side: that some lines of credit were available through the discount market after acceptance by you that were not available through the banks?——I would not think so. There is no doubt that a part of the reduction between September and December has been due to credits reluctantly cancelled or reduced as a result of the credit squeeze.

5843. On the foreign side did you mean that firms who could buy sterling three months forward found it convenient to have bills accepted here?——*Sir Edward Reid*: Yes, certainly that happened with imports of raw materials into the Continent. The discount on forward sterling made the cost of the whole transaction very little.—*Mr. Macartney-Filgate*: It is relevant, when looking at that curve of bills and acceptances for 1956 and 1957, to look also at the value of U.K. trade, and, on the other chart at the value of imports and exports, all of which were showing the same upward tendency at the same time.

5844. There is a normal seasonal movement, but I should have thought that in this case the swing was prolonged beyond the period at which a downturn began to make itself felt in the turnover of trade?——The figures for the value of U.K. trade and of imports and exports were not available right up to the date for which we gave the figure of the acceptances, but there was a definitely rising tendency up until the middle of 1957 both in the value of U.K. trade and in the value of imports and exports.

5845. More a difference in slope; little difference in trend?——A very definite rise in trend.

5846. *Professor Sayers*: Even after making allowance for that, have not your acceptances been going up relatively to the value of U.K. foreign trade?——Yes. I can give you examples. There was a big acceptance facility, in which nearly all the accepting houses and one or two of the joint stock banks participated, which finances the French purchase of Australian wool. That has been going on for a number of years. There have been years when the French have not used that at all, and other years when they have used £15 million. There may, for all I know, be several others, not of the same size, but of considerable volume. The non-use of that wool credit in some years was due to the fact that the French had sterling available and paid cash for the wool, and on other occasions the cost of the sterling commitment was such that it became very expensive. There was a swing of £12 million on that one credit alone due to a number of reasons.

5847. Sir Edward Reid mentioned a domestic demand for credit as accounting for some of this rise in acceptances in the last two years. Was that on account of new customers, or was it that the old customers were opening more credits, or were the old standing credits being more fully used?——*Sir Edward Reid*: A little of all that, I should say. My own experience was that existing lines were tending to be rather more fully used.

5848. Were there also new customers?——Yes.

5849. Did those new customers come after they had had difficulties with their clearing banks?——*Sir Edward Reid*: No, I do not think so.—*Mr. Macartney-Filgate*: Would it not be again a case where there were customers with both overdraft facilities and acceptances? Very often these acceptance facilities are fixed for a year.

5850. Are you suggesting that when they are told that they must not increase their overdraft they begin to use their acceptance facilities more fully?——It may happen that, if we commit ourselves to granting a line of credit to a customer which he can use, say, until March, 1959, and if he is not using that in full and he has reached his limit on his overdraft facilities, he may tend to use the acceptance line to a greater extent. I can only speak for my own firm, but we are facing virtually nothing of a demand for acceptance facilities to replace what I might call a squeezed overdraft.

5851. *Chairman*: What is covered by the words you use in paragraph 20: " . . . in some quarters in the City a certain preference is still expressed for the bill associated with international trade "? Is that on policy grounds?——*Sir Edward Reid*: Yes; in some quarters in the discount market there is a tendency to prefer an international bill.

5852. On the general feeling that it is good for the health of this country?——Yes.

5853. *Professor Cairncross*: When you say: "A substantial part of the commercial credit business of the accepting houses is now devoted to home trade", is it possible for you to give any indication of the magnitude of that trade?——*Sir Edward Reid*: There is no hard and fast rule, but in my own firm's business the position at present is that about 80 per cent. of our outstanding acceptances are for home account and about 20 per cent. for foreign account.—*Mr. Macartney-Filgate*: Our proportion at the moment is almost the same.

5854. Is that the proportion between home trade and foreign trade, or between home and foreign sources of drawing of the bills?——Between domestic and foreign customers. A lot of the home business is for international trade, but what I mean by home business is that the customer to whom we look for repayment is in this country.

5855. My question was rather directed to the other issue: what proportion of new acceptances would be in respect of trade taking place between one British businessman and another?——*Sir Edward Reid*: It would be a very much smaller proportion. I cannot tell you exactly. —*Mr. Macartney-Filgate*: On the definition used for the credit squeeze, internal finance in our case is very small.

5856. *Chairman*: What is involved in your argument in paragraph 27? When Bank Rate changes, the cost of the commission charged to the customer is not affected; those two things have no necessary connection with each other. But if he takes an accepted bill, Bank Rate having gone up, to be discounted in the London money market he is going to get less money for his bill?——*Sir Edward Reid*: Yes.

5857. Does it not follow from that that there is some diversionary effect if the rate at some foreign centre which he can resort to is comparatively more favourable?——Yes.

5858. Is that an observable result of raising the comparative rate in London against the rates somewhere else?——Yes.

5859. Is there a tie between the fact that it has been accepted by the London house which, as you pointed out, does not make it more expensive, and the market to which he resorts to discount his bill? For instance, if a customer had a sterling bill accepted by a well known

London house, and it turned out that owing to the rise of Bank Rate be would get less from discounting it in London than he could in New York or Amsterdam, would he take it off at all to be discounted there?——No, I do not think a sterling bill accepted by a London accepting house would be discounted cheaper in New York or Amsterdam. I doubt indeed whether it could be discounted there at all. If anybody in New York or Amsterdam wanted London paper they would come to the discount market and get it there; that is the market for that paper.—*Mr. Macartney-Filgate*: The discount rate in London would still apply; the business would not have left London.

5860. *Professor Sayers*: Have you any evidence of any of your acceptances travelling in this way to a foreign centre?——I do not think so. There are overseas houses or governments which keep money here in London; they might leave it with the discount market, but there is a tendency to buy Treasury Bills and, I suppose, bank bills. London is still a place where a great many overseas concerns keep a part of their reserves.

5861. Would a New York bank, not having an office but merely a correspondent in London, and wishing to put money into the London market to take advantage of the bigher rate, normally buy U.K. Treasury Bills?——*Sir Edward Reid*: Yes.—*Mr. Mackinnon*: Particularly at the moment, because of the divergence in the rates of the U.S. Treasury Bill and the U.K. Treasury Bill. The U.K. Treasury Bill is an attractive thing to hold just now.

5862. It would seem on the face of it that it might be more profitable for them to buy bank bills, but you believe that they do not do that?——*Sir Edward Reid*: I do not know. I have no actual experience of that.

5863. After all the yield on the bank bill is higher, and we believe a bank bill is as good as a Treasury Bill?——*Mr. Mackinnon*: Yes.—*Sir Edward Reid*. It is perhaps a matter of courtesy that the British Government gets a slightly better rate.

5864. *Mr. Woodcock*: Was this never done?——It has been. I remember thirty years ago a period when we regularly bought packets of bank bills for a continental bank.

5865. *Professor Cairncross*: So it is the normal practice that bills will be sent for acceptance to the centre where it is intended to discount them?——*Sir Edward Reid*: Yes. —*Mr. Macartney-Filgate*: There would not necessarily be a movement, but there might be an inquiry by some foreign users of London acceptance facilities to try and get a similar facility in Amsterdam if the rates there were lower. But then they would be drawing in florins, and sterling would not come into it.

5866. *Chairman*: The acceptance and the market in which the bill is to be discounted are tied together?——Yes.

5867. *Professor Sayers*: The last sentences in paragraph 28 seem to indicate that, if economic and financial tendencies in the world were adverse and things looked more risky, the accepting houses would contract the total of their acceptances. Is that so?——*Sir Edward Reid*: Yes; if a particular country looks in a bad way we would tend either not to give a credit that we were asked to, or not to renew one which fell due.

5868. Would this relate to what was happening in particular countries and particular trades rather than in the world in general?——*Sir Edward Reid*: Yes.—*Mr. Macartney-Filgate*: It is really a question of the ability of our debtor to remit the funds to meet the bill when due. Our debtor may be solvent, but we may have doubts whether the exchange control of the country concerned would permit the remittance of sterling when needed.

5869. You are thinking very much of particular groups of risks here, rather than of general tendencies in the world at large?——*Sir Edward Reid*: Yes. I do not think that the world is in such a bad way that we would give up business altogether!

5870. I was rather reading these two sentences as indicating that you took a view of the world and said: "We had better cut down our acceptances". Does it not happen like that?——*Mr. Macartney-Filgate*: We should have emphasised that we were talking about foreign risks when we said that, not domestic business.

5871. *Mr. Woodcock*: You do say "economic and financial tendencies in the world generally"?——There is a tendency today, for instance, toward a fall in commodity prices which may put some countries into balance of payments difficulties. We might not want to extend our commitments in those countries, or there may be a political factor in one country, and we may think they are heading for a revolution; there might be exchange difficulties, and we should not get paid when the bill was due.

5872. That is not a general tendency as the first one, falling commodity prices, was?——"General" is perhaps not quite the right word.

5873. *Professor Sayers*: You mentioned earlier that over the last few months the figures show a sizeable decline in acceptances. Is this related to the deliberate drawing in of horns, or is it simply to the extent that commodity prices are falling?——*Sir Edward Reid*: The reduction of acceptances in my own firm is due to two things: (1) a deliberate reduction of certain domestic credits in response to the credit squeeze, and (2) the restriction mentioned in paragraph 5 (*b*) of Annex 2 to our answer to your question 1:

"Documentary credits to cover purchase by one country outside the sterling area from another country outside the sterling area could only be made available by sight drafts, that is to say that the accepting of term drafts for foreign account is now only permissible to finance trade in which the seller of the goods in whose favour the credit is opened is in the sterling area."

I cannot tell you more than that, but we are probably fairly typical.

5874. *Chairman*: Are there any questions on Annex No. 1, on the London foreign exchange and bullion markets?—*Professor Sayers*: Could we be told something about the forward exchange market? Do your members take a very large part in this market?——Some do.

5875. Is there a very large and active market not only in dollars, but also in the principal West European currencies?——Yes, in American and Canadian dollars and in European currencies.

5876. Are all the dealers in London banks or accepting houses?——There are brokers, of course.

5877. But the actual dealers, and the people with whom they deal in other centres, are exclusively banks?——*Sir Edward Reid*: I should think so, yes.—*Mr. Mackinnon*: Exclusively.

5878. *Professor Cairncross*: Would the foreign banks with whom you deal hold open positions in forward sterling and a variable position in sterling?——I could not speak for foreign banks as a whole, but the ones with whom I deal keep a very closed position.

5879. Would there be foreign banks who hold open positions in forward sterling?——There is no means of knowing that.

5880. *Professor Sayers*: Dealers in London are allowed to keep a certain position for working purposes, which can vary. Can it vary within very wide limits, or are the limits narrow?——*Mr. Macartney-Filgate*: I do not think the limits fixed for them are really relevant, because, speaking in our own case, and I think in most cases, we keep our books even for dealing purposes. We obviously have a certain margin (I have not got the figure in mind) in case we are caught overnight and cannot keep even, but as far as my own firm is concerned we like to see that we keep an even book.

5881. *Lord Harcourt*: That is in fact the general practice?——Yes.

5882. *Professor Cairncross*: Is that true in each currency independently?——Yes. What our counterpart, the man to whom we sell dollars, does, we have no means of knowing.

5883. Did you find last autumn that there was any substantial increase in the volume of transactions? Did they vary, say, between the period before the rise in Bank Rate and that after the rise in Bank Rate?——I

should like to check up on that, but I do not think they did. Most of it was actual business which involved cash payments.

5884. We are naturally interested in the way in which movements in commercial credit either reflect themselves in the forward exchange market or can themselves be affected by the forward exchange market. It is commonly said that last autumn there were movements in commercial credit of quite major magnitude. Is it your impression that this was not reflected in the forward exchange market at all?——*Sir Edward Reid*: One particular continental friend of ours made pretty large forward purchases of sterling which seemed to be taking advantage of the discount either to cover sterling credit used here, or to meet commercial commitments; but it is very difficult to answer that question generally without looking further into it. Even if we did I do not know that we would be able to get anywhere.—*Mr. Macartney-Filgate*: One might draw a false conclusion. If a foreign bank rings us up in order to carry out an exchange operation, we do not know what lies behind that operation. It may be one hundred per cent. commercial, or it may be one hundred per cent. speculative; we cannot tell. But if, on the other hand, a British firm in this country wanted to sell sterling forward, he would have to produce a commercial reason for doing so.

5885. And you would see only that side of transactions?——We only see one side of the transaction.

5886. *Chairman*: Would anybody be in possession of enough information to be able to deal with the question as a whole?——*Sir Edward Reid*: I suppose the Bank of England might; I do not think anybody else would.

5887. Would they be in possession of the motives that move the various operators on the other side of the fence?——I should not think so.

5888. *Lord Harcourt*: They would only be in possession of more information than the private houses on the net position that arises from a multitude of transactions?——Yes.

5889. *Chairman*: If one can only deal with this in the net I do not see how one can answer this?——*Mr. Macartney-Filgate*: I do not think one could possibly answer it.

5890. *Professor Sayers*: In paragraph 32 you say

> "Provided that changes in Bank Rate are suitably backed up by open market operations . . ."

What does "suitably backed up by open market operations" mean?——*Sir Edward Reid*: By credit restriction. The point is made in the next sentence:—

> "In the second place the market will not react in the manner which could normally be expected if Government budgetary and debt management policy results in a continuous expansion of the Treasury Bill issue; this must inevitably frustrate any attempts to use normal open market techniques".

5891. *Chairman*: Do you mean operations in the money market or operations in the long term market, when you say "open market operations"?——Both; but I was thinking of the effect on the money market.

5892. *Professor Sayers*: You mean here in effect: "Provided changes in Bank Rate are made effective in the old sense"?——Yes.

5893. Is that so under current conditions, that: "Provided changes in Bank Rate are suitably backed up by open market operations, any desired degree of credit restriction can be brought about"? Would the open market operations to which you have referred reduce the volume of liquid assets available to the banks?——*Mr. Macartney-Filgate*: I would have thought that it was more in the bond market that they would achieve success.

5894. What is the criterion of suitability here? What is "suitable backing"?——If the authorities raise Bank Rate with the object of making credit more difficult and more scarce, and go into the market and sell Government securities, is that not going to take money out of circulation?

5895. Must not the securities sold be beyond the money market range?——It reacts on the money market. The joint stock banks come into it as a result of that operation.

5896. So the securities sold must be beyond the money market security range, or Treasury Bills sold to the public?——This is almost suggesting a conflict of action between the Bank of England and the Treasury. Suppose that the Bank of England raises Bank Rate in order to restrict credit; if the Treasury is at the same time enlarging the credit base then the Bank of England action is made to that extent less effective. A foreign banker pointed out to me once that we had perfected the money market to such a point that we had removed from the Bank of England the power to operate on the credit base, because the Government could enlarge the credit base as fast as the Bank of England restricted it.

5897. When you refer to the raising of rates of interest here, what rates of interest have you in mind?——*Sir Edward Reid*: What we had in mind was that the authorities in the past seem to have shrunk from using the interest rate weapon. We had not a particular rate in mind.

5898. Which rates do you think that they should have raised but did not raise at any time?——A good example was when they raised Bank Rate by a half per cent. in January 1955. That was obviously not enough, and they had to raise it by a further 1 per cent. a month later.

5899. If you are thinking of Bank Rate, why do you say "rates of interest"?——*Mr. Macartney-Filgate*: Bank Rate really affects all the others; when Bank Rate goes up the joint stock banks readjust their lending rate and their call money rate, the discount market adjust the bill rate, and the whole bond market in its turn reacts. I do not think that a 6 per cent. Bank Rate has ever dissuaded an industrialist from borrowing money if he saw the means of making a profit on the borrowed money. If he pays 6 per cent. on his debentures, about half of that is charged against taxation. 6 per cent. does not deter people from borrowing when trade is good. A 10 per cent. Bank Rate (to pick a figure out of the hat) would make people pause, just as the present 7 per cent. is rather clamping down on the new issue market: people do not want to saddle themselves with a 6½ per cent. bond for twenty years.

5900. When you say that the authorities shrank from raising rates of interest, do you think that they were right to shrink from raising any rate except by raising Bank Rate?——There is no other rate they can raise.

5901. You mean there is no other rate they do raise?——Unless they want to make a present to the purchaser. For instance, a new issue of Government bonds would be made approximately at current market rates. Bank Rate is the only rate which the authorities can raise with the object of all other rates being raised more or less in conformity, which does automatically happen.

5902. So in fact you are thinking about the authorities' action on Bank Rate?——Yes.

5903. *Professor Cairncross*: From what you say in paragraph 35 it seems that Treasury Bills show a trough in the first quarter of the year, when commercial bills show a peak?——*Sir Edward Reid*: Yes. The peak in commercial bills in the early part of the year is due to seasonal movements of commodities. Treasury Bills are governed by entirely different considerations.—*Mr. Macartney-Filgate*: The ratio of Treasury Bills to bank bills is such that the reduced volume of Treasury Bills has a much greater percentage of effect on the total bills in the market than the increased volume of bank bills.

5904. *Professor Sayers*: In paragraph 36, when you talk about "the total value of U.K. trade", you mean in effect U.K. external trade?——Yes.

5905. *Professor Cairncross*: It would seem from your charts that the bills outstanding represent only a small fraction of the volume of British trade, about a third, and that the acceptances by your member houses are in turn a very limited fraction of these bills. Of the total bills drawn, some fraction is said to represent trade between foreign countries. One would not expect on that kind of relationship too close a symmetry between the movement of bills drawn and movement of total U.K. trade?——*Sir Edward Reid*: No; but I suppose a relatively constant proportion of British trade is financed by bills.

5906. Is that particular fraction of trade mainly commodity trade?——I suppose so.

5907. You discard completely in this discussion the trade between two foreign countries as an element in the situation. Are we right in supposing that this is a very small fraction of the total business?——At present.

5908. Or even in the past, in the period covered here? ——Are you including trade between a country in the sterling area and a country outside the sterling area?

5909. I am including that in trade between foreign countries for this purpose, because that would not be reflected in British trade?——It is difficult to say how much it is. Imports into the Continent or into Japan of Dominion wool, for instance, would probably be financed by sterling bills, but I do not know what the amount of it would be.

5910. I really want to know what proportion of the bills drawn represents trade of which the United Kingdom does not form one of the terminals?——*Mr. Macartney-Filgate*: Not a great deal.—*Sir Edward Reid*: Relatively little, from our actual experience; but I could not estimate a figure.

5911. This trade, and the acceptance and discount business arising from it, has often featured in discussions on the invisible earnings of this country. Is it your impression that it is not in fact a large proportion of the total business in the City?——It is difficult to say. There are certain commodities for which the Continent traditionally pays, or opens credits, in London. There is a large volume of business done by opening sight credits in London, but I cannot give you any estimate of what the turnover is, nor of the number of bills drawn in the sterling area paid or accepted for South American or Eastern account. In my own experience it has varied a lot; there have been times when it has been quite big, and then times when it has fallen off. I should not like to hazard a guess as to how much it was.

5912. *Chairman*: What causes it to rise and fall?—— *Sir Edward Reid*: All sorts of reasons. Cost is the main element, but there are other reasons. For example, for a few years my own firm used to finance the exports of Australian produce in large amounts to Canada and the United Kingdom. The business was done in London and the necessary credit was provided in London. That went on for a few years, and then it stopped because the exporters in Australia said that they would get the finance locally from an Australian bank. I do not know that there was much in the cost; probably the Australian bank said: "This is rather nice business; why not let us have some of it?". Even that sort of reason can create quite big fluctuations up or down.—*Mr. Macartney-Filgate*: There have been some bilateral trade agreements which have cut out this.

5913. Bilateral trade agreements being a product of difficulties between two countries?——Difficulties between two countries in their balance of payments. Brazil, for instance, drew up a number of bilateral trade agreements, which were ultimately funded, if I might use that word, in what is called "The Hague Club". For a long period there were bilateral agreements of this kind, and they crop up now and again, to prevent the financing of trade through London, by means of clearing accounts chiefly.

5914. *Lord Harcourt*: Those clearing accounts, being under pressure from various organisations, tended to reduce the volume of trade?——That may be one of the factors.

5915. *Sir John Woods*: After noticing the Bank Rate rises in 1955 and 1956 you come in paragraph 41 to your conclusion:—

"Thus although some connection can be traced between the volume of bills outstanding and the level of Bank Rate it is not consistent and the changes in the volume of bills can equally convincingly be explained as being due to other causes."

Is that conclusion affected at all by experience between September 19th last year and today? Was there any noticeable drop in bill business when the Bank Rate went to 7 per cent.?——*Sir Edward Reid*: Yes. Our acceptances have fallen from £130m. odd to £119m., by nearly 10 per cent.

5916. *Professor Cairncross*: Against the normal seasonal movement?——Against the normal seasonal movement; but I mentioned two reasons which in my own firm's case caused the reduction, neither of which was Bank Rate.

5917. *Sir John Woods*: That experience would not alter your general conclusion? You think there were other reasons than Bank Rate?——There certainly are. We were all asked to come in on this credit squeeze, and the exchange control has stopped the acceptance of bills for trade between two non-sterling area countries.

5918. *Professor Sayers*: May I ask Sir Edward to go back to his very early years and to tell us whether at any time in his experience the volume of bills outstanding did seem to respond markedly to changes in the level of Bank Rate?——*Sir Edward Reid*: I could not answer that, I am afraid, without having studied the question. If you would like some research done on this question I will see what I can do.

5919. I personally should be very interested indeed, but I cannot press it as a matter for the Committee. Then I wonder if you have noticed in general, or over the last ten years, any change in demand for acceptance credits to finance the holding of stocks of commodities? Is there any connection between that and movements in interest rates? I am thinking not of the shift between bank overdraft and bill finance, but rather of the possible effect of the cost of short term borrowing in general upon the willingness of people to hold stocks of commodities?—— *Sir Edward Reid*: The merchant, of course, will want to hold his stock of commodities to be able to satisfy his customers.—*Mr. Mackinnon*: It must depend a lot on the period of time. The bill after all only runs for six months, and if it is stock credit then the acceptance fades out and the man has to find some other form of finance.

5920. Do you not accept bills that are used to finance the holding of commodities?——*Mr. Mackinnon*: Provided they are self-liquidating, but not otherwise.—*Mr. Macartney-Filgate*: We would not allow a manufacturer to finance what one might call his permanent stock holding by bills.—*Mr. Mackinnon*: Timber, for instance, may come in for a period of seasoning, or anything of that sort.

5921. Do you find that people are less anxious to keep their stocks, or are more anxious to hold on to stocks, if money is cheap?——*Sir Edward Reid*: I would say they are more influenced by what they expect the price of their stocks to be when they sell them.

5922. This is not a matter on which your own experience really throws any light?——No.

Chairman: I think we will break off now; may we continue after lunch?——*Sir Edward Reid*: Certainly.

(*Adjourned until* 2.15 *p.m.*)

SIR EDWARD REID, BT., O.B.E., MR. ANGUS MACKINNON, D.S.O., M.C., T.D., and MR. J. V. MACARTNEY-FILGATE, M.C., T.D., recalled and further examined.

5923. *Chairman*: We had reached paragraph 45, and our question on the effectiveness in economic policy today of monetary measures, with particular reference to, firstly, movements of short-term interest rates. You say that movements in short-term interest rates have been ineffective as an instrument for controlling the amount of physical stocks held. It is often said that the short-term interest rate and its movement bears particularly upon that. Had you anything particular in your mind from your own observation with reference to physical stocks? ——*Sir Edward Reid*: We are saying that it does not appear to have had any.

5924. It might in theory, but has not, so far as your observation goes, in practice?——*Sir Edward Reid*: I think I am right in saying not at all.—*Mr. Macartney-Filgate*: From the financing end, yes. I would say that one or two industrial companies with which we are connected have tended to reduce their stocks, if their type of business is such that they indulge in the luxury of carrying heavy stocks when they think prices are going up.

5925. Is that because they represent a fairly easily contractable part of their total financing? If they want to shrink their business a little they can do it in that manner more quickly and easily than elsewhere?——If

they are using a raw material which has a very free market. I have seen one or two cases where it was thought that, if there could be a saving of several hundred thousand pounds, which at 1 per cent. interest made a difference of a few thousand, it was worth doing because the stock was available and could be easily replenished.

5926. They can restore the position at short notice if they want to?——Yes. That can only apply in certain things and certain commodities, because a very complex industry which has to carry a great number of subsidiary bits and pieces would have to carry a heavy stock made up of a large number of different components. A manufacturer with a lot of bought-out parts cannot afford to run those down; but a man who is carrying copper for the manufacture of copper rods would be more affected by his view on the price of copper than by the cost of the money for running stock.

5927. I was thinking primarily of raw material stocks; I think you were travelling on to semi-processed stocks?——Yes, I have moved away from acceptance credits; we could not finance some of the things I have mentioned. But I would have thought with raw materials the price trend of the material would have a greater impact than the cost of carrying.

5928. Could you distinguish at all between the kind of industry or activities in which some impact is made by the interest rate and the others?——I think an industrialist ought to do that; I do not think I am really competent.

5929. This is only from your own observation?——Just one or two companies I happened to discuss the matter with.

5930. *Professor Sayers*: This is not speculation as to what might be expected to happen but an account of what did happen?——Yes, of what has happened. People tend to carry bigger stocks when they consider the price is low.

5931. *Mr. Jones*: There has been a fall in commodity prices throughout the world. Would there be a tendency to buy and maintain and even build up stocks in those conditions, bearing in mind that short-term interest rates are higher?——*Mr. Macartney-Filgate*: I hesitate to go outside my own business on that.—*Sir Edward Reid*: It is very difficult to generalise on that.

5932. *Professor Sayers*: When the rate of interest goes up do expectations of some check to the movement of prices have any effect at all on views on stocks?——*Mr. Macartney-Filgate*: I would not have thought so; these are mostly world prices.

5933. *Chairman*: Has there been any difference in what you have seen or heard since September of last year?——Yes, I would have thought there was. This is the first time we have had an 8 per cent. overdraft rate. It is just getting to the point where it does make people think.

5934. *Professor Sayers*: What about the 5 per cent. Bank Rate?——I do not believe that, when the Bank Rate was 5 per cent. or 5½ per cent. and the overdraft rate was 1 per cent. over that, and people were getting tax relief of almost half of their financing costs, that it caused them to hesitate at all.

5935. Do you think the extent of the jump is at all important on the attitude of people carrying stocks?——I would not have thought so. It is not the extent of the jump but the actual cost, leaving out the psychological factor of what comes next.

5936. You mentioned a minute ago that on the whole commodity prices are governed by world conditions. In the first half of 1952, there was a world fall in many commodity prices, and it seemed on the face of it to be associated with a world-wide rise in interest rates. Were the two connected?——I think it was still partly the collapse of the post Korean war movement. But it is almost impossible to separate out the influences.

5937. It is possible to argue that the shake-out of the world commodity position was accentuated by the hardening of interest rates all over the world, or almost all over the world, at that time. Did you see anything that would lend support to that view or contradict it?——Not in my own firm.

5938. *Chairman*: Then in paragraph 49 you say:—

"So far as international movements of money are concerned, differences in interest rates between different centres are still effective given two conditions, namely:—

(i) absence of official interference with the free flow of funds, and

(ii) absence of overriding fears regarding currency stability."

I would have thought those two sub-heads have been pretty effective elements in post-war experience. Have they not really dominated the scene?——*Sir Edward Reid*: Yes, certainly, particularly the latter, as far as this country is concerned.

5939. *Professor Sayers*: Is not this in fact a circumlocutory way of saying that differences in interest rates between different centres have ceased to be effective?——*Sir Edward Reid*: Nearly, perhaps, but not quite.—*Mr. Macartney-Filgate*: There has been a certain movement of funds, for instance, from America to this country. On the other hand because of lack of confidence it has all been covered on the forward exchange market, which has gradually counteracted the differential between the two interest rates.

5940. *Chairman*: Forward covering when movement of short-term money takes place is almost accepted form?——I should have thought so.

5941. *Professor Cairncross*: Would that have been true in the 1920s or the 1930s? Is this something that goes a long way back?——I dare say that there was free movement in the 1920s.

5942. *Lord Harcourt*: I would have thought that after the shock of 1929, and certainly from 1931 on, there always was forward covering to close the position. Would that be your impression?——So long as one could take gold out of the Bank of England I dare say there was not much. As to the 1930s I would not like to say.

5943. *Mr. Jones*: For what period forward would this covering be effected?——Most of the money sent over here is put into Treasury Bills, and covered three months forward.

5944. It would not cover any investment beyond three months?——It might.

5945. In circumstances where it did cover more than three months would there be forward purchase of the initial currency?——There is a forward market.

5946. Beyond three months?——In dollars, yes.

5947. To what extent would forward buying be effected? Is twelve months a reasonable period?——We are talking purely about movements of short-term money; but there are cases of manufacturers in this country getting contracts abroad, payable, shall we say, in dollars, who might be selling those dollars forward quite a long way: a year, or two years.

5948. *Professor Sayers*: When an American bank buys Treasury Bills and covers forward, does not its sale of sterling in the forward market have to be covered, on the basis of what you were telling us this morning, by some bank in the market buying spot dollars?——Yes; or it might be able to match a forward contract the other way.

5949. It can only attract fresh matching in the forward market if a movement of the forward rate brings in people in support of forward sterling. On the experience of the last year or two is not the weight of the transaction brought pretty quickly on to the spot market?——There have been some quite wide movements in the spread between the spot and the forward rate without the spot rate moving. In other words, if one can get 6 per cent. on money here and 2½ per cent. in the United States, quite a lot of money might come over here which would just happen to meet a demand for spot dollars for some quite different reason, so that the spot rate might remain unchanged but the forward rate would move because at that moment there were more sellers of sterling forward than there were of dollars.

5950. Would you say that the potential forward demand for sterling that can be brought in by a movement of the forward rate is very limited?——Yes; I should think it is more ironed out by arbitrage transactions.

5951. Which means forcing the rate on to the spot market?——It is difficult to separate out all the influences

bearing on a free market where there are financial movements, commercial movements, trade movements and everything going on at the same time. Only somebody who is sitting in a dealer's room and watching these things closely could form even a rough opinion. I am not a foreign exchange expert and I would hesitate to talk much about that.

5952. You really do not want to say whether the forward market is fairly elastic or not?——I personally would not want to make a comment on that.

5953. In paragraph 48 there is a statement:—

"It would appear that since the end of the war long-term interest rates also have moved within too small and too low a range to be effective as a deterrent to borrowing."

What range of movement would you think would be big enough, and what range would be high enough, to be effective as a deterrent to borrowing under current conditions?——*Sir Edward Reid*: It is very difficult to say until we reach it, but I would have thought the rates that we have been having now are getting near to it. There have still been large issues of debenture stock made, but I think people have been thinking twice.

5954. Why have they been thinking twice? Is it just that the novelty of these rates is beginning to have some effect, or is it that the rates are too costly for the business?——It is very difficult to say; the attitude of different borrowers must vary. Some will take the view: "I know I am going to want this money; even at present rates I had better make sure of having it." Your question really is whether the cost of this borrowing makes an operation uneconomic.

5955. Whether it is because of that that people are beginning to think twice?——*Sir Edward Reid*: I would have thought not.—*Mr. Macartney-Filgate*: There is the expectation of what is going to happen next and how long one can hold out. If at 7 per cent. one thinks the next move is downwards and one can hold on six months before borrowing, one postpones whatever it was one was planning to do, if it is postponable; if one thinks the next rate movement is going to be upwards then one probably arranges one's borrowing now.

5956. What about your actual spending?——If a firm has some capital development plan which it can either do now or in six months' time, and it thinks that in six months' time the Bank Rate will come down and borrowing will be cheaper, it would tend to postpone it for six months.

5957. They postpone borrowing, but not spending?——Once they have the money they can spend it, because they have borrowed it for that purpose. I am talking of long-term borrowing.

5958. What have you in mind in paragraph 50: the perverse effects of official requests?——*Sir Edward Reid*: We give an example of it: the banks and accepting houses have all been asked to reduce the facilities given to hire purchase finance companies. The result has been that they have been soliciting deposits from the public instead of getting what they want from the banking community. The authorities just have not achieved the effect that they wanted of reducing the amount of hire purchase finance granted. All that has happened is that many hire purchase finance companies throughout the country are taking direct deposits from all and sundry.

5959. And paying for them; there has been this effect, that hire purchase finance has become dearer?——I suppose so, yes.

5960. *Sir Oliver Franks*: I was not quite sure that I understood paragraph 51. If one takes as a possible statutory regulation a power to vary liquidity ratios, and compares that with requests to bankers, I am not quite clear why the one impinges less than the other upon traditional flexibility. I see that it impinges less upon traditional usage; but in what sense is the one less flexible than the other?——*Mr. Macartney-Filgate*: So long as it is not governed by statutory regulation we can meet an emergency of one of our customers under the request. I think the Bank of England would accept that in some particular case there might be an urgent need for a short period to take steps which, were we statutorily controlled, would bring us below our statutory ratio. Most of these requests are left to the bankers to interpret and, as long as they interpret them in good faith, knowing what the authorities want, they have more elbow-room than if, when they reached a certain figure, they must stop by law.

5961. *Professor Sayers*: If advances are to be restricted to a certain amount, it is better to do it by request than by statutory regulation?——Yes.

5962. You do not mean that the present system we have of requests to bankers would be better than the various alternative ways of checking the bankers in their lending, either by market operating or by statute?——Certainly I prefer not to have them checked by statute. Market operations are in themselves flexible, because whatever market operations may be carried out the axe does not fall on a precise figure on a precise day; there is still some elbow-room.

5963. Suppose that you were choosing between a request to bankers to keep their advances down to a certain figure, and a request to bankers to keep their liquidity ratios up to 40 per cent.; which would you prefer? There is no question of statutory regulation here, but of choosing between two requests.——I would prefer a request to limit advances to a certain figure, because I think I could work it more easily. But this is not a good question to put to me; it is a question for the joint stock banks.

5964. *Chairman*: Now we come to paragraph 59, on the "financing of capital goods exports involving medium-term finance, that is to say, finance covering periods of up to five years from the date of shipment," in which you say accepting houses may become involved. You deal with the situation before the second world war, when the City of London was one of the principal financial centres where overseas borrowers could raise long-term loans by means of bond issues; "since the war . . . that has not been feasible." You say: "there has emerged a new type of business, namely, the arranging of *ad hoc* medium-term loans to finance individual contracts." Then you say in paragraph 61: "the British manufacturer is unable to offer the credit required from his own resources and cannot or is unwilling to borrow the funds on his own account from his bankers because his balance sheet would be seriously distorted and his statutory borrowing powers might be exhausted or even exceeded if he did so." Speaking generally from your knowledge of the large manufacturer in other countries who is concerned with this kind of contract, is there anywhere where you find the manufacturer able or expected to carry this kind of finance on his own resources?——Nearly all European countries have one or other form of state insurance for exports of this type. They vary in the extent to which they will guarantee exports, but they all have some powers and they have nearly all of them used them. I ought perhaps to say that, when I define medium-term finance as involving a period of up to five years from shipment, I only say that because that is the most that can be done under the system of export credit guarantees in this country; I do not regard five years necessarily as medium-term finance.

5965. Is it inevitable that the state should be the facilitating agent for this purpose? You find it, you say, at present in all these European arrangements; you find it, in another form no doubt, in America?——Yes, in the form of the Export-Import Bank. The normal commercial risks would be capable of being insured in the normal way in the insurance market, but not the two major risks, the political risk and the exchange transfer risk. Any manufacturer is capable within reason of satisfying himself about the standing of his client, even though five years is a long time: most of the purchasers of this type of equipment are very substantial corporations. But the losses which would be involved in the event of war or of the stopping of sterling remittances, which is a political act outside the power of the overseas customer, are elements which cannot be insured at the present time in the City of London.

5966. *Professor Sayers*: Why cannot Lloyds cope with risks of this kind?——I do not know whether it is in their statutes, or whether it is the size of the risk. After all, one cannot insure anything on land in this country against war risks. If I may take the simplest case of a ship being built, one may insure against war risks

when it is afloat under marine insurance, but one cannot insure it against war risks while it is being built.

5967. It is in fact a fable that you can insure anything at Lloyds?——Yes.

5968. *Chairman*: These special risks which you have been drawing attention to have been present now in a great deal of overseas trade for a number of years; they are not new elements of risk. There must be accumulating a great deal of experience about the actual significance of that risk, so far as one can express it in terms of a premium. As they become a normal feature of international trade, and as experience accumulates, why are they not capable of being expressed by an insurance premium?——The view which an insurer would have taken on the likelihood of war in Egypt in 1952, basing his views on experience up to date, would have been very different from his view in 1956.

5969. I follow that; but very great unexpected events are in fact covered by insurance and always have been: the San Francisco earthquake, and the Kingston fire. Why do these differ in kind from the kind of risk which has to be faced anywhere by insurers?——Possibly in the extent. I do not know, as I say, whether Lloyds and the insurance companies refuse this type of risk by some rule of their own, or because of its size, or because cover can be obtained somewhere else; all I know is that they will not do it.

5970. Is it your impression that the state organisations on the Continent run at a loss, and that the taxpayer carries some margin of risk; or that they can be in fact run without cost to the public?——I do not know what their experience has been, but I should not imagine that it is very different from the experience here, where the Export Credits Guarantee Department, except for the years of the Brazilian difficulties, was putting a surplus into the Exchequer every year.

5971. *Sir John Woods*: Do these European insuring institutions limit the amount of any contract they will cover, as in the case of E.C.G.D.?——Yes.

5972. They do not normally take 100 per cent.?——They none of them take 100 per cent.

5973. Does it follow from that that the European manufacturer who gets the benefit of these facilities is himself bearing part of this risk, or have they other means of laying it off?——All I know is that the state insurance covers a limited percentage; whether there are private interests who take over the balance I do not know. But in this country, even if private interests were allowed to take over the balance, E.C.G.D. would not allow them to. It is one of the requirements of E.C.G.D. that the manufacturer shall be interested in the risk. Even if a manufacturer with 85 per cent. E.C.G.D. cover could insure the remaining 15 per cent. with Lloyds, E.C.G.D. would withdraw their guarantee if he did.

5974. *Chairman*: Do you think any valuable result is procured by leaving the manufacturer with these uncovered percentages?——None at all.

5975. *Sir John Woods*: Is not the net result that the manufacturer puts up his price?——If he can. He tries as far as he can to be his own insurer by an increase in the price.

5976. *Professor Sayers*: Would not that equally apply to a continental supplier?——Yes. E.C.G.D. make two points, to the best of my knowledge: first, that if a manufacturer or an exporter can contract out of all the risk by insuring 100 per cent. he will be careless and will not worry about what it is he is shipping; that he will behave in a dishonest manner, to put it in plain words.

5977. Might not that result be produced by any form of ordinary insurance?——It might, yes. These particular contracts are almost always carried out by firms of good standing who are just as jealous of their good name as they are of their monetary risk, and who have every interest in fulfilling the terms of their contract. Under their contract they could not ship rubbish. The other point which the E.C.G.D. make is that it is a principle of credit insurance that the insured person must have a continuing interest in the risk.

5978. *Mr. Jones*: E.C.G.D. make provision for insurance. Is there any difference between their position and the position of the Export-Import Bank in America? Do the Export-Import Bank, in addition to providing insurance against risk, also provide credit themselves?——They provide cash, yes.

5979. So it is an institution of a much more all-embracing type?——Yes. They always provide the loan to the foreign borrower, so that they not only do the financing but they carry the whole of the risk of the loan which they grant, which may or may not be the whole.

5980. *Lord Harcourt*: The percentage of loan which they make is more limited than our E.C.G.D. cover; it is limited to 60 per cent.—*Sir John Woods*: They provide the cash and do the borrowing; they do not, as far as I know, insure at all?——No, I do not think so; they are their own insurers. The difficulty about the 15 per cent. which E.C.G.D. will not cover is that, as I understand it, they are not prepared to discriminate between manufacturers in this country. I have pointed out that with the great firms in this country there would be no degree of difference in the care with which they executed their contract or the services they performed, whether they bore 15 per cent. risk, no risk, or 100 per cent. risk, and that, for people of that sort, for reasons which we give I think later in this memorandum, there should be something better than 85 per cent. cover. If it was some small intermediary in some obscure corner of London who was shipping these things out, he would not get the same amount of insurance; but the Department say they cannot discriminate between firms in this country.

5981. Have you ever heard it suggested that the Department should cover the whole contract with the exception of the manufacturer's estimated profit?——The Department argue that the 15 per cent. is largely the manufacturer's profit. That is their main argument, apart from the two principles I have mentioned.

5982. *Chairman*: One hopes there is a certain percentage of profit; I do not know whether 15 per cent. is realistic in the competitive markets of today?——I should have thought it was on the high side.

5983. *Sir John Woods*: In paragraph 62 you say:—

"As a general rule, British financial institutions will not grant medium-term credits to foreign bodies if they can only look to the foreign borrower or to foreign guarantees for repayment of such loans."

When you say "foreign" do you include Commonwealth countries?——No. I know personally of two five year credits to a Commonwealth country, for which no E.C.G.D. guarantee was required.

5984. *Chairman*: In the old days when the City floated foreign loans and asked the British investor to subscribe the money, he was asked to lend his money to a foreign borrower without any state guarantee or anything else?——Yes, but he was using his own money and it was up to him to decide to risk it or not. This form of finance is provided by the banks who are using other people's money.

5985. *Professor Sayers*: Before 1914 the London banks invested very largely in foreign railway bonds. It was not particularly their own money; what is the difference now?——I would say it is very different now. The financial morality of the world has changed a good deal, and their ability to meet their obligations. It may be that the figures of investments in the banks' balance sheets today are made up of very different components from what comprised their investments before 1914. To-day, except in the case of certain Commonwealth countries, my experience has been that they would not lend money overseas. Moreover, if they held foreign bonds in the old days, they could always sell them, if they thought that things were going wrong in that country, but they cannot under this system.

5986. They had to take their chances on the market; it would sometimes dry up in a particular security?——Yes, but there was a market. In this particular form of finance there is no market, as things stand. If I got a joint stock bank to grant this credit, from the moment he has issued his letter of credit he is on that commitment

to the bitter end, it may be for seven years; he has no way of getting out if he sees, looking quite a distance ahead, political or financial trouble building up in that country.

5987. You are saying in effect that the British financial institutions will not now go into this kind of risk as they used to, and that therefore the Government should underwrite the exporters' risks?——I am not quite saying that, because I do not know what they used to do before the first war; I accept your statement on that. But I still maintain that holding a marketable bond, no matter how narrow a market, is very different from being tied irrevocably over seven years to lend money to that country, whatever it might be.

5988. *Chairman*: The statement you make here is:

"As a general rule, British financial institutions will not grant medium-term credits to foreign bodies. . . ."

Is that a rule that has taken shape since the last war, or is it the product of the disasters after 1929?——It is merely my experience in trying to do this business since the last war. It did not arise before, because there was a foreign bond market in London. I do not think these medium-term credits existed at all before the war.

5989. *Professor Cairncross*: Would it not also be true that in the old days the kind of construction projects involved abroad did not incorporate so much British machinery as is sometimes now incorporated in projects like steelworks and power stations?——In the case of long-term loans issued in the City of London before the war, the currency of course could be spent anywhere. A man could borrow £10m. and then go and buy German machinery. He could not do that today.

5990. Have you any idea as to the magnitude of medium-term credits now?——The volume of medium-term credits running at the present time and underwritten by E.C.G.D. is about £200m.

5991. How far short do you feel that falls of what might be required to finance this proportion, which is quite a small proportion, of total British exports?——It is the other way round: what is required is the ability to meet the demand from abroad to the extent to which we can afford to sell our products on credit.

5992. I accept that, but I was suggesting that there was some kind of ceiling to the requirement, which would be set by the proportion of our exports consisting of goods ultimately incorporated in these foreign contracts?——I could not suggest a figure. The order book of most manufacturers of this type of equipment is fairly full at the present time. What you are getting at, I suppose, is what is required year by year to ensure full employment in this country.

5993. Not at all, no. Perhaps I might put the point to you in more detail in this way. If we had a little more latitude as to what we could lend abroad, we would have the alternatives of throwing upon the London market loans on the pre-1914 model or putting up rather more money through the banks with E.C.G.D. guarantees along the lines you are recommending here. I am suggesting that the second alternative would be likely to involve only a limited capital requirement in comparison with the first?——Yes, because what governs the demand for these medium-term credits is not only the potential orders from abroad but the ability of the British manufacturer to compete with his opposite number in Germany, France, Switzerland or anywhere else. Up to the present we have found that we have never yet failed to be able to say that cash was available if the contract was awarded to our customer in this country.

5994. But there must be some cases where contracts are lost because the foreign purchaser is not offered the credit that he would consider adequate, or to an extent which he can perhaps obtain elsewhere?——Which he can certainly obtain from the Export-Import Bank; in appropriate cases, he can get up to fifteen or eighteen years, but he has got to buy American equipment which, by and large, is more expensive than the same thing from Europe.

5995. But, if what you are telling us is true, then the additional medium-term credit that could fruitfully be used by British exporters in present circumstances is not large?——The additional medium-term credit additional to what they are using now is there, to the best of my knowledge, if they want it, but limited to five years. Contracts are lost not through the inability to get this credit but through the inability to offer more than five years' credit post shipment.

5996. *Sir John Woods*: The Berne agreement I understand, limits the continental credit insuring bodies to the same term as E.C.G.D., or indeed the banks, limit themselves here: roughly speaking to seven years from the date of contract. From the point of view of the length of insurance one can get, there seems to be nothing in it between this country and those other countries which have credit insurance institutions according to the rules of the Berne Union. Is it your suggestion that the other countries do not stick to the rules of the Berne Union?——Certainly some countries have been able to get nine years' credit out of foreign manufacturers. The other day a big group in this country were concerned in getting a contract in Portugal, which they lost, to a Belgian-German consortium very largely on the term of credit offered. Although the state insurance organisation of the country involved said that it had stuck to the rules, what in fact was done was that the export credit finance risk was insured for five years post shipment, but the terms of repayment were such that by five years post shipment a very large proportion had been repaid. The manufacturer who borrowed from his banker got this credit on the basis that it was insured up to the fifth post-shipment year and that be, the manufacturer, undertook to repay the balance to his banker over the remaining two or three years. That was a risk which be could take, because the outstanding balance after seven years (two years manufacturing and five years after shipment) was comparatively small; most of it had been repaid at the end of the seventh year. There might be a few hundred thousand pounds outstanding, but the manufacturer was quite good enough for that amount and his bank took his word for it. Here E.C.G.D. will not insure a portion of a contract. Given a contract which calls for annual repayments over ten years, if they were asked merely to give seven years' cover to the bank and leave the last three years uncovered, they would not do that.

5997. If I understand you aright, they will not do it because they say it is contrary to the rules of the Berne Union?——It is contrary to the rules of the Berne Union.

5998. *Chairman*: In the case you were quoting the manufacturer was left with quite a margin of risk to carry?——Three-tenths, or it might have been a little less.

5999. I think it was a nine-year arrangement. Are both Belgium and Germany parties to the Berne Union?——Yes, they are. But it is maintained that the Berne Union is a union of state insurers, and that all the Berne Union calls for is that the state insurance organisations should not give guarantees beyond five years post shipment. It is argued that the Berne Union cannot restrict the private relationship between a manufacturer and his banker about borrowing.

6000. Is there an accepted view as to why the Berne Agreement chooses five years as the period?——I do not know.

6001. *Lord Harcourt*: When was the Berne Union formed?——1934.

6002. *Professor Sayers*: On paragraph 64, would you define a little more closely what you mean by "a high degree of liquidity"?——*Sir Edward Reid*: There is no fixed rule for the accepting houses, but we have to keep a much higher degree of liquidity than the joint stock banks, for two reasons: firstly, the joint stock banks have so many deposits all over the place that it evens out more or less, whereas we, or some of us at least, have a few very large ones which can fluctuate very much within a few days; one house may find a large proportion of its total deposits in relatively few accounts. Secondly, the accepting of bills is a large part of our business, and those bills have to be met on maturity whatever happens. If our client cannot meet them, or even if somebody bas put a cheque in the wrong envelope and it does not come, those bills have to be met. They are nearly always met by the drawer, but they might not be. So, for both those reasons, we have to be a good deal more

liquid than the clearing banks. But our business is such that we can use our commonsense, looking at our liabilities.*

6003. What degree of liquidity do you aim at? How much in cash; how much at the Bank; how much in call money plus Treasury Bills?——The composite figures are are follows: on 31st December, 1957, the seventeen accepting houses together had £9,800,000 cash; £62,600,000 call money; £28,000,000 discounts; and £37,200,000 British Government securities. They also had advances amounting to £52,800,000. Against that their deposit liabilities were £159,500,000.

6004. *Lord Harcourt*: And bills accepted about £130m.?——£119m. in December.

6005. *Chairman*: You add deposits and acceptances together for the purposes of measuring liabilities?——I do not know that we add them together, but they are both factors in considering the liquidity we want to keep.

6006. *Professor Sayers*: You have liabilities under both heads, but they are not purely additive?——That is so.

6007. What proportion of your Government securities would he under five years?——*Sir Edward Reid*: I cannot speak for all the houses, but I think the majority would be under five, or perhaps under seven years.—*Mr. Macartney-Filgate*: In our case 100 per cent., I should think, would be five years or less.*

6008. You mentioned how your deposits move up and down a great deal. I presume that the main strain is taken in your call money; that is the thing that varies most?——Yes.

6009. Did the accepting houses generally experience a big run-down of deposits during the first three weeks of September last year?——*Sir Edward Reid*: Yes, they did.—*Mr. McKinnon*: In August/September, noticeably.

6010. We know the story from one of the accepting houses; was the experience that was revealed anything like a typical experience for accepting houses in that period?——*Sir Edward Reid*: I could not deal with that without asking them; I do not know.

6011. *Professor Cairncross*: You did not regard the experience referred to as unusual?—*Professor Sayers*: I believe that it was said in the evidence before the Parker Tribunal that the experience last September was not a very extraordinary thing?——*Mr. Macartney-Filgate*: I can only speak from personal experience: it was very unusual.

6012. *Chairman*: In paragraph 65 you come on to the point that the E.C.G.D. bankers' guarantee is only available where an amount of at least £250,000 for a single order is involved.—*Sir Oliver Franks*: It is quite an important point, I think?——From the manufacturer's point of view it is a very major point. So often an exporter in this country will get a series of orders possibly all for the same commodity, and all for the same country, and they add up to considerably more than £250,000. But unless one individual order is for £250,000, this particular form of guarantee will not be forthcoming. As an example of that, there is a big programme in Brazil for road-making which calls for a contract from the manufacturer to provide certain heavy earth-moving machinery over a period of time. The initial order is going to be for so much, and it is virtually certain, though it is not in the contract, that that will be followed by others. The initial order in that particular case was for something like £150,000, and, if that was satisfactory, there was going to be a series of orders over a period of time which would have amounted to several millions. But in order to get into this it was essential to get the initial order, and the initial order could not be underwritten in this manner because it was less than £250,000.

6013. *Chairman*: I would suppose, from the way you put this paragraph, that this point has been quite often brought to the attention of the Export Credit Guarantee Department, but somehow they are immovable on the subject?——Yes.

6014. *Sir John Woods*: The effect is that the manufacturer can get the first type of guarantee, but not the unconditional banker's guarantee?——That is right. In other words, he has either to finance it himself or borrow from his banker on the security of the ordinary contracts policy. There has been discussion, which I do not think even now has been satisfactorily solved, as to whether the assignment of an ordinary E.C.G.D. policy would be proof against a receiver, because it has not been tested in the courts. We are advised that, if the claim on E.C.G.D. is in a certain manner it would be proof against a liquidator, and if it was not it might fail. So in order to get the initial £150,000 the manufacturer would have to borrow on the ordinary contracts policy, if he was in need of cash.

6015. *Lord Harcourt*: What underlies the refusal of E.C.G.D. to give bankers' guarantees for smaller sums than £250,000?——I think that it is largely a wish to restrict the volume of such guarantees, and the work which those guarantees involve; and on the grounds that for an order of less than £250,000 the manufacturer should follow the usual course and borrow the money himself.

6016. *Mr. Jones*: Have the Department, having regard to the tremendous volume of insurance that they have been called upon to undertake, had any very difficult risks to meet overall?——They have had some risks which have turned out badly. They have a statutory limit as to the amount which they can guarantee, which is now, under the normal operation of the Act, £750m.; when they run short they go to Parliament and ask for additional powers, as they have done for the past three times.

6017. Is it a fact that the premiums they have collected for this particular service have more than covered the risks they have had to undertake?——Yes; with the exception of the Brazilian year, when they had to pay out very big claims, they have consistently each year paid in a surplus to the Exchequer.

6018. What would be the effect on our external trade if amounts of less than £250,000 were covered by the E.C.G.D.?——It would help a very great deal in certain industries.

6019. What industries would be mostly affected; the engineering industry?——Yes, nearly all of this is engineering in one form or another. Two specific cases I will give you, because I have had experience of them: heavy earth-moving machinery, and motor buses, trucks, heavy trucks and that sort of thing.

6020. *Sir Oliver Franks*: They are characterised as all being semi-capital equipment of moderate but not very long life?——But we do not get five years post shipment on it.

6021. *Professor Sayers*: The units are moderately small; they are not like electricity generating plants?——No. I ought not to speak too generally of five years post shipment; the period for which E.C.G.D. will underwrite varies according to the nature of the equipment. On motor trucks the limit is three years.

6022. *Sir Oliver Franks*: You gave three reasons for the existence of the five year limit; are those reasons which have occurred to you in the course of your experience and dealings with the Department, or are they also the reasons which the Department itself gives if one asks?——They are the reasons the Department will give. On the £250,000 limit on bankers' guarantees, what I have said is based on the impression I have formed in discussing it with them; the major one is, I think, the desire not to open the doors of this form of guarantee to the smaller firms.

6023. *Professor Cairncross*: You mentioned a possibility of an order for £150,000 from Brazil for earth-moving machinery. What was the period of credit that would have been involved there?——Four years post shipment.

6024. So that to that degree it was distinct from the type of contract which is normally covered by the bankers' guarantee? There would be the ordinary contracts guarantee indemnifying the export; is not the banker's guarantee intended to deal with capital goods and for much longer periods of credit?——That is right. It lifts the weight of financing off the manufacturer, because the person committed then to find the money is the customer; and it also absolves the manufacturer from having to borrow this money, or use his own money in this one transaction, over a period of seven years.

6025. The period of the loan is not something which is laid down; it is £250,000 for whatever period up to five years?——That is so.

* See Appendix to Minutes of Evidence.

6026. *Mr. Jones*: When the Department have taken the risk of an undertaking, say, in Brazil, and the Brazilian Government will not provide exchange for the purpose of carrying out that purchase, are there not means later on, when the situation or resources of the Brazilian Government change, for that debt to be honoured? It is not a permanent risk?——It is a risk which continues until it disappears. The Brazilian Government stopped payments; the E.C.G.D. then reimbursed the exporters on this side up to the proportion which had been guaranteed, and the Department then became the creditor of Brazil. There was then a series of conversations between the two Governments, and the Brazilians made an offer to remit that sterling over a period of so many years, so much every year, and as that sterling came across it was divided in the proportion of 90 and 10 between the Department and the exporter.

6027. *Chairman*: Does the Department regularly become the creditor?——No; it lays down that the holder of a guarantee shall take such steps as the Department may require to recover the debt. It is a policy of the Department not to allow a foreign customer to know that his liabilities have been guaranteed by E.C.G.D. Nearly every foreigner knows it perfectly well, but no banker who issues a letter of credit to a foreign customer is allowed to mention it.

6028. *Sir Oliver Franks*: We never do; we are always told by our foreign customer.——Yes, it is invariably known.

6029. *Chairman*: So you do not get the strength of the Department behind you when it takes on a guarantee, and the manufacturer or exporter, or whoever it is, is supposed to stand in front and do the negotiations?——That is what they lay down in their policy. I have not yet found myself in the position of finding out what E.C.G.D. want me to do, but they always include it as a condition that the banker, under a banker's guarantee, or the manufacturer, under a contracts policy, shall take all the steps he can "and such steps as the Department may require".

6030. *Lord Harcourt*: He acts as the agent for the Department?——Yes.

6031. *Chairman*: I should rather have expected to see the insurers taking over negotiations themselves and handling all that?——That did happen in the case of Brazil; it became an inter-government consultation. If it was due to governmental action, that is to say to stoppage of sterling remittances, and was not due to any action on the part of the foreign customer, I think that course would always be adopted. But if it was bankruptcy on the part of the customer, then it would be the manufacturer who would do most of the work.

6032. *Sir John Woods*: In paragraph 65, you say: "the Export Credits Guarantee Department dislike the method of granting cash advances to the overseas purchaser." Do you know the reason for their dislike of that method?——I think the main reason is that the Department reserve the right to withdraw their guarantee at any moment if, in their own judgment, they think that further work on the contract or further shipments to the importer's country will result in a loss and therefore a claim on public funds. They think that they therefore have the right to say to a man who is manufacturing a fleet of diesel locomotives: "You must stop work because we think the country concerned is about to have a revolution or is going to fail on its balance of payments". They undertake to compensate the manufacturer for the frustration of that contract in much the same way as they would do if there was a default. What they cannot compensate for (and I have argued this with them many times) is the loss of the manufacturer's good name, in a case where the manufacturer breaks his contract for no reason apparent to his customer. For example, if somebody was shipping equipment under a big order to a foreign country, and the Department took fright and thought there was going to be a crisis in that country, and called upon the manufacturer whom we are now discussing to break his contract, and in fact that crisis did not develop, the good name of that manufacturer in that country would be gone for ever. That is incapable of compensation, as I see it.

6033. *Chairman*: The manufacturer cannot reveal why he is doing that?——That is why it arose. If the credit is granted to a foreign borrower it takes the form of an irrevocable credit which we are bound to pay if the pieces of paper which, under the letter of credit, justify the action of payment are presented to us. We would not accept a guarantee which might be removed from us during the lifetime of that credit unless we were allowed to write into the credit the fact that this credit was available unless the Export Credits Guarantee Department told us to terminate it. That was something the Department would not allow, and they therefore said: "If you will not issue an irrevocable letter of credit against a revocable guarantee, we must find another way of doing it which will still enable us to withdraw our guarantee if we want to." So they came to the second method, by which we do not communicate with the foreign borrower at all; we write to the British manufacturer, and we agree to buy from him the promissory notes which he receives from his overseas customer. We are then able to say to the manufacturer: "We shall stop buying these notes if the Department so direct us," so there is no disclosure to the foreign customer that the Department is in the picture.

6034. *Sir John Woods*: So there is no relationship with the ultimate importer?——No relationship at all.

6035. *Chairman*: The manufacturer is still left in some uncertainty?——In considerable uncertainty.

6036. *Sir John Woods*: This provision about the Department being free to withdraw their cover at their discretion has been in the contracts for quite some time; but is it not true to say that they have never exercised the right?——Except in the Brazilian case; and of course on Egypt, but that was obviously a special case.

6037. *Professor Cairncross*: In either of these cases was any long-term construction work affected extending over a period?——Not to my knowledge, but we are only one of the houses doing this business. The other reason why the Department dislike cash advances to the foreign customer is that it calls on each occasion for a financial contract between the bankers here and the customers overseas. Each of these is inevitably different in form from the others, and it therefore throws a certain amount of work on the E.C.G.D. in studying each of these contracts. As regards the purchase of promissory notes from the manufacturer, on the other hand, there is a standard and very brief form of guarantee, which covers one sheet of paper.

6038. *Sir Oliver Franks*: Do you consider that this administrative convenience makes for good public policy?——No. The promissory note system involves an enormous number of complications, because we have to invent a document which remains within the terms of the Bills of Exchange Act and yet does all the things which the credit requires and the terms of the contract call for.

6039. On the first of the reasons, the desire not to reveal to the foreign customer that E.C.G.D. stands behind the credit, have representations been made to the Board of Trade or to the Treasury to point out that, when a secret is as open as this one in fact is, it does not make very much sense to preserve the position?——*Mr. Macartney-Filgate*: That has not been done, to my knowledge at any rate.—*Sir Edward Reid*: I know of one case where the fact was disclosed by the Board of Trade.—*Mr. Macartney-Filgate*: There have been a number of cases where Ministers have disclosed it to foreign customers, certainly. I should say that for contracts of £5 million and over I am told that the Department will still give adequate guarantees for the old form of cash advance. But the objections to the promissory note system are really two-fold: we either have to expand the promissory note to such a figure as, under seven years' discount, would produce what a manufacturer wants, and that, of course, looks horrible to the foreign customer; or else we have to work out a curious document which is a promise to pay a given sum and to pay interest; and then, as the payments to the manufacturer are quite different in timing and progression from the repayments which are assured by this promissory note, we have to enter into a very complicated plan by which the amount of the promissory note is reduced at various times: the interest liability is reduced, and we come into grave danger of finishing up with a document which is not a promissory note under the Bills of Exchange Act. On the other hand, with the cash advance to the buyer, once

one has established one's letter of credit (and it really does not need such careful vetting by the Board of Trade Solicitor, because it goes through the hands of many solicitors before it emerges) the procedure is so simple. One is establishing with the foreign customer when one is paying money out to him that the interest runs from day to day, and the man is bound by his acknowledgment of your advices.

6040. *Chairman*: Has anybody ever used this method of discounting for, say, a seven-year period?——Not for seven years; we have had experience of a shorter period.

6041. Normally you would try to work out an interest arrangement?——Yes, because it would be very difficult to persuade a foreigner that he should pay approximately £105,000 in order to get £90,000 worth of goods; and also because of this fundamental problem, which has been put to me by several manufacturers. If the principle of the interest-bearing promissory note, with a rate written into it, is adopted, the customers are used to talking to bankers about the rate of interest, but when the manufacturer starts talking about rates of interest, they get into a great deal of difficulty and argument. First of all, the customer thinks that the credit granted to him is somewhere in the price, and once he is persuaded that it is not, then he does not see why the manufacturer should charge such an exorbitant rate of interest as he says the banks do. He thinks the manufacturer should be a more easy-going person than the banker. I am told these discussions go on, and I think there is something in it.

6042. *Professor Cairncross*: On paragraph 67, has there been any suggestion that the banks might act together to deal with this problem of commitments on unsuccessful tenders? Presumably any one of them might have some money tied up in this way, but a group of banks taken together would be unlikely to have it tied up?——We have not had any difficulty yet in raising money, except when it is a very big figure, and then one has to go round and find a consortium of banks. Your point is that a bank does not want to commit, say, £15 million of its funds to one contract, if it is likely to learn six months later that the contract has not been obtained?

6043. That is the point that I think you are making here?——If one goes to a group of banks, one gets the £15 million. It is just rather more work for the managers of the credit.

6044. *Mr. Jones*: Is that the sort of thing they do in Germany?——The position is greatly eased because the German banks get a piece of paper which they can negotiate and sell. In many countries the banks have a rediscount facility with an *ad hoc* organisation which, in its turn, can rediscount with the central institution. A bank in Germany does not necessarily get full up with these loans, because it gets a bill of exchange which it can sell to the central institution and start again.

6045. Is there not a consortium of banks working together to deal with these applications for credits?——I think that it is very much the same in Germany as here, though I have not any real knowledge: one goes first to the manufacturer's own banker, who may or may not want to commit himself to deal with that size of transaction. If he does not, one goes to another who may be larger-minded, or to a group who each take a proportion. In principle we speak to the manufacturers' own banker first, to see whether he would like to do it.

6046. *Lord Harcourt*: If the German bankers receive a negotiable instrument, it makes it very much easier; the manufacturer's own banker can negotiate the whole loan, even though he may not have the slightest intention of keeping it, because he can immediately lay it off?——Yes.

6047. *Sir John Woods*: Is the reason why we cannot have a negotiable instrument that the E.C.G.D. refuse to appear in the situation so far as the customer is concerned?——I do not think so, because we could get a negotiable instrument upon which one could put an E.C.G.D. endorsement after the customer had had it. The objection to it, according to my discussions with the Bank of England, is that we should be creating a new form of Government paper, over which the Bank said they would have no control. It is true that we should be creating a new form of Government paper, but they would have complete control over its creation. We have to get the consent of the Foreign Exchange Control Committee and the consent of the Capital Issues Committee before we do one of these seven-year credits, so that, just as Exports Credits discriminates as to what it will underwrite and what it will not, so in my opinion could the authorities discriminate as between what volume of these medium-term credits they require to be done and what limit there was; and if the limit was reached we would have to resort to other things.

6048. *Chairman*: Their hand would be forced into creating this new form of Government paper by means of the Export Credits Guarantee Department?——Except that before they can issue that guarantee, if it concerns a foreigner (which it always does) it has to be brought up to the Foreign Exchange Control Committee.

6049. *Professor Cairncross*: If E.C.G.D. issue the guarantees, the total of paper would really not increase: it would change its form?——Under present conditions, no; because there is still money available under the old law. It would simplify matters because one would do it more quickly. The first bank would take it.

6050. *Chairman*: In paragraph 68 you are dealing with the suggestion which has been made of a new institution to be set up for the specific purpose of providing medium-term export finance. You say: "The advantages of this are not apparent. The problem, if there is one, is not a lack of institutions; it is to find a more simple and direct way of tapping the funds which could be available if a suitable instrument were offered. What is needed is a negotiable document." Then you suggest that an appropriate portion of the foreign customer's indebtedness could be evidenced by promissory notes. What is meant by "appropriate"?——Appropriate in the sense of the proportion which the Department would guarantee. We do not mean to imply that 85 per cent. is the appropriate proportion.

6051. If it issues an unconditional guarantee, that is a Treasury Bill, in effect?——Yes, or a short-term bond.

6052. A short-term bond is more appropriate; and there would be no lack of people ready to find money for that?——At the right rate of interest.

6053. *Sir John Woods*: Would it have to be an unconditional guarantee, and so go against the present policy of the Department to retain the liberty to withdraw cover if they desire?——Yes.

6054. This would bring the E.C.G.D. into the open?——In this country, but not more than it is already abroad, because, though that negotiable instrument would have to be signed by the borrower, as a promissory note is today, the guarantee of the Department or H.M.G. could be attached when the promissory note was received back in this country from the borrower. In fact it would be exactly as it is today, when the promissory note goes out to the foreign customer, and he signs it and it comes back to this country; what happens to it after that he has no idea.

6055. *Chairman*: But if it becomes a negotiable instrument in whatever market can deal with that kind of short-term bond, would not reports reach him about his paper?——I do not think any more reports than reach him now. It is pure fiction in 90 cases out of 100 that the foreign customer does not know that there is the E.C.G.D. guarantee.

6056. *Lord Harcourt*: Surely 99·9 per cent. know that they would not get the credit anyway if it was not guaranteed by E.C.G.D. The moment they receive credit facilities they know instinctively that they are guaranteed?——The most embarrassing thing is when the foreign customer asks what proportion of the money represents the E.C.G.D. premium!

6057. *Chairman*: In paragraph 69 you draw our attention to a number of points which arise from your experience with manufacturers with whom accepting houses have worked. We have, I think, discussed the £250,000 minimum limit and its implications; we have discussed the amount, if any, which should be left at the manufacturer's risk.——I would like to make a point on that, if I may; it is not just 15 per cent. on one contract over this period of seven years. One manufacturer may get six or seven large contracts, and in the end the contingent liability which he has to show on his balance sheet

can reach a point where it might embarrass his ordinary bank borrowing. It also raises the difficult question, which is very important from the manufacturer's point of view, as to when he can bring into his profit and loss account the profit on that contract. If we assume that his profit is 15 per cent., he cannot regard that as a profit, while he risks having to reimburse it. This is perhaps an administrative problem, but it could make the profit and loss account of a big manufacturer quite unreal one way or another.

6058. It is an accumulating figure, and it could make the balance sheet very awkward when you get to the height of the accumulation?——Yes.

6059. I do not see how you will ever escape that difficulty?——Yes; but the less the recourse, the less the distortion and the less the headache for the manufacturer. If he can carry out a contract in this country without any of these liabilities attached to it, and the business is there, there is a very big temptation to take that business rather than to respond to this call for exports and be rewarded by having a 15 per cent. liability for seven years.

6060. Is there anything on (*g*), the point about delays?——That is based on manufacturers' reports, although the banks have also had considerable experience of it.

6061. How much importance do you attach to (*h*), the Department's refusal to limit cover to political and transfer risks? I assume this is solely in order to keep the overall premium down?——I was asked by some of our immediate customers to raise this point. It is possibly that; and I can imagine some rather complex legal points arising as between transfer risk and credit risk. For instance, if a man was not permitted to remit the sterling when he should have done and he became insolvent subsequent to that date, I do not know what the liability would be on that point, but I can see there would be difficulties.

6062. *Professor Cairncross*: On (*f*), would you give us illustrations of these cases where the period of credit, in your view, is too short?——Some manufacturers would say that for heavy lorries and earth-moving equipment it should be much more than three years.

6063. *Chairman*: Then in paragraph 70 you make the point that if E.C.G.D. shows a surplus, which I gather has happened in most years, that ought to go back to the customer?——This is a very controversial point; but many manufacturers will argue that, inasmuch as there is a surplus every year of premiums over outgoings it is a form of taxation, and that surpluses should be retained and used, as any insurance company would use them, for quoting better terms. After all, the terms which the Department quote are almost incapable of discussion, because there is no yardstick to measure them by: there is no competitive body which is prepared to do business more cheaply. The only yardstick one can measure them by is the surplus at the end of each year, and over the years it looks as though the premium has been too high.

6064. *Sir John Woods*: I suppose they must keep a reserve; and then something like what happened in the case of Brazil wipes out all the surplus?——There had to be a supplementary grant that year, but every year since 1954 there has been a surplus.

6065. *Professor Sayers*: Does not that fact ever excite the appetite of private interests in the insurance world?——There has been discussion, I believe, of an alternative scheme, which would be the setting up of some body to do this. In the earlier years that would have to have some Government commitment behind it, until it built up reserves; and there has been a suggestion of re-insurance with the Government. But nobody has ever taken any active steps. As I say, I am not quite sure whether they are not prevented by one regulation or another from doing it.

6066. *Sir John Woods*: On paragraph 71; if the Export-Import Bank extends its activities as it has done recently, would not the fact that it can lend up to eighteen years give it a considerable competitive edge?——Yes indeed: and the danger, as I see it, is that if there is a general recession and American industry becomes rather more active in seeking foreign markets and the Export-Import Bank go with them, the impact on this country might be very serious.

6067. *Professor Cairncross*: Do you think that foreign countries would be anxious to incur future dollar liabilities?——I think there are always some countries who are ready to incur liabilities.

6068. Dollar liabilities? Have not many countries hesitated a great deal before doing so?——I think they have, but I would not like to be downright on this point. I think the chief objection from borrowing from the Export-Import Bank is that they have to buy their equipment in America, which has been very expensive.

6069. And also means repayment in dollars?——Yes.

6070. *Sir John Woods*: If the American depression should deepen, the price of their exports might come tumbling down a long way?——Certainly.

6071. *Professor Cairncross*: It is not your object in paragraph 71 to suggest that it is appropriate to offer terms of credit equal to the life of the assets?——We are speaking there purely on the financial basis and not on the balance of payments basis. Whether we could afford to do that is another matter. We are saying that, if we give money to a man to build an electric power station and we expect to get repaid in seven years, we are relying on him finding some other source of finance to repay us, because he certainly cannot have recouped enough from the earnings; it has only had five years in operation in which to pay off the whole of this cost.

6072. Unless some part of the cost is met from local capital?——There is the civil engineering; but the E.C.G.D. are saying, in effect, that the supply of plant for the station must be paid for within five years of its commission.

6073. You would not welcome a change in the world, by which it became habitual to give credit abroad for periods equal to the length of life of steelworks, power stations, and so forth, at the cost of the manufacturer or at the cost of export credit guarantee finance?——That was the view of the authorities with regard to the Trade Facilities Act, although, of course, the number of transactions to which that was applied was very much smaller than what it would be today. It would have to be restricted to some major schemes, such as an entire power station or steelworks. All we are pointing out here is that it is unreal to expect repayment in five years after commissioning. It means that E.C.G.D. are in fact encountering an additional risk, which may merely replace the different kind of risk they would have in having the loan outstanding for fourteen years.

6074. From the point of view of the borrowing company, they would take a medium-term credit if they cannot get a long-term credit?——Yes.

6075. Do you feel that we have to accept as an inevitable long-term trend that more and more long-term requirements will be met through medium-term credits?——I would not like to crystal-gaze on that. It is so much bound up with balance of payments problems in the countries concerned.

6076. *Mr. Jones*: Do the Iron Curtain countries enter into the E.C.G.D. field as customers?——I do not know of any.

6077. *Sir John Woods*: What about Poland?——Poland, yes.

6078. *Professor Cairncross*: You look upon this as a major long-term change in the way in which people lend to other countries?——Yes; I am really saying that, as bankers, we are lending money to the borrower without knowing how he is going to repay it, because we know he cannot repay it out of his own earnings within the period.

6079. You make an exception in favour of the International Bank?——The International Bank operates under rules according to which the Government of the country concerned guarantees the repayment of the loan.

6080. True; but many of the cases you are discussing here involve Governments only?——Yes.

6081. *Chairman*: If this kind of lending could have the shape of being merged with a certain kind of local finance, the first tranche could come back at the external level, and the second tranche would be left to be met over a long period internally?——What we are lending is the money required for the purchase in this country of what they need, so that all that has to be repaid by our

borrower. It is a question how he gets the sterling. A power station is not directly producing sterling, but is presumably improving the economy of the country concerned, and therefore improving the availability of sterling from the total resources of the country for a remittance to us; but in order to get hold of that sterling the customer has to have the local currency with which to buy it. In the case of the steelworks it is slightly different. The Indian Government told me that they expected at an early stage to start exporting more, and thus get direct earnings themselves; but in something like the electrification of the railways, where there are no foreign currency earnings by the borrowing corporation itself it has to buy foreign exchange with local currency, and it cannot earn that amount of local currency.

6082. *Professor Cairncross*: It is the generation of local currency which is uppermost in your mind in the presentation here?——Yes, it must be, because so many of these projects do not themselves earn foreign currency, and if they do they almost certainly have to turn it into the central institution.

6083. *Sir John Woods*: You say that in pre-war years the problem now being considered was at times met by the facilities offered by the former Trade Facilities Act. The purpose of the Trade Facilities Act was basically to provide employment at home, so that it was not deliberately designed to meet the sort of problem we are talking about here?——No.

6084. And from that point of view it was automatically rather selective?——It was selective, and, as I said earlier, in the case of insurance the Government guarantee was on the paper arising from the system of financing. The great advantage was that the proportion which is now guaranteed by E.C.G.D. then took the form of a bond which could be sold to an insurance company or something, and the portion which the manufacturer had to carry in many cases took the form of equity capital in the foreign company. There were cases where the undertaking was so sound that it was possible to sell those shares, so that under the old Trade Facilities Act, although a percentage (and I think it was more than 15: more like 30) was left to the manufacturer, it was left to him in a form in which he could dispose of shares, so that he got rid of his recourse as well as everything else.

6085. I think in fact the amount guaranteed under the Trade Facilities Act was normally not more than 60 per cent.?——60 to 65 per cent.

6086. The balance would be found either by equity or second debenture or something of that kind; but the manufacturer, it is true, was not left with this guarantee of a credit risk which is no part of his normal business?——He was left with something, but it was something he could sell if it was a sound undertaking. There is no piece of paper today which will enable a manufacturer to get rid of that 15 per cent. liability.

Chairman: Are there any more questions on the paper? Then I think we have come to the end of our questions, gentlemen; and we are very much obliged to you all for your day's help. It has been very illuminating to us.

(*Adjourned until Friday,* 21*st March,* 1958, *at* 11.0 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-FOURTH DAY

Friday, 21st March, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.B.
W. E. JONES, Esq., O.B.E.
PROFESSOR R. S. SAYERS

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, Esq., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

THE RT. HON. THE LORD KENNET OF THE DENE, G.B.E., D.S.O., D.S.C., Chairman, and G. G. SANGSTER, Esq., Secretary of the Capital Issues Committee, called and examined.

6087. *Chairman*: The Committee are very much obliged to you for coming and giving your help, Lord Kennet. You stressed in your answer* to my letter that your function on the Capital Issues Committee is advisory. You are concerned to advise the Treasury?——*Lord Kennet*: That is so.

6088. You do not deal with applications that concern the financing of the nationalised industries?——No.

6089. Since 1956 you have not been concerned with local authority financing?——That is so. We were before that.

6090. But otherwise there pass through the hands of your Committee the applications for raising money either by issue of shares or by loan in the private sector?——All those that fall under the controlling orders. There is no other big exception than those you have mentioned.

6091. You have been Chairman of the Committee since September 1939?——Yes. The Committee is a descendant of a previous Committee, the Foreign Transactions Advisory Committee. That ceased to be what it was when exchange control was instituted, but it was continued as the Capital Issues Committee; so altogether it has been in existence for 22 years.

6092. I understand that you have seen the paper on the capital issues control which the Treasury have submitted to us. In paragraph 5 of that paper they gave us the names of the present members of the Committee. We were told that the members are unpaid. In appointments to the Committee is a balance maintained as to the kind of experience which the members have to support them?——Yes, I think that has been so. I should say broadly speaking that the idea was that it should represent experience both from the industrial side and from the financial side. I think you will find that maintained throughout the existence of the Committee and at the present time.

6093. Looking at the names, I recognise Sir Percy Lister; he comes from the engineering side of industry?——Yes.

6094. And Sir Thomas Barlow was in the cotton world, was he not?——He has had great experience of the Lancashire textile industries altogether, and particularly from the cotton angle; and he is also a banker, of course.

6095. And the others would be banking, insurance and that kind of thing?——Sir Thomas Frazer, insurance; Mr. Berry, the issuing houses; Sir Otto Niemeyer, the Bank of England; Mr. Turle, the Stock Exchange. There has always been somebody acquainted with the Bank of England, and somebody acquainted with the Stock Exchange.

6096. Has any system worked under which there is a rotation of members, to make a regular change of membership from time to time?——No; the membership has been very constant. There has not been any system of retirement in order to give a fresh outlook.

6097. Do you think that there is anything to be said for some regular system of change of that kind?——I see the point, of course; nevertheless I should say that long experience of the work of the Committee is even more important.

6098. Suppose that one served for five years or six years, then there was a regular change; do you think that would be a pity?——I should be reluctant to encourage that, from the point of the efficiency of the Committee. I think its efficiency is better maintained by the close co-operation over long periods.

6099. Sir Thomas Barlow came on in 1952; before that the last appointment was Mr. Berry in 1947. What caused the vacancies which they filled?——In one case there was a death and in another case a retirement, not by request, I need hardly say, but for the personal reasons of the retiring member.

6100. I should like to get an idea of the method by which the applications which come to you are dealt with. Perhaps we could first of all look at the kind of instruction that you have from the Treasury on the policy you are to follow. Does that still depend mainly on the basic letter of 4th December, 1951?——That is the basis of it.

6101. Since then particular instructions or guidance have been given you from time to time?——That is, I might say, a continuous process.

6102. We have been given in the appendix to the Treasury paper the subsequent letters or instructions that have reached you, with one exception. It seems to me, looking at this from outside, that the instruction that you got in the letter of 4th December, 1951, is of a very wide and general order. Would you agree with that?——It is indeed.

6103. You are given as your general test the contribution which an application can make "to the surmounting of our present difficulties". This is to be your basic criterion, and then certain instructions are given as to what is to enjoy priority, and there are references to desirable markets, basic deficiencies, and efficient and economic use of resources, and then to discouragement of applications for "projects for the production of inessential goods". Those are all wide phrases that need a good deal of interpretation. How is the process worked by which the interpretation of those phrases has been applied? Is there constant exchange between your Committee and the Treasury?——The working of the process is first of all the knowledge of the applicant of the conditions of the control as published; and secondly the application form, which supplies the necessary information. That comes in to the staff of the Committee, who examine the replies received from the applicant and ascertain whether or not, on their experience of the working of the Committee, the necessary information which the Committee will require has been supplied on the application form. If in any way it is deficient, and the necessary information for formation of a judgment has not been supplied by the applicant, they indicate that to the applicant and request further information upon this

* Memoranda of Evidence Part IV No. 4.

topic. The application is referred to the related Department, from which the Committee has a report upon the application. When all that has been done, the application comes before the Committee, which forms a judgment as to whether it is in accordance with the policy as directed.

6104. Does it often arise that you say to the Treasury: "We have a difficult case; what do you think we ought to do in applying your instructions?", or do you find you can really form your own interpretation without reference?——I cannot think of any case where we have gone back to the Treasury and said: "What about this?" I think you may take it that it is not necessary to have any consultations with the Treasury on the applications. A recommendation is made, and if the Treasury does not understand the recommendation, it may ask for explanations; but that is very seldom.

6105. Is your recommendation a simple "aye" or "no", as it were, or do you submit a reasoned recommendation to the Treasury?——Infrequently the latter; occasionally the Committee add a note of explanation as to why the recommendation is made, because it knows that the Treasury would welcome such a further explanation.

6106. It is your own judgment that leads you to decide whether to put the explanatory note on or not?——Yes.

6107. The Treasury told us that certain cases were dealt with in a special way: those in which you were recommending refusal, and those that involved an application for over a million pounds. What is there that is different in your treatment of such cases as between yourselves and the Treasury and others?——We do not know about that. The Treasury, I understand, has given you some information as to how the Treasury deals with it but that is not a matter in which we have any say.

6108. The impression I got from them was that these two categories involved something like a special reference from you to them; but you would not recognise that?——No. I am aware, of course, that there has sometimes been one procedure at the Treasury and sometimes another, but it is not a matter in which we have a voice at all.

6109. *Professor Cairncross*: Would you append your reasons in every case where refusal is recommended?——Not in every case; only where we think that it may not be clear why it is rejected. In ordinary cases it is perfectly clear to the Treasury why it is rejected.

6110. *Chairman*: We have learned already that it is altogether exceptional for your advice not to be taken by the Treasury. Before that stage, are there a number of cases each year in which there is further discussion between you and them before they accept your view one way or the other?——No, that would be very exceptional, too.

6111. So it would be true, as a result of this, to say that the effective burden of applying this control lies with your Committee; it is very rare for the Treasury to take a different view?——I should not accept that as a proposition. The authority is entirely with the Treasury. The Committee is purely an advisory committee. The decision is the decision of the Chancellor of the Exchequer.

6112. I quite appreciate the constitutional shape of it; but it does seem that what you decide does, except in a very few cases, amount to the effective decision?——That has been how it has worked.

6113. *Mr. Woodcock*: Is there a large staff?——Fourteen.

6114. Do they specialise? Do you have departments for different industries?——*Mr. Sangster*: No. There is a staff of seven handling the applications; with myself that makes eight. The rest are clerical staff.

6115. *Lord Harcourt*: The seven are what you might call examiners?——Yes, and they prepare cases for submission to the Committee.

6116. *Mr. Woodcock*: Any case may go to any one of the seven; you have not found over a period that some man acquires a special knowledge of one type of industry? Do not these applications involve fine opinions about such things as the prospects of an industry or a particular product?——*Lord Kennet*: What the staff has to be expert in is what the Committee will require, in relation to the directives, to decide the application; they have to be experts, in other words, not in weighing the merits of the application, but in deciding whether there is the necessary information to come to a decision on the merits.

6117. But is not the question of merits a ticklish one; for example, on whether a new product is likely to succeed or not?——There we are very largely dependent upon the recommendation of the production department.

6118. Are your staff civil servants?——*Mr. Sangster*: Yes; they are members of the Treasury staff, appointed to prepare the cases for submission to the Capital Issues Committee.

6119. What rank are they?——Executive grade, from Executive Officer up to Chief Executive Officer.

6120. *Chairman*: I think it follows from what you said that we must think of them as doing administrative work; seeing that the instructions of the Committee are carried out and the necessary information collected?——*Lord Kennet*: That is no doubt the appropriate adjective.

6121. *Professor Cairncross*: Does the Committee ever delegate a decision in any case to members of the staff?——Never.

6122. *Chairman*: The general letter of 4th December, 1951, sets out certain instructions about priorities which are to be given. How is that worked? Are you given by the Treasury any general conception of the resources that may be regarded as available each year for capital investment?——The answer to that is quite clear: it cannot be a quantitative decision. It must be a qualitative decision upon the nature and the purpose for which it is intended.

6123. So it is a sort of qualifying inspection, to see whether the proposal is the kind of thing covered by the instruction?——"Qualifying" is I think the right word; the question is whether it is of the quality which is favoured or the quality which is not favoured.

6124. *Professor Sayers*: No regard is paid to the amount asked for?——Let me distinguish: the total amount of capital investment may require grave consideration from the point of view of the national economy, but that is not the point from which the amount of an application is regarded. The point from which the amount of an application is regarded is whether the amount is appropriate to the project defined and approved in the application.

6125. You do not consider whether you have not already recommended too many applications in a particular line during the year to allow any further applications in that particular line of business?——In such a matter we should have to depend on the recommendation of the department which is acquainted with that branch of industry.

6126. *Chairman*: How can this idea of too large a flow of applications for particular purposes be dealt with, if you are given no overall view? Do you get advice from the department to that effect?——Yes; the advice we get from the department is as to whether the object of the application is in the national interest or not. As regards the amount, the department will in an appropriate case criticise. If the department criticises the amount in any particular, then we give due weight to the criticism of the department. We on the other hand may ourselves distinguish: we may believe that in some respects the amount seems excessive. Let me give an example of that: we may have to consider a big application, part of which is for capital expenditure, and part for working capital to be increased as a result of the increased production. We should naturally criticise the amount of the working capital which is asked for in relation to the increased production which has been recommended by the department.

6127. That is a criticism brought to bear upon the amount of money that is asked for in relation to the purpose to which it is directed. I was wondering if anybody could work a system under which the department said: "In the course of this year you have had a great many applications for building, say, commercial premises or offices, and we think that you ought to cut down this new one, simply for that reason"?——That is not a very favourable instance, if I may say so, because an application to finance office building would be looked upon as not having any priority unless it was very strongly supported. But, if it was a question of additional plant in the steel industry, for instance, we should have to depend upon the advice of the department as to whether or

not this was to the national advantage, to the extent asked for in that year.

6128. *Professor Sayers*: Would the department advise you only in relation to the specific application before them?——No. If the department were to take so narrow a view as that I imagine the department would not be fulfilling its proper function.

6129. The department might recommend you to recommend a refusal in a particular case because there had already been such a great flow of money into this industry during the year?——That would come to us, perhaps, in the form of advice from the department that they thought the facilities for the production of this particular form of article were already adequate.

6130. *Mr. Woodcock*: Would that be given to you generally at any time, or only in relation to a particular case?——A particular case.

6131. Never generally?——No, not by a department.

6132. *Professor Cairncross*: You mentioned a moment ago that you thought an application in respect to offices would be given no priority; do you derive that from your instructions or from what the departments tell you?——I think, if I may say so, that we derive that from common sense. We always carefully scrutinise expenditure upon office accommodation aloce, and it would have to be supported by some special circumstances.

6133. Do you regard office accommodation as in a different light from factory accommodation?——It would require more careful attention, and perhaps a rather more conservative approach, than expenditure on actual production.

6134. *Professor Sayers*: Are there any other preferences you apply through the exercise of common sense?——I hope we apply it in all cases.

6135. Here you are in effect putting very low on the list, and therefore as highly eligible for refusal, the building of office premises. That attitude you do not base on the instructions you have received from the Chancellor, nor do you base it on any advice you have received from the department; you base it on the exercise of common sense. Is there any other category of investment that you place similarly low for similar reasons?——I hope the Committee will not think that I have been selecting office accommodation as having some particular black mark.

6136. The purpose of my question is to find out what are the other items that might be put alongside office accommodation?——I should like to generalise then, and ask you to merge the case of office accommodation into our general approach to all cases, which is to see whether there is any unnecessary expenditure involved in an application for a good purpose.

6137. *Professor Cairncross*: Do you have in your mind certain categories of expenditure that you regard as of rather low priority?——We have our directives from the Treasury as to priorities. I have explained that "priority" is here a qualitative priority.

6138. *Sir John Woods*: In paragraph 19 of the Treasury paper, it says: "The Committee are asked to recommend against investment for production or distribution or provision of services in the home market which, in the judgment of the Committee is not urgent and can therefore be postponed (e.g. shops, offices)." Are there any other things you can add as examples?——That is a very wide direction both in its intention and its application, and urgency and necessity are now judged on a strict standard in accordance with the Chancellor's directives, again in relation to the advice received from the department concerned as regards to what extent the application possesses the necessary qualifications.

6139. You do not feel able to specify any other categories, like shops or offices, which are scrutinised particularly carefully?——*Chairman*: There is the phrase "inessential goods" in the governing letter of 4th December, 1951; I imagine it has rather grown out of that?——That is where we should have to look for cases coming under the heading to which Sir John has referred: the production of inessential goods for the home market where there is no export market and no necessity or urgency for their production in the home market.

6140. *Professor Cairncross*: In interpreting the word "essential" does your Committee rely on its own judgment or build on consultations with departments in cases?——Rather the latter; but I would not say that there might not be a case in which it would be so obvious that the production of the goods was neither necessary nor essential that the Committee would not rely on that factor, to which I perhaps rather imprudently referred: common sense.

6141. Is not the difficulty with common sense that it is sometimes a little difficult to exercise? Take hotels, for example: some people might think them inessential, but I notice they are singled out as of special essentiality?——The principal factor of essentiality in the hotel applications is the foreign tourist traffic.

6142. In considering these applications is it the Committee which judges that the hotels are under this category, or the department consulted?——We get the Board of Trade's report on the hotels.

6143. *Professor Sayers*: On the specific cases?——On the specific cases.

6144. The Board of Trade makes up its mind which future hotels are inessential?——The Board of Trade gives us information on the subject.

6145. *Mr. Woodcock*: If you have first the Treasury directions, and then the department's interpretation in particular cases, does this not begin to look a very small and unimportant job, hardly worth calling together very busy people for?——That is hardly for me to say. We do not always agree with the department.

6146. *Chairman*: Do you call the departments in to your Committee to discuss their views or criticise them?——No; we get their written report.

6147. It is always on paper?——Yes.

6148. Does the secretariat work it out with the department?——There is a good deal of to-ing and fro-ing.

6149. *Mr. Jones*: Do you find yourself at any time in a position to reject the advice of the department concerned?——Yes.

6150. Do they come back then, or accept your decisions? Is any action taken by a department on your recommendation for a decision, if you have gone against the department?——I do not know. It does not come to us. The Treasury does not tell us if they do.

6151. *Sir John Woods*: It would be between the Treasury and the department?——I do not know if the Treasury goes to the department and says: "What are you about?"

6152. *Mr. Jones*: Do you recommend consent as well as refusal of applications against the advice of the department?——It might just as well be one as the other.

6153. *Professor Sayers*: When there has been to-ing and fro-ing between the secretariat and a department on a particular case, does the Committee ask the Secretary to explain to it the department's view on the case?——It would be not infrequent that after first consideration of the case the Committee should refer some aspect of it back to the department for further advice.

6154. *Chairman*: Do you build up records which categorise closely the applications that have been passed or rejected year by year?——I do not think there is any very particular analysis made of the cases; general statistics are, I believe, being prepared.

6155. Would it help you in dealing with this large volume of applications to have a fairly close analysis of what you have dealt with in the past and see what lines you were running on, so that you could keep to them in one year, or depart from them in another?——Actually I do not think it would help; I think that that aspect of control of the national economy must be more for the Treasury and the departments. We decide the application on the merits of the case.

6156. *Professor Cairncross*: Would you decide the application in the same way in each successive year if it were submitted? Suppose that for some reason or another the Treasury wants to curtail investment and asks you to be more rigorous; if the same application came before you, would you give it the same treatment?——That would depend on whether we had had a fresh directive on the subject. If we had had either a general or particular new directive, then the same application might be differently dealt with after the new directive from what it was before.

6157. Would the directive be one which ruled out a number of possible types of application, or would it merely instruct you to be more rigorous in your interpretation of the word "essential"?——Sometimes one, sometimes the other; we have had both. For instance, as is well known, there was the big general direction to be extremely economical in 1956; I am afraid we referred to it as "the squeeze".

6158. Do you find it possible to interpret that regulation except by deciding that certain types of goods will no longer qualify for recommendation, or do you continue to look at each case on its merits?——The Committee works rather in reference to the words "urgent and essential". The result of the squeeze is that cases which might have been admissible before that may no longer be considered urgent or essential.

6159. *Mr. Woodcock*: What period must elapse before you would receive an application submitted for the second time?——That requires a little explanation. It is often said that there is no court of appeal from the Committee. That, of course, is perfectly true, in the commonly accepted sense of the word "appeal". A committee, after all, is not a court; and there is no other body which is not the Treasury which could give a different recommendation to the Treasury; in that sense there is no appeal court. In a very practical sense, however, there is no reason whatever why any applicant should not put in his application as often as he pleases, and as a matter of fact they sometimes do. It sometimes but not very often happens that the result of the rejection of an application is that further explanations are given by the applicant, and some circumstance comes out which puts a completely different aspect on the application, which the man had never thought of stating before, and that may possibly result in his getting a favourable recommendation instead of a negative. He may appeal in the sense that he may apply as often as he likes; but we do not encourage it unless he has new matter.

6160. Take a case where a man applied, say, in January last year, and you turned him down; and after a reasonable time has elapsed (he has not just thrown it back to you as soon as he can rewrite it), you get the identical application, say this January; and in the meantime you have had no further directions: would that be administratively dealt with by the staff?——No.

6161. It would still come to you, and go through the paraphernalia of reference to the department again?——Yes, it would.

6162. *Professor Sayers*: In such a circumstance you would not consider yourselves bound by your own precedent?——We are not bound by our own precedent, but we should not come to a different decision if there was no difference in the case.

6163. Even if the general circumstances of the economy appeared to your common sense to have changed?——The common sense to be applied in this case is not ours but that of the Chancellor of the Exchequer. If he has not given us a fresh directive, we must assume that there is no change.

6164. *Professor Cairncross*: The change must be recorded officially in a directive to you?——An application submitted after a new directive had been indicated to us might receive a different recommendation from what it would have received before.

6165. *Chairman*: I have the impression from what you have been telling us that the advice of the department is an important element in the process of forming a recommendation. You have *ad hoc* advice on virtually every case from a department?——That is so.

6166. I suppose the department you are most in reference to for this purpose is the Board of Trade?——You might fairly say that the Board of Trade is the most frequent; but I cannot think of any department which does not sooner or later come in: the Ministry of Power, the Ministry of Transport, the Ministry of Agriculture.

6167. *Sir John Woods*: And the Ministry of Supply?——Yes, that is very important indeed.

6168. *Lord Harcourt*: Do you give quite a large proportion of partial consents? Do you reduce a large proportion of applications, because you think an amount of capital applied for is extravagant in relation to the project proposed?——No, not a large proportion; I should say that it was exceptional but not infrequent.

6169. *Chairman*: How often is departmental advice overruled by your Committee?——Seldom, but it happens.

6170. I should like just to get a little more detail about the course applications take. They begin with a questionnaire from your Committee for the applicant to fill in?——Yes.

6171. The completed questionnaire is scrutinised to see whether the answers then given are given as fully as required?——*Mr. Sangster*: Yes.

6172. The next course is then to go to whatever is regarded by your secretariat as the right department to take a look at it; the Committee do not see anything at this stage?——That is correct.

6173. Do you find it difficult to get the answer back out of the department?——We ask them to reply within ten days, and generally speaking they keep to that; so that we can expect the delay between the receipt of an application and presentation to the Committee to be about fourteen days. Sometimes it has exceeded that, naturally.

6174. After he has answered the questionnaire, does the applicant see you at all? Does he get a chance of knowing what the department has said about his application, for instance?——*Mr. Sangster*: No. Any applicant is welcome to come and see the secretariat, but the Committee never see the applicant at all.—*Lord Kennet*: The Secretary does not mean that he is not accessible.

6175. *Chairman*: No, I did not take it that way; but I wondered what could be done about a view or a fact being included in a departmental report, that the applicant might well feel he could controvert?——In a difficult case where there is any doubt the Committee asks the department to talk to the applicant again.

6176. Is it habitual that the applicant has seen the department himself at some stage?——I should not say habitual, but it is common in difficult cases.

6177. *Professor Sayers*: Does the Secretary ever advise the applicant to see the department?——Not before the case has been to the Committee. If the Committee have some doubts, they sometimes suggest that the applicant should be advised to get in contact with the production department.

6178. *Mr. Jones*: The number of applications that has been rejected has increased within the last two years; has that put any greater weight of responsibility for giving advice upon the secretariat?——No weight of responsibility. It has naturally caused additional work; but an applicant has the opportunity of seeing the secretariat and he is advised that if he wants to re-submit his application he must produce fresh facts.

6179. *Mr. Woodcock*: You tell him what would be covered by fresh facts?——It is very difficult to specify or to generalise as to what the fresh facts are. The thing first is to advise him to tell anything he has not already told the Committee.

6180. It seems to me from what has been said that the Committee must be in a sense the representative or the advocate of the applicant. The applicant depends to a very large extent on your Committee. He is engaged, from his point of view, in a very serious matter; he needs money to engage in business. He has a right to have his application fully considered, which involves the right to be told what is objectionable about his application. If he is in that position, where does he get it from? Does not a responsibility rest on you for seeing that his case is properly presented and that things are not allowed to go by default?——The nature of the control and of the information required is now very well known publicly, and the legal and the accounting professions are also well acquainted with it, so that it would be infrequent that an application is presented omitting any really material facts. If an application is presented, and on the face of it there is some reason to suppose that material facts have not been included, then the Secretary will inform the applicant before it goes to the Committee. If it comes to the Committee, and it is still apparent that there is some material fact not included in the application, then it will be referred back for further information. If, owing to the nature of the way it is put forward, there is nothing on the surface of the information supplied to suggest that something has been omitted, then it may be

that the application is rejected, but I do not see any remedy for that except a further application, which is quite frequent in cases of refusal, from which it may turn out that the applicant has omitted to mention some material fact.

6181. But there might be a matter of opinion which ought to be very closely argued. The view of the department must be opinion in the last event; it is a judgment about the facts. Does the applicant have a chance to put his point of view, as against the department's?——If he has supplied in his application form all the necessary and relevant information to form a decision, the answer would be in the negative.

6182. *Professor Sayers*: Does the Secretary disclose to the applicant the reasons given by a department why an application should be refused?——*Mr. Sangster*: No.

6183. *Chairman*: I know that it has been the Committee's practice not to allow an applicant whose application you are in favour of refusing to appear before you and put his case; therefore I imagine you do not think it is the right thing to do. What are the objections to it? We gather he does not know what the department has said about it when it comes before you. Would it be unreasonable to give him a chance of knowing what the objections to his application are and trying to meet them?——*Lord Kennet*: The practical answer to that is that from his application we judge whether all relevant circumstances have been declared or not. If we are not informed about the relevant circumstances, then it is referred back, at the earlier stage by the staff, or afterwards by the Committee, to obtain that further information. After we have obtained all the relevant information on the matter, then it does not seem to me that any further purpose could be served by discussion about matters which have already been present to the mind of the Committee.

6184. *Lord Harcourt*: The applicant is entirely ignorant of the basis on which the department has recommended that his application should be refused; and therefore, if he is merely filling in a questionnaire without knowing what the contrary arguments are, it seems to me that he does not have an adequate opportunity of presenting his case fully. He can answer a questionnaire as fully as he possibly can, but unless he knows what the contrary arguments are, it is very difficult to fill it up in the most beneficial way to himself as the applicant.—*Professor Sayers*: It is not a matter entirely of having the full information. It is a matter of argument, of making sure that the applicant has used the most effective arguments for his purpose, in the knowledge of the arguments that have been put forward against it?——I can well understand the frame of mind of the applicant. He deserves sympathy: nevertheless, in my experience of the administration, I should say that the case for or against an application is without doubt ascertainable and is ascertained from the information which has been supplied in writing and after discussion with the department.

6185. *Mr. Jones*: Are there any cases on record where, following the reply of the department concerned, it has been necessary for the secretariat, before submitting that case to the Committee, to obtain further information from the applicant, and to deal with certain matters that have arisen from the reply of the department?——*Mr. Sangster*: There have been such cases.

6186. Are they frequent, or are they the exception?——They are the exception.

6187. *Mr. Woodcock*: Let us take an example of what might be a particular case. Let us say that a man wants to extend his works, or even start a business, for making some fancy kind of paper. We will assume that everybody would agree that, in so far as he proposes to make and sell this paper in this country, it is inessential: it is merely a fancy thing, which might help to please the customer but would not be put as high as a steelworks. All the facts are known. Nobody denies his capacity to make this paper; nobody denies that for domestic consumption it is not essential, but his case, essentially, is that he could create a market for this, and he could sell this abroad. Does he have to have an order book before that is accepted?——*Lord Kennet*: That is really asking the question, I think, whether a new invention at its start has any chance. Of course it has.

6188. How does it get its chance? Supposing the department on their judgment of export possibilities does not agree with him; since it is new, it is something he cannot prove. He is very confident himself, and has every reason, from his own experience, to think that this thing will be a good British export; but somebody in the department does not think so, and looks at it and says: "Here is an application to invest £1 million on something which is immaterial, and in my opinion its export prospects are not worth it." That is really what it must come to. What does the man do in those circumstances? Does he have to sit back and take it?——In the circumstances of some new article on the market, and so on, we should always need the advice of the department which has more direct knowledge of that industry and its comparative industries. They might often take an oncoming view, even since the closer limitation of credit because of the squeeze. I can remember quite a number of cases of new products which have gone ahead with the recommendation of the department. Occasionally, I think rarely, the department says: "No, we do not think there is any prospect for this at all." Then the Committee will look at the case and make its own judgment as to whether they think there is, or not, any prospect. If they think that there is, they will disagree with the department and they will give it a favourable recommendation; if they do not, and the department seems to have a common sense view, they make a contrary recommendation.

6189. You are in the position there of being the advocate of the applicant. That is your function at that stage?——Not unless the Committee has not got before it every circumstance which it considers relevant to the urgency and necessity of the project, and its prospects.

6190. All that the applicant can put down on paper is some general statement on his hopes. You look at that and you form a judgment, but there is no chance of him meeting your general views. This is not a question of fact; he does not deny that perhaps his process is not new, or that his stuff is a triviality; the simple point is that he could sell this abroad. He has to say that on paper. Is that all he can do? Can he not meet the man who does not take his optimistic view, and argue it out with him?——I am not for a moment ignoring the desire of the inventor or of the enterprising projector to have his say in interviews and so on, but I think this control works without doing any injury, either to the applicant or to the national interest, by obtaining all the relevant particulars in the way in which we do.

6191. *Sir John Woods*: You feel that if all the facts are disclosed, and assuming they are disclosed and known, a process of argument and counter-argument about the application of those facts to the criteria which you have laid down for you by the Treasury would not in fact change the view of the Committee?——I would rather generalise a little, and say that I do not think the way in which the present control works, with the very careful preparation of all the relevant circumstances, works either against the interests of the individual or the national interest.

6192. *Chairman*: It would help us if we could have supplied to the Committee the form of questionnaire that you use. It is a regular set form; it does not vary, I gather?——*Mr. Sangster*: No.

6193. Could we have some copies?——Certainly I will supply those.

6194. Do you find that most applications, at any rate those involving largish sums, are handled by expert accountants or firms of solicitors?——*Lord Kennet*: Practically always.

6195. Do you find a distinct difference, when applications relate to smaller sums, in the hands through which they come and the way in which they are presented?——There has been an enormous improvement, from the point of view of good administration. In the old years long since, before the control was understood and when it was a novelty, the Committee was much troubled and sometimes embarrassed by what I might call the amateur application made without advice. As time has gone on, I would say that the course of business is so well known that very seldom indeed do we get an ill-prepared application.

6196. Even in the case of quite small sums?——*Lord Kennet*: The limit is down to £10,000 now; but even when one is dealing with £10,000 one thinks twice about it and takes professional advice. But unsatisfactory applications do still sometimes occur; in such cases the Secretary

always takes particular care to assist the applicant.—*Mr. Sangster*: The secretariat know the type of information the Committee want, and if that information is not supplied when the application first comes in they ask the applicant to furnish the additional facts. Otherwise the case would be referred back by the Committee, asking the secretariat to produce that information. So we endeavour to submit to the Committee an application as fully prepared as possible.

6197. And do you find that, in dealing with the smaller sums, you have to do more spontaneous work on your own to get the thing right for them?——Not so much for the smaller sums as in dealing with the provincial applicants, who have been drawn into the control as a result of the reduction of the limit from £50,000 to £10,000.

6198. *Professor Cairncross*: You seem, in fact, to reject about one in four of the cases between £10,000 and £50,000. In the first half of the last year, of the applications in that range for commercial and industrial issues, you rejected applications to the value of £4 million, and you allowed applications to the value of £13·8 million. That seems to me a very high proportion?—*Lord Kennet*: It is very difficult to base general conclusions on statistics about the way the Committee works. One large hopeless application may give the figures a swing in a direction which looks as though the Committee has been turning down a lot more applications than it has.

6199. I am not basing myself on what happened in one particular period; the proportion I mentioned holds quarter by quarter, and has held ever since the limit went down to £10,000?——*Mr. Sangster*: That is assuming that all the applications under £50,000 are approximately the same value. I think those figures cannot be taken as representing one in four of applications.

6200. Could we have the figures?——I will ask the statistical section if they can produce them for you.

6201. Is the number of applications you now have for amounts under £50,000 approximately equal to the number that you have for amounts above £50,000?——Yes.

6202. You have, in fact, roughly doubled the work of the Committee?——Yes.

6203. This means that you now handle something like eighty cases each week?——Yes.

6204. What is the average time that the Committee gives to each case?—*Chairman*: Do you not have great difficulty in dealing with the very great volume of money involved in the applications, and the number of the applications.—*Lord Kennet*: In the manner which has already been described the information is collected, analysed and arranged by the staff, who obtain all the information which will be required by the Committee to make a recommendation on the case. That is then set out in a précis on the case, giving all the necessary information, which may run to pages and pages. Those précis are circulated to each member of the Committee as soon as they are ready, and arrive throughout the week, so that the members of the Committee have a full account of every case days before the Committee meeting. If I may say so, they study them with the greatest industry and attention, form their own judgment on them, and note them. They thus arrive at the weekly Committee meeting with their cases prepared. The cases are taken in turn; each member gives his own view of the case, and with the assistance of the previous study it can be reduced to a discussion on each case which leads to a prompt conclusion. It is very seldom that conclusions are not the same all round the table. Of course, it takes a longer time for discussion when different views have been formed by the various members of the Committee.

6205. It would not really be possible to have discussions of any length about each case in turn, in view of the number with which you are dealing; is there some process of weeding them out automatically?——There is no automatic weeding out; the weeding out does itself, because the great majority of the cases would be straightforward.

6206. *Sir John Woods*: That amounts to saying that the effective work done by the Committee is very largely homework?——Yes, and very regular homework it is.

6207. *Mr. Jones*: But how can that help the Committee to do their work in a co-ordinated, co-operative sort of way? In view of what takes place, does it not look as though, substantially, decisions are tentatively arrived at by the secretariat and confirmed by the Committee?——No. Believe me, that is a complete misconception.

6208. What focal consideration can the Committee as a whole give to every individual case coming before it, when there are eighty cases coming before it on one day?——The first important consideration, from that point of view, is that the majority of the cases will be normal cases of a kind in which the Committee is extremely well versed. They fall into a certain pattern in which the conclusion is easily arrived at, and has been arrived at by each individual beforehand, and the conclusions of all the members are found to coincide. The remainder of the cases will be cases which present doubt or difficulty, and need further enquiry. They will form the subject of discussion, but the discussion will take place amongst the members of the Committee, who are already well acquainted with all the relevant aspects of the case. Under those circumstances, it is possible to get through the business.

6209. I would have thought that it would have been impossible for a Committee of four or five people to deal with half this number of cases, even having regard to the fact that the individual backgrounds of those cases were known to members of the Committee?——It would be quite impossible if they were all subject to doubt, but the great majority of them will fit into well-ascertained patterns, and the conclusion will be arrived at independently, but similarly, by members of the Committee before they come into the room. For the remainder, I assure you, you are underrating the ability of members of the Committee each in turn to express with the utmost clarity and extreme certainty in a very short time his view of the case.

6210. Are there minority views in the Committee from time to time?——I do not remember a case in which we have not arrived, ultimately, at a unanimous decision. I can remember many cases in which we started with differing views, and we have been able to approximate them.

6211. *Professor Sayers*: These are matters where judgment of essentiality and urgency are called for. Is it not strange that half a dozen men should be able to agree so very quickly on such a large number of cases, on these very difficult matters?——I can only answer that being acquainted with the work of the Committee I do not find it strange.

6212. *Professor Cairncross*: Do you think that it would be impossible to devolve on the Chairman or the Secretary of the Committee a decision on the cases which you feel fall into a definite pattern, on which members of the Committee are unlikely to form different opinions?——To a large extent that is done. In practice I go through the cases, and all those which are absolutely routine I can mark as such.

6213. Have you formed any view about the lower limit which has been set at present?——I recognise that this is not a matter on which your recommendations as a Committee would necessarily bind the Treasury, but have you formed any view of whether £10,000 or £50,000, or any other limit, would be an appropriate one?——That has not been discussed by the Committee, and I should not think it would be appropriate for us to discuss it, unless it were referred to us by the Chancellor.

6214. You have no personal view on that?——I have so many personal views, but I am here as the Chairman of the Committee.

6215. *Chairman*: If you feel precluded from expressing it, then you must not do it; but it would help us, of course, because of your experience of this, if you did express a view?——I think I should not. It would be only a preliminary view, until I got views from the other members of the Committee, who have much more experience of the actual issue market, and that sort of thing, than I have.

6216. May I take your mind to one branch of your field, and that is applications which deal with capitalisation of reserves? Do they form part of the more difficult branch of your work?——No, an easy branch.

6217. Does that mean that the principles on which you are required to work in dealing with them are easier to interpret than on other cases?——No; I should say the facts are simpler.

6218. What principles do you apply?——I must refer to our directive on this:

"In making recommendations regarding bonus issues and issues containing a bonus element, the Committee should bear in mind that all of the following requirements are also to be fulfilled: that the application relates as a single operation to the capitalisation of true reserves. . . ."

There, for instance, comes the question of whether it is a recent revaluation. If it is a recent revaluation we may doubt whether it is a true reserve or not.

6219. Do you not find it difficult to ascertain and apply the conception of whether it is a true reserve or not?——Not generally. After all, a typical reserve is the sort of reserve built up out of profits.

6220. You are supposed to be dealing throughout with revenue reserves, are you not?——Yes. Then the directive continues:

". . . and is one which will benefit the stability, credit or efficiency of the undertaking, and that it does not take a form which will enable tax liabilities to be reduced."

That is with reference, particularly, to the issue of redeemable preference shares and debentures.

6221. Apart from cases of redeemable preference shares and debentures, does that third category raise a difficult question?——There is the question of the company which has distributed capital, and then proceeds to replace it with a bonus issue. There are various tax-dodging devices of this sort, which the Inland Revenue dislikes.

6222. Could not they be dealt with more appropriately by the Inland Revenue?——They could be much more efficiently dealt with by the Inland Revenue, if it had the power to do so.

6223. I want to come to the question of the publication of reasons for refusing the applications, and my impression is that a certain amount of the comment which the absence of reasons arouses very often relates to these cases of capitalisation of reserves. Do you see an objection to the publication of reasons where the applications are refused?——I am going to venture a personal opinion here, and I am not speaking as Chairman of the Committee. My personal opinion is that it would not make for good administration. I believe that administration is more effective when it is conducted on the present basis than it would be if it were extended in the manner which you suggest.

6224. I am not quite sure what is covered by the interests of administration; but would it not be desirable that the person who has had his application refused, and has seen another application passed, should be able to know, for his own enlightenment, why? Is not that really due to him?——You are rather taking me beyond my functions in the Committee. That is really a question for my lord and master, the Chancellor, because the decisions are, not only in form but in substance, his. The final decision upon the matter of publishing reasons must rest on Treasury Ministers.

6225. I quite accept that, but I was wondering whether it would impede the effective working of the Committee, if reasons were made public. I think you were rather hinting that you thought it would a minute ago?——I gave that as my personal opinion. My personal opinion is that the Committee is more efficient for its purpose, and also in the interest of the public, including the applicants, working in the manner in which it works at present.

6226. Could you enlarge at all on the reasons for that opinion?——Only, as I think I have already mentioned, that I think the process of previous examination and consideration, which I have already described, succeeds in eliciting everything that is relevant, and I do not think that individual discussion with the applicant would do anything by way of adding to the ascertainment of what is relevant.

6227. Is it not rather a separate point as to whether, if he has had no opportunity of presenting his case before you, it would not be reasonable and satisfactory for your work if, when the thing is refused, the reasons why should be made public?——That is a further matter which, I think, I must leave to the Treasury for an expression of opinion. The function of the Committee is to make their recommendations to the Chancellor, and the Treasury decides. Whether they should give reasons for their decision or not is a matter upon which I hardly ought to have an opinion.

6228. If we were able to persuade them that there was no reason why the reasons should not be given, it would not materially impede the working of your Committee?——It would not impede it, but it might delay it.

6229. *Professor Cairncross*: You mentioned earlier that your Committee had always reached unanimity in its recommendations; does the Treasury sometimes overturn your recommendation, and issue a different decision?——I think you would not go over to the second hand in counting on your fingers the number of cases where that has happened, and I think you would find, when you looked at them that there was always some special reason.

6230. There are times when the application is granted subject to certain conditions, or subject to a limitation as to amount?——The only condition I can think of is the source of borrowing, on which under the Chancellor's direction we are instructed to limit bank borrowing to the utmost. Of course the timing of any issue over £100,000 is under strict control, but we are not talking of that. As to limitation of amount, certainly; applications are cut down sometimes.

6231. If an application is cut down, is that in any way the outcome of negotiation with the applicant, or is it a unilateral decision?——Unilateral.

6232. Is it a decision taken by your Committee or by the Treasury, or a recommendation made by you in the first place?——I am only speaking now of the recommendations of the Committee as accepted by the Treasury. It would be a recommendation of the Committee.

6233. The Treasury would not subsequently introduce a limitation of their own?——I do not know. I think they would tell me of any case where consent was issued other than as recommended, and I cannot think of any case of the Treasury limiting the amount after we had recommended consent.

6234. *Lord Harcourt*: Do you know of any cases where an arbitrary cutting down of the amount applied for has led to the abandonment of the project?——It is possible that I might not get to know of that. I cannot think of any conspicuous case which has come to my attention through the newspapers, or in that sort of way.

6235. Have you any record of the number of people who have applied to your Committee, have been given consent, and then have, in fact, not gone ahead, or have allowed the consent to lapse?——No, we do not know at all.

6236. Do you have many cases of people who, before the expiry of the six months' period of validity of a consent, come back for an extension of permission?——*Mr. Sangster*: Yes, that frequently happens, especially in cases where building is concerned, and owing to delays they are unable to complete the building and the borrowing within the prescribed period.

6237. *Professor Cairncross*: You mentioned earlier that some of the provincial applicants did not seem to know the ropes, and were liable to make submissions that were incomplete or unsatisfactory. Have you found that this continues to be true?——The £10,000 limit has been in force now for two years, and we are finding that the applications from the provincial applicants are steadily improving.

6238. Would a substantial number of the recommendations for rejection relate to these provincial applications?——No greater proportion than from any other area.

6239. You do not think the incompleteness tells against them?——Definitely not. The Committee makes its recommendation on the merits of the case.

6240. But you agree that the facts presented have a bearing on the decision taken, and if the facts are not all there that may not assist the applicant?——If the facts are not all there the Committee asks for them to be provided.

6241. *Chairman*: Would it be difficult to institute a system of following up whether applications which are granted are, in fact, utilised?——*Lord Kennet*: I do not know what the Treasury would think of that. Would it not be thought rather inquisitorial?

6242. It must be very relevant to the purpose for which the control exists; if a large volume are only paper consents, and they fall to the ground, the actual flow is very different from that which would appear?——Yes, from the statistical point of view, that might have significance. I think it is worth departmental consideration.

6243. *Professor Cairncross*: Is your Committee ever consulted on general policy issues? Are you invited by the Treasury to express a view on how the control of capital issues might be altered or amended?——The Chancellor of the Exchequer has sometimes been good enough to consult the Committee through me when he is considering some new directive, or something like that, to see whether the Committee has any contribution to make to his decision. The original communications which I received long since from the Chancellor of the Exchequer who set the Committee up encouraged the Chairman of the Committee to approach the Chancellor of the Exchequer if he ever needed to explain anything, or make any suggestions and so on. That has been occasionally done throughout the years.

6244. Are you consulted, for instance, about the machinery for the timing of issues?——No.

6245. That is entirely with the Bank of England?——Issues over £100,000 have to go to the Bank to get into the queue.

6246. *Chairman*: Do you get complaints at any time about their fate in the queue?——They would not bring them to the Capital Issues Committee, because they know it is not our affair. I am also a private individual, of course!

6247. *Sir Oliver Franks*: If there are no more questions on our proper subject matter, would it be possible to ask Lord Kennet whether he would be willing, in his purely personal capacity as a member of the City of London over many years, to give any purely personal views on one or two of the topics to which we have been specifically asked to direct our attention as a Committee, such as, for example, the relations of the Bank of England with the Treasury?——If it would not be gravely inconvenient to the Committee, I should prefer not to deal with these more general topics on the same occasion as I have been here as the Chairman of the Capital Issues Committee. But if I could possibly be of assistance to the Committee on any other matter on another occasion, I should be most willing to do my best.

6248. *Chairman*: That is very kind of you. I wonder if you could think it over. The relation between the Bank and the Treasury is one point which is vitally important to us, and has been referred to us, and the other question, based on that, is the proper constitution of the Bank of England under present conditions. If you felt you could offer us any views, based on your long experience, we should welcome them very much?——I could certainly offer an opinion.

Chairman: That is all anybody can do. Thank you very much, Lord Kennet. We are most grateful to you and Mr. Sangster for your help.——*Lord Kennet*: I am grateful for the patience with which you have heard my long exposition.

(Adjourned until Thursday, 27th March, 1958, at 10.30 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-FIFTH DAY

Thursday, 27th March, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 6412 to 6549 only).
PROFESSOR R. S. SAYERS, F.B.A.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR EDWARD THOMPSON, J.P. Chairman and Joint Managing Director, John Thompson Ltd., E. N. GRIFFITH, Esq., Chairman and Joint Managing Director, Rotary Hoes Ltd., and R. A. PITTMAN, Esq., Chairman, Council Member and Secretary respectively of, and representing The British Engineers' Association, called and examined.

6249. *Chairman*: We should like to run through your memorandum*, Sir Edward, and see what questions arise on it. If there is anything you would like to add by way of filling it out, that would be welcome. Your Association is, you tell us, the representative trade association for mechanical engineering, and engineering exports account for nearly 40 per cent. of the total visible exports. Within the engineering field the major section is the mechanical engineering industry.——*Sir Edward Thompson*: The British Engineers' Association is a rather unique association in that it is almost entirely advisory for its members; it is not a price-fixing association. The members consist of various trade associations in the mechanical engineering industry, and of the larger individual firms. We are members of the Federation of British Industries, and speak for the mechanical engineering industry through the Federation. We have also close contact with other large associations, such as the Society of Motor Manufacturers and Traders and others, on common problems.

6250. How long has your Association been going?——*Mr. Pittman*: Since 1912.

6251. In paragraph 2 you say: "Engineering exporters who are engaged in exporting have found that, increasingly, purchasers seek to place on the exporter the responsibility of providing finance". Can you enlarge upon the main causes which have led to the purchaser expecting to be financed by the exporter?——*Sir Edward Thompson*: The general lack of money, and credit problems in the various countries to which we export.

6252. Is it lack of foreign exchange in those countries?——I should say so. Immediately after the war, with countries like Egypt, we sometimes got payment of one-third down with the contract; they had plenty of sterling balances which they wanted to make use of. Now that situation has changed, and many countries, India particularly, are wanting credits in excess of five years.

6253. Is it mainly the lack of foreign exchange in the importing country, or because the nature of the thing going to be sold is such that they could not pay for it except over a period of years?——*Mr. Griffith*: In the earlier years after the war there was such a shortage of goods that the competition to get them enabled the manufacturer to have money deposited in London before shipment. As increased competition arose, especially after Germany came into the market, there was competition to sell goods; and one of the chief forms of competition is supplying the finance.

6254. *Professor Sayers*: It is really a phenomenon of the disappearance of the sellers' market rather than anything to do with credit tightening?——*Mr. Griffith*: Up to a point. Another thing is that many countries are clamouring for a standard of living far beyond what they were accustomed to before the war, which they have not got the resources to do, while other countries are clamouring to keep their own people employed and are helping to provide the finance.—*Sir Edward Thompson*: In many countries it is, as here, a question of trying to spend too much on investment too quickly.

6255. *Chairman*: Is this competition in the sellers' market a special condition of the last few years?——*Mr. Griffith*: It has increased in the last few years, and during the last six months the position has got worse. In my view that deterioration will go on through this year at least. It is anybody's guess how long the depression will last in America, which of course affects commodity prices and so on; if they get out in three years we shall be lucky.

6256. *Sir John Woods*: Have you found already that there has been a considerable falling off in export demand?——*Sir Edward Thompson*: It depends on the product. No doubt competition is increasing very much. And another problem comes into it: even in the Commonwealth, with a nationalistic outlook every country is trying to produce more and more in its own country, even if it is uneconomic to do so.

6257. Have you noticed as a result of these conditions in the last few months a general diminution in inquiries from abroad?——*Sir Edward Thompson*: It is very difficult for me to answer for the whole of the variety of manufacturers who are members of the British Engineers' Association, and I can only give my answer on what I know of our own firm. I should say there is a reduction. —*Mr. Griffith*: Except in the motor car industry.

6258. *Chairman*: We have to ask for generalisations from you, since you represent the Association; but, if I follow you, the terms of credit which can be given by the exporter have become a very important element in success or failure in obtaining foreign orders?——*Sir Edward Thompson*: Yes.

6259. *Lord Harcourt*: Do you find that pressure for credit is extending outside the real capital goods market? Are foreign importers tending to press for credit on some lines on which in the normal course of events they would not ask for credit at all?——*Sir Edward Thompson*: We only represent capital and semi-capital goods industries.—*Mr. Griffith*: Many countries are giving credit to their peasants on small machinery. For example, in Italy they give up to three years' credit free of interest. We are competing with those people.

6260. *Professor Sayers*: Who is giving the credit?——It is under the Fanfani law.

6261. Is the credit tied to the purchase of Italian machinery?——Yes; and they have such high import duties.

6262. But surely this is a reason why you do not need credit facilities here, if the importer is already getting them?——That is for the big co-operative society, which is the biggest industry in Italy; they handle 80 per cent. of the total grain, imported or internal.

6263. *Chairman*: They arrange internal credits up to three years?——It is a big scheme, connected with anti-Communist propaganda on the reduction of starvation in

* Memoranda of Evidence Part VII No. 7.

southern Italy. They are encouraging the peasant, and giving him his machinery on three years credit. But of course there is a very large private trade as well. The majority of the English importers go through private trade. That is an exceptional case, of course.

6264. *Professor Sayers*: You are producing it as an exception to the general rule?——It is.

6265. *Chairman*: In paragraph 3 you say that the financing of the contract is the responsibility of the manufacturer involved, and the present Government policy of restriction on overdrafts will affect the ability to export; and that a company may be unable to raise additional overdraft facilities to carry out the work. This financing of the contract from the manufacturing exporters' own resources would be a very heavy burden?——*Sir Edward Thompson*: The credit squeeze is very serious, particularly on the smaller firms who may be developing some new speciality in engineering which has got very good export possibilities. It is very difficult for the small manufacturer to finance not only the working capital necessary for expansion but the time lag of manufacture.

6266. But I understand that if you go to your bank and say: "I want finance for an export contract", the Government restriction does not apply. Does it not work out that way?——I would not like to say that it does not apply. We have had every help in financing certain large contracts, but with the high Bank Rate the burden still comes on the firm.

6267. *Professor Sayers*: Although you may get the finance, the height of the Bank Rate is an impediment to your trade?——I would say so.

6268. High interest rates are affecting your business?——I would say they affect business in general, yes.

6269. But confining it to firms within your Association?——*Sir Edward Thompson*: I would say they are.—*Mr. Griffith*: Anything that puts up costs is bad.

6270. *Chairman*: Is it your observation, so far as members of your Association go, that it has in fact affected your ability to obtain the orders you think you otherwise would have obtained?——I can give you a particular case: in my own case our overdraft facilities were reduced from £500,000 to £250,000. This is in a seasonal trade. Our biggest market for agricultural machinery is the United States. We have to ship in November-December for delivery to the farmers, who buy about March or April on the west coast and later on the east coast. We have to start manufacturing in August, and build up for a peak selling period of probably a month or six weeks seven or eight months later. We have to carry that for all that time, and that is why we want these overdraft facilities. If those are restricted, then the total we send to the States will be restricted also.

6271. *Professor Sayers*: Are they restricted?——They will be; we shall be restricted from the normal business point of view. If we think our bank is not going to go beyond it, we shall reduce our whole level of production.

6272. *Sir John Woods*: On the hypothesis that the financing of export contracts is free of the credit squeeze, then I should have thought you ought to have been able to get the accommodation from your bank?——It is not a contract; that is the difference.

6273. Does that make all the difference as to whether or not that variety of export would be free of the credit squeeze like other exports? Have you put that point to the bank?——They know the whole of our business; we give them monthly reports. One of the points is that in this particular case we have our own company in the U.S.A., and we thus cannot get export trade guaranteed by the Export Credits Guarantee Department; so we have no hacking for hills.

6274. *Professor Sayers*: You say that the bank knows everything about your business; they know what you want credit for. Are they restricting the amount they lend you on credit squeeze grounds, or on purely banking grounds that they do not like this business?——They assess it on our total worth and on our bricks and mortar.

6275. That is on banking grounds, not credit squeeze grounds?——No, not credit squeeze grounds; but there is an element of credit squeeze in this, because we have always enjoyed £500,000, and now we are down to less. If we pressed a bit we might get more; I think we should.

6276. *Chairman*: The general run of our evidence has been that up to now there has been no lack of the finance required to carry on export contracts, but that the system is such that there may be a lack in the future. Are you indicating to us that, so far as your Association is concerned, there has been a lack already, and the credit squeeze has cut down on what might otherwise have been available?——*Sir Edward Thompson*: I think the banks have been extremely helpful in providing finance for export. But when a small firm has a definite overdraft limit, and it takes time to deal with an application for an increase, one may get some inquiry coming along immediately, within a month, and, though the banks are fairly easy, having this very fixed overdraft limit it has that sort of psychological effect; added to which, of course, the higher interest rate is another matter. But I think that if there is a definite overdraft limit and an insistence on the credit squeeze, and one is told that it is going to be very difficult to give more, and probably a hope or request is expressed that one can bring the overdraft limit down, that has a psychological effect on the smaller firms.

6277. It has a limiting effect on their minds?——Yes.

6278. *Lord Harcourt*: If one was more specific in a request for an overdraft and in dealing with the banker; if one said: "I want so much overdraft for working capital at home, and I want so much additional to cover this contract and that contract abroad"; do you think one's negotiations with the banks would be easier?——I have found it easier when we have a big inquiry for an export. Then we go to the bank and say: "This is a special job, involving two or three years' credit, can you help us?" In many cases they have helped us, working also through merchant bankers. But the bank are very interested to know what are likely to be the total of one's demands on big contracts, and it is very difficult to tell them, because one may have big tenders outstanding throughout the world, which may be outstanding for several months.

6279. Do you think it is easier for the large firm which has a very large overseas contract to get that financed by the bank than it is for a smaller firm, or even for a large firm which deals in a very large number of small contracts abroad?——*Sir Edward Thompson*: I would think so. The larger firm generally has closer contact with a bank, although my experience is that the bank managers in industrial districts are very good indeed; but there is no doubt the bigger firm does get more pull.—*Mr. Griffith*: There is the smaller type of firm which does not get contracts as such. One has to take a view of the production level, and buy one's material. Up to last year some material was on as much as a year or eighteen months' delivery. It is better now, but one still has to take a view of one's level of production. We have no knowledge when we take that view whether the product is going to Australia or New Zealand, where we do not need an export guarantee because the money is in London before we start, whether it is going on the home market, whether it is going to America or to other markets. So our overdraft facilities are based on a general prospect rather than on a particular country where the goods are going to; we do not know that up to the last moment.

May I develop a little the help the E.C.G.D. is and where we think it falls down? The E.C.G.D. at the moment is only covering about one-sixth of British exports. That one-sixth probably covers the smaller firms in a bigger proportion than the large firms. One can imagine that the larger firms with their own good and established agents abroad would not wish to cover the commercial risk; there is not any commercial risk in those cases. On the other hand there are certain countries where there is a very big commercial risk, and other countries where there is a very big political risk. Take Finland: the average importing firm there is extremely sound, but the political risk is very great. On the other hand take Canada or the United States: there is no possibility of the dollar going sour and not being available, but for the small firm the commercial risk is very great. We are suggesting that a large number especially of the larger firms are not using E.C.G.D. because they only want cover for political risk, which cannot be underwritten anywhere else, and they do not wish to have the commercial risk covered. We have had cases where our small

agents in Canada, owing to their not being paid by their farmers because they have got three or four years of wheat in stock, are slow at getting the money. The agent says that he cannot pay us, and E.C.G.D. say that they will not pay us unless we sue our agent. We do not wish to sue our agents, so the E.C.G.D. cover is completely useless. We are forced to have it because we wish to cover Finland; therefore we have to cover the business in Canada. The theory in spreading the risk was to make a lower overall rate; but it has distorted the business, because in the more difficult countries it should bear a higher rate because of the risk, quite legitimately, and there would be no difficulty in getting it. We could sell goods in the Argentine and get two or three times the value, whereas in the highly competitive places the cost of insurance is loaded to cover the bad risk. We suggest that the E.C.G.D. should take on its real function, which is the covering at the exporter's option of the political or commercial risk; and that they should also quote, as they do at Lloyd's, for a particular risk or a particular country. The exporter should be allowed to pick his risk and pay the proper rate; he will accept it, even if it is much higher, as long as he can divorce the political risk from the commercial risk.

6280. *Chairman*: How far is there an alternative insurer in this country apart from E.C.G.D.?——There is nothing for the political risk.

6281. Must it be a Government department? Is it inconceivable that it should go to Lloyd's?——*Mr. Griffith*: They will not do it. They would cover the commercial risk, if it could be divided from the political risk.—*Sir Edward Thompson*: Another thing is that if one wants a special credit from the bank for a medium or long term contract, the bank almost invariably insists on having an E.C.G.D. guarantee for that credit; whereas if one did not require the money, it is possible that one would not insure with E.C.G.D. That of course puts up the price.

6282. *Sir Oliver Franks*: What is there to prevent the exporter from loading his costs differently from the spread of the E.C.G.D. premiums? If you imagine a trader trading with a dozen countries, of which he regards one as a really bad political risk, and because of that he insures all his business, including that to the eleven good risk countries, why cannot he put the whole of his E.C.G.D. charge on to his pricing for the one bad country?——If he were doing a steady trade with all those various countries that might be possible, but engineering exports are not like that. We may occasionally get one big contract in a very doubtful country, while the bulk of our business may be in countries which are reasonably stable.

6283. *Chairman*: Is it your suggestion that E.C.G.D. should always be available for insuring the political risk, if resorted to by an export house, and that it should also be available for insuring the commercial risk on any particular contract, but only if the exporter asks for it, and that the exporter should be able to go elsewhere if he wants?——Yes.

6284. *Sir John Woods*: Do you add that in relation to political risk you would like the E.C.G.D. to give you the choice of whether you insure a particular contract or not?——*Sir Edward Thompson*: Yes.—*Mr. Griffith*: That you do not have to cover all your business or nothing.

6285. *Sir Oliver Franks*: You accept that in that case the rates would have to go up?——Yes. Further to that, there is the question of the proportion of the risk which an exporter cannot cover. The argument used by the E.C.G.D. is that it is an old axiom of insurance that the insurer should take part of the risk so as to prevent fraud. I suggest that it is also an old axiom of insurance that there must be good faith on both sides, and that it is up to the insurer to know his client and to know the risks he is running. If the E.C.G.D. argument is valid, I suggest that it would be an excellent thing if all E.C.G.D. insurance went through brokers. The underwriter knows his broker and the broker keeps his underwriter straight. The broker-underwriter system is an excellent system. If a system of broker-underwriter could be solely used, I think it would be an improvement. As it is, the whole onus of knowing the client can fall on to the officials of E.C.G.D., which is perhaps not fair. A small firm's overdraft facilities from its banker, in the ordinary way of business, are based on its creditworthiness; it may have a product which it can sell in vast quantities abroad, yet its trade is limited by its overdraft facilities, plus E.C.G.D. cover. If it is turning over its capital two, three or four times a year, the 15 per cent. which E.C.G.D. will not cover might represent 80 per cent. of its total capital; and if we came into a bad time like 1929, a lot of small firms might be completely bankrupt, and today should be looked upon as over-trading if they are doing too much export. If we could insure the whole risk, it would relieve a lot of people's minds.

6286. *Professor Sayers*: Why do you take notice of the argument that the risk must be shared by the insured? Everywhere one finds advertisements in which the insurance people are saying: "You must insure your house fully; are you fully insured?" No one could pretend for a moment that this is an old axiom of insurance. Why do you not quote these advertisements to the E.C.G.D.?—*Chairman*: The E.C.G.D. may have meant that it was an old principle of credit insurance?——Yes. I am very glad that you are with me on that.

6287. *Sir John Woods*: Assuming that is what was meant, and that it was an original principle of E.C.G.D., the reason was to prevent fraud. Is that what they said?——If a firm was selling spring fashion frocks to America some had got past their season and had to be scrapped, the firm could ship all these goods out, and get an E.C.G.D. cover and claim the cover on the lot. If there was a broker between, he would know the client; the broker would help E.C.G.D. in this. They would soon sort out the chaff from the wheat.

6288. *Chairman*: You suggest that the outstanding risk, the 5, 10 or 15 per cent., should be covered by a supplementary policy. Is there any point in dividing it into two policies?——*Mr. Griffith*: No, I do not think so; but I think that extra 15 per cent. is worth a little more premium. —*Sir Edward Thompson*: On the bigger contracts another point comes in. With a complete scheme we have to put the plant into commission and guarantee the proper performance. In any case we should probably not get paid until the plan was built and working, and we may get 5 per cent. or 10 per cent. carried over for two years as retention money; the manufacturer has to carry that on top of everything else. But the E.C.G.D. look upon this extra 10 per cent or 15 per cent. as profits.

6289. *Sir John Woods*: The principle is that they insure a contract, and they assume inside the contract a 10 or 15 per cent. profit?——*Sir Edward Thompson*: I think that is so.—*Mr. Griffith*: In a manufacturing industry, what is a profit? I might sell goods in February and I might have a very bad second half year; although I might say I had made 20 per cent. on the goods I sold in February, by the end of the year I should have made a loss, because of the spread of overheads.

6290. *Chairman*: What is there wrong in your insuring that element in the contractual sum that represents the profit on that particular transaction?——*Sir Edward Thompson*: We have to build up our estimates and our prices at the beginning of the year, and we have to base those prices on what we estimate our output will be in that year. We have a break-even point. If trade drops, what we had estimated as profit is no longer profit, and may indeed be a loss. So although E.C.G.D. may say they are not prepared to insure profits, it is not necessarily a profit; it is a margin.

6291. *Sir John Woods*: I have one further question about this 15 or 10 per cent. Is it the practice among manufacturers, where they have to carry the credit risk, that they correspondingly load the price in order to protect themselves against the 15 per cent.?——*Mr. Griffith*: So far we have always been able to add the insurance risk to our price; but that is not the point.—*Sir Edward Thompson*: We have to cover the premium, but I doubt if we can afford to cover the extra 15 per cent. if we are going to get the job.

6292. *Chairman*: It would not be a regular element in costing the contract?——No.

6293. *Professor Sayers*: In paragraph 3 there is a suggestion that, where long-term finance facilities are granted for five to seven years, movements in the Bank Rate can absorb a material proportion of the profit margin. Is that necessary? When you get long-term finance facilities,

can you not get them at a fixed rate of interest?——*Sir Edward Thompson*: That fixed rate of interest is based on what the Bank Rate may be at the present time.—*Mr. Griffith*: One cannot have a bill of exchange with a life of more than three months.

6294. *Professor Sayers*: I agree, but are there not plenty of other ways of getting finance?——*Sir Edward Thompson*: For most people the point of E.C.G.D. cover is to be able to negotiate a bill of exchange. One has to go to the bank every three months to re-negotiate a bill of exchange, and pay another lot of stamp duty.

6295. *Chairman*: When you are talking about long term finance facilities, the facility may take the form of a bill of exchange which is renewed every three months?——Yes.

6296. *Professor Sayers*: There seem to be considerable disadvantages; why not get a bank advance?——*Mr. Griffith*: On a big contract, yes; but when one is selling goods one cannot do it; one must have a bill of exchange signed by a customer abroad, which one discounts.—*Sir Edward Thompson*: I should like to put a point for the smaller manufacturer. Many small engineering firms in the Birmingham district have potential export capabilities. Our Association is trying to get together some joint selling organisation to help those people; but they are not in the same position as the big firms to know how to get finance. If credit finance could be made easier for those smaller firms which form a very large proportion of the engineering industry, I am sure we could not only maintain but increase our exports.

6297. *Sir Oliver Franks*: Is that an argument for having a branch of the Export Credits Guarantee Department in the Midlands?——*Sir Edward Thompson*: I think they have one at Birmingham; but I was thinking generally.—*Mr. Griffith*: A broker system would cover that.

6298. *Professor Sayers*: A broker system would not cover the point about the interest rate?——No, it would cover the point of the 15 per cent.

6299. *Chairman*: In paragraph 4 you are suggesting the creation of something on the lines of an export finance corporation.—*Professor Sayers*: You say: "it is felt that, given encouragement, it should not be beyond the ability of the institutions of the City of London to form such an organisation". Why should any encouragement be necessary, if this is a real need towards which people would be prepared to pay? Should not the City of London be capable of finding sufficient enterprising people to set up such an organisation in response to the demand for it, without any encouragement?——*Mr. Griffith*: Without encouragement they have not done it.—*Sir Edward Thompson*: We are pointing out the need for it and for seeing if it could be done as soon as funds are available.

6300. *Chairman*: Is the difficulty behind it that such a thing has been positively not encouraged by the authorities, on the view that this long-term finance is not a thing we can afford?——*Mr. Griffith*: If one had a corporation on the lines of the Export-Import Bank or the German A.K.A., with re-discounting facilities through the Bank of England, there might be adequate finance for industry. Another very interesting suggestion was made by Sir Francis Glyn about six months ago, that perhaps the finances of the insurance companies, backed by Government guarantee, could be used to finance this organisation. Another interesting thing happened during the last fortnight: the London County Council and the Manchester City Corporation are going to go into the markets to buy equity shares. Other corporations will probably do this, and there will be a general permanent lock-up as the years go on of more and more of the best equities; that in itself would be inflationary. The other big buyers of equity shares are the insurance companies. If one counter-balanced the anticipated purchases by these Corporations of equity shares, by encouraging insurance companies not to go solely to the market but to make some of their finance available to the Export Finance Corporation suggested, it might be a source of finance which it is suggested is not available to the banking channels of the City of London to-day.

6301. You say in paragraph 5 that the E.C.G.D. has given a very fine service?——*Sir Edward Thompson*: Certainly, within its limits.

6302. Then you stress quickness of movement as being important and not always available. The next points we have already covered. In paragraph 10 you say that a quite small item can last twenty years. Is there anybody who would get 20 years' credit?——*Mr. Griffith*: No, we were not suggesting that period of credit. The point is that the size of the thing should not have any relation to the credit worthiness of it.

6303. Is there anything you want to enlarge upon in paragraph 13?——*Sir Edward Thompson*: I have in mind a large power station contract for Australia, where we had special banking facilities and E.C.G.D. cover; we could not get E.C.G.D. cover for the part of that contract which was specified and had to be supplied from Germany. If it was a small article, forming part of a machine, which was shipped here from Germany and then shipped abroad, we should get the cover, but where it is part of a large contract which has had to be made and shipped direct from Germany to be built up on a site in a country abroad, the E.C.G.D. will not give us cover for the goods made in and shipped directly from Germany, although we should be responsible for the whole contract.

6304. Is there anything else on the paper?——On the point of business subsidiaries in paragraph 12, it may be rather difficult to suggest that E.C.G.D. facilities could be arranged on a reciprocal basis in non-Commonwealth countries; but in the Commonwealth it might be helpful for the wholly owned subsidiaries of British firms. These overseas subsidiaries of British companies are a great advantage in the sterling area, and if their trade with foreign countries could be assisted in some way it might be a help; but perhaps that is rather outside the scope of this inquiry.

6305. Is there anything else you want to raise?——*Mr. Griffith*: It is probably beyond the scope of this Committee, but I do suggest that, if gold was re-valued it would solve most of these problems. I should also like to draw your attention to the terms of a recent offer, which I have seen, from the Export-Import Bank to a client abroad. Firstly exporters can be granted a line of credit not exceeding $10 million in any one year, which can be extended outside the country to distributors. If I were in New York that would give me $10 million which I could pass on to distributors abroad, and they could pass it on again to their clients. Secondly, they offer better terms than France and Germany, who are giving five years. They charge 2 per cent. per annum interest on the amount guaranteed, 1½ per cent. on the amount guaranteed as service charge on transactions maturing from one to three years, 1¾ per cent. from three to five years. It is interesting to know what one's "enemy" is doing.

6306. *Sir John Woods*: There is the point on the other side, that normally in respect of any particular activity they do not advance more than 60 per cent.; the other 40 per cent. has got to be found somewhere?——*Mr. Griffith*: They will give an all-risk guarantee up to 75 per cent. of the balance remaining after the 20 per cent. down payment.—*Sir John Woods*: That is 60 per cent. of the total.

6307. *Chairman*: Is it your experience that this bank does not cover anything like as large a percentage of the risk as E.C.G.D.?——*Mr. Griffith*: I think E.C.G.D. gives better cover, but on the other hand it is rather nice to be given an omnibus lump sum and get on with it and do what you like.—*Sir Edward Thompson*: E.C.G.D. is an insurance.

Chairman: I think that completes our questions: we are very much obliged to you for your attendance.

(*The witnesses withdrew.*)

J. R. MEAD, Esq., J.P., Chairman, Taxation Committee, BERTRAM NELSON, Esq., C.B.E., J.P., Member, Taxation Committee, and DAVID GRAY, Esq., Secretary General, representing the Engineering Industries Association, called and examined.

6308. *Chairman*: If you would have your memorandum* in front of you, Mr. Mead, we will work through it, and see what questions arise: if there is anything you want to enlarge upon from your own side, you are at liberty to do so. Would you first tell us briefly what purposes are served by your Association?——*Mr. Mead*: The Association was formed in 1940 to deal with problems of excess profits tax and other problems arising from direct taxation and the finance of war production. It has expanded in its terms of reference since then. The Financial Problems and Taxation Committee, of which I am Chairman, deals very largely with direct taxation problems and such things as purchase tax and the like. There are other branches of the Association's activities, such as mutual transfer of capacity and technical problems; it is not a sectional association. There are sectional trade associations, for nuts and bolts and machine tools and all that sort of thing, but the E.I.A. comes between those sectional associations and the large national associations which cover industry as a whole. We try to cover the whole of the engineering industry in all its aspects.

6309. By what method are you able to obtain the views of your members on a subject of this kind? Do you have regular meetings of representatives, and send out questionnaires?——Yes. The Association is divided up on a regional basis; the regions coincide with those of the Ministry of Supply. That is a structure which originated during the war. The regions are sub-divided into groups; there are 17 in the Metropolitan area alone. As a source of information we circularised a questionnaire, but we got a rather limited response.

6310. When did you send the questionnaire round?——In November, 1957. The response was not large enough for us to tabulate the results in an elaborate form, but views have been conveyed to us on quite a large scale from group meetings through group secretaries to regional secretaries, and collated at regional level. We feel therefore that we have been able to form a fairly reliable overall view of our members' experiences on the various matters dealt with in the memorandum in that way.

6311. In paragraph 2 you open by saying:

"The 'Credit Squeeze' has led many engineering businesses (particularly small and medium sized businesses) to postpone or cancel plans for new plant and for the expansion of sales."

How much is that built up out of the factual information you have been able to collect?——*Mr. Mead*: It is based on the proportion of complaints, if that is the right word; on the apprehension which members have expressed. That is one of their leading apprehensions. When you ask people these questions they are always rather loth to be specific, and my personal view is that this postponement or abandonment of expansion schemes has been caused rather through psychology. They are schemes that have probably never in fact commenced to be embarked upon. A member is inclined to say to us: "If it was not for taxation, or the difficulty that I foresee in getting the money to do the job, I would have done so and so; but with taxation being what it is and the bank being cagey about lending me any money for so and so, the whole thing is not worth while, so I did not pursue it." Would you agree, Mr. Nelson, that there is a lot of psychology in this?——*Mr. Nelson*: Yes.

6312. The credit squeeze in the ordinary sense covers a period of years. You are using it in that sense?——*Mr. Mead*: Yes.

6313. Do you think the impression you convey here has been one which is cumulative as the credit squeeze has tightened, particularly after 1957?——I would say so. The pressure which has been put on recently, which has received a wave of publicity, has rather caused these apprehensions to come to light. The very appointment of your Committee, and the publicity that has attended it, and the questionnaires that have gone round from various sources, have highlighted that.

6314. *Professor Sayers*: Would you have written this first sentence in such a document as this in 1955 or in the first half of 1956? The banks were under very strict instructions at that time, and interest rates had already risen quite a way; and the credit squeeze was much talked about. Had you at that time any such impression of postponement or cancelment of plans?——A far less strong impression than recently. In 1955 and 1956 the credit squeeze had been in existence for a time, and I think the initial excitement had died down; it had come to be rather an accepted thing and its significance had relaxed somewhat.

6315. But in 1955 and 1956 it intensified so far as official announcements and action were concerned?——In 1955 there was, as you say, an intensification, and the credit squeeze was a topic of discussion. But there is a tendency always for these things to die down. Possibly it was by early 1957 that the engineer had become rather used to the credit squeeze, and found it not such a disastrous measure as he originally thought it might be.

6316. *Professor Sayers*: By "dying down" do you mean that they were getting money more easily?——No, not necessarily; but on the whole a slight relaxation was experienced. Then, of course, the brake came on again suddenly and heavily in 1957, and possible projects people had begun to think about during this period of what seemed to be slight relaxation were scotched again. That, I think, is the practical experience that our members are trying to put over to us.

6317. You are saying in effect that the projects that are postponed or cancelled are projects that are at the moment still only very vague intentions, and that in the realm of capital development vague intentions take a lot of time to mature into definite plans and still longer to mature into actual work, such as putting up buildings?——Yes.

6318. Does not that seem to suggest that the intensification of the credit squeeze in 1957 would be affecting activity in 1959 or 1960, rather than in 1957 and 1958?——Yes, I would agree with that.

6319. The quick effects on economic activity were negligible, so far as your experience was concerned?——Yes.

6320. *Chairman*: The credit squeeze has consisted of measures taken, appeals issued and directives given. Could you, from your experience of your members, say which of those things you think has been the more important one in having this effect upon capital plans?——I think movements in interest rates have on the whole had less effect than the actual availability of bank finance. The difference between 6 per cent. and 8 per cent. on a bank overdraft is not a good thing, but I feel the engineer, if he was keen enough and confident enough in expansion, would say that the extra 2 per cent. was chargeable for tax anyhow, and that he would have to get that back off the customer. I do not think that is good economics.

6321. *Professor Sayers*: You say "keen enough" and "confident enough"; are there not some men sometimes who are not quite keen enough to do it when money is going to cost them 10 per cent., but are keen enough to do it if it costs them only 6 per cent.?——Certainly.

6322. One in a hundred?——There would be quite a big stratum of those marginal cases.

6323. So the interest rates might affect a small percentage of people?——Yes.

6324. At what level does it begin to affect them at all seriously? Does it affect people all the way up the scale, or is there some level at which they really begin to sit up and take notice?——One tends to talk about interest in terms of paying 5 per cent. on one's money. That, of course, is cheap, but it was not cheap before the credit squeeze started, when one could borrow money from the bank at 5 per cent. I think an engineer will begin to think about the cost of his money when it goes over 5 per cent.

6325. *Lord Harcourt*: Is that largely because 5 per cent. on his money is a standard allowance when he is costing?——*Mr. Mead*: It is rather a bold statement, but I would say so.—*Mr. Nelson*: I think that there are perhaps two factors in the Bank Rate position. The first depends entirely on what section of the engineering indus-

* Memoranda of Evidence Part VII No. 6.

try one is looking at. Where capital costs are important in relation to total costs, a change in the rates of interest is more significant. For an engineer making anything in relation to nuclear energy, where labour charges are low and capital costs are high, a change in the rate of interest may make a project quite impossible, because the cost of his capital determines whether it goes on; the high rate of interest completely stops development, since that rate of interest is one of the main elements of his cost of production. The second element, which is reflected in all sections of the industry, is that a high interest rate may be taken as a danger sign, and may, therefore, warn people from going ahead too actively with the development programmes.

6326. *Professor Sayers*: This is what your members say?——Yes. The first element depends on which section of the industry you are looking at.

6327. *Chairman*: Is there some level of interest above which it begins to be regarded as high?——Anything over 5 per cent. is regarded as high, perhaps exceptional.

6328. *Sir Oliver Franks*: Was it not the case in the North of England during the second half of the nineteenth century and the early part of this century, that whatever the Bank Rate one on the whole paid 5 per cent. for one's money to the bank? It was only when the Bank Rate went really high that people were called upon to pay more, but they never paid less?——*Mr. Mead*: I think that is so historically. When I first began to know anything about interest rates as a junior articled clerk I always thought in terms of 5 per cent.

6329. *Chairman*: Are you thinking about between the wars?——Yes.

6330. You were comparing the effect of interest rates as part of the credit squeeze with the availability of credit?——Yes. From the information that we have received from our members the availability of credit exercises their minds to a far greater extent. This arises because for the small and medium sized firms who predominate in our Association their source of extra money for a long time past has been the bank, and their imagination has not extended very far beyond that. The provision of capital for fixed assets is not a function of banking; we, as an Association, recognise that and approve it. But the fact remains that, particularly in times of prosperity, profits earned have repaid existing overdraft facilities used for trading and thus released those facilities for fixed asset investment. In times outside the credit squeeze the engineer has been used to going along to the bank, and collecting the odd five or ten thousand pounds for his factory extension, in the knowledge that he will be able to amortise it out of the fruits of that extension within a reasonable time, and the banks have been prepared to accept that point of view.

6331. They have left him in possession of that line of credit?——That is right.

6332. *Sir John Woods*: What is a reasonable time in practice? How long would you expect before repaying to the banks?——I would say five years; if one can amortise on a 20 per cent. basis, one makes good use of the capital investment and derives a proper return from it. A high level of taxation on profits rather actuates against that amortisation, but between the wars the five year amortisation, with direct taxation at a lower level, was a fairly good speculation.

6333. *Professor Sayers*: When we began on this point you were saying that before the credit squeeze the banks used to be prepared to play on the basis of a period of years. Are you saying that five years is the sort of period on which the banker would play?——Prior to the credit squeeze directives he would have played on a longer period. Five years was the period which I think the engineer would have hoped to amortise over. I seem to remember banks saying: "You can have £10,000, which we shall expect you to repay at the rate of £1,000 a year." I believe that actually happened.

6334. *Chairman*: Are we to think of medium and small sized engineering businesses as normally equipped with a bank overdraft?——Not by any means all of them. There is a varied cross section among those types of firms within my own experience. There are a tremendous number of small and medium sized engineers who rely on a bank overdraft and always have done; and with high taxation they have never been able to extricate themselves from that position by the time the working directors have drawn an adequate remuneration. But it depends on the original structure; I am a practising accountant in the Midlands, and there are still plenty of family engineering companies among my clients who have a credit balance at the bank.

6335. And who would not expect to resort to the bank for loan facilities?——No; but it is not always the company that has the credit balance at the bank who wants to be the most progressive as regards expansion. One tends to find that it is the man who has the overdraft who wants some more to do some expansion.

6336. Is there nothing which determines how a company likes to be financed except its history and structure?——Not entirely: there are technical considerations. You might have two engineering firms doing similar work and the same volume of work, one working on free issue material and the other having to buy its own. The firm that has to buy the castings and machine them wants far more working capital than the firm that has been provided with the castings which it machines. The difference in the amount of working capital requirements of two firms who employ the same number of people and pay the same amount of wages, earning the same amount of profit, can be amazing.

6337. *Professor Sayers*: Has the business of free issues changed at all in credit squeeze times?——*Mr. Mead*: Somewhat, as we say in paragraph 17; but I would not say that it has changed a lot. I have not come across much experience of changes; have you, Mr. Nelson?—*Mr. Nelson*: No. There does not seem to be any appreciable change in that.

6338. It is a way in which a firm could push its own credit squeeze problems on to somebody else?——*Mr. Mead*: It is certainly a way in which it can be done.

6339. But is not?——I do not think a lot. The people who issue are usually the larger firms, and it would be dangerous for them to try and shift the financial burden to a small sub-contractor who might lose production.

6340. *Chairman*: In and out of the engineering industry there are firms that habitually look to the bank for finance for development, expecting to be allowed between five and twenty years in order to repay the finance provided. Over the last few years there has been a restriction on availability of credit. You say that has made an impact?——Yes.

6341. *Professor Sayers*: You say the thing which has made most impact is the refusal of banks to supply permanent capital?——*Mr. Mead*: Yes.—*Mr. Nelson*: Many a firm comes to the bank with the knowledge that if a new line starts up that inevitably means more working capital. Many firms can manage capital out of their own resources, but in the past they felt that if they were successful with their sales they could go to the bank with the certainty of getting temporary overdraft facilities. Now there is more uncertainty about the facilities being available, the feeling being that with the credit restriction it is not possible to plan big developments with the certainty the bank will help.

6342. *Chairman*: Do you think that either of these elements, the interest rate or the restriction on the availability of credit, has been as important as a general feeling that the level of trade was going to be lower owing to the operations of the credit squeeze?——They came at different times; the anticipation of recession came much later.

6343. *Sir Oliver Franks*: Would you say that people began to take the possibility of a recession in trade quite generally into their thoughts, so that it affected their outlook?——*Mr. Mead*: The average small and medium sized engineer has very little knowledge of the national economy; he does not study the financial press daily; he reads the popular press. In July last, before the rise in Bank Rate, reading the popular press he would have judged that we were in a boom period; he would not have realised that there was any danger around the corner, and was probably in a frame of mind to consider expansion schemes, and to go out and try and get the money at the then rate of interest, and push his business along at full pressure.

6344. When did they begin to think recession was possible?——September was the first time that in going

round the country I heard suggestions from members that there might be the beginnings of recession.

6345. It is difficult to disentangle the effect on people's expectations of the Government measures announced in September from the effect of their own reflections on the course of trade in the world and in this country. How far could you disentangle the times at which these different lines of thought came into play?——It is very difficult, because I do not think that the majority of the smaller engineers would be clear in their own minds as to what actual factor had encouraged them to make this statement. My own feeling is that the impact of the increase of the Bank Rate had made most of them think more closely about this matter, and there might have been at the same time on the fringes of the big industrial areas the beginning of a slight recession anyway.

6346. If you look at the general figures for all industrial production over the period from last September to now, they have been almost stationary and any movement has been a tiny rise; so that broadly things were good and they stayed good. On the other hand at some point in last autumn I suppose a number of people began to become aware that things were not quite so good on the American continent?——*Mr. Mead*: That is right.—*Mr. Gray*: I think that so far as medium and small engineering firms were concerned there had been what the Prime Minister described as good times, and that there was some time in August and September last year on the fringes of the industrial areas (taking the London area, for example, in places like Poole, Bournemouth and Southampton) a slight steadying. It certainly could not be called a recession; but there was more thought about where the next job was coming from.

6347. That was already happening before September 19th?——Yes.

6348. You have referred to the London area and points south-west. Mr. Nelson, you are probably more directly acquainted with the north-west; do these remarks bring any echo in your mind, or was the experience different in the north-west?——*Mr. Nelson*: It varies very much from section to section in the industry. The machine tool industry will begin to think about a depression rather before the manufacturer of consumer goods. I think that there are no precise data which would enable one to say that there was a sudden change of atmosphere.

6349. Can you point to any evidence of the softening of the boom psychology?——A dramatic change came, I think, with the rise in the American unemployment figures.

6350. That was considerably later?——Before that certain sections of the engineering industries, such as the radio and television industry, were beginning to wonder about future orders.

6351. Has Mr. Mead any comment for the Midlands on this particular point?——*Mr. Mead*: Mr. Nelson has mentioned machine tools; the Midlands are concerned there. The impact on the machine tool industry in the last six months has been severe. They are making capital equipment, and the accentuation of the credit squeeze, following upon the rise in Bank Rate and its effect on expenditure on capital equipment, has been most marked in its impact on the machine tool trade.

6352. *Chairman*: Had not the machine tool order books been declining for some years?——They had been levelling off; now they have gone below that datum line on the graph. That would appear to be due to this curtailment of capital expenditure. Although the overall national production figures have remained fairly level it is our apprehension as the Engineering Industries Association that that productive level is being maintained without the requisite modernisation of plant taking place. We come back to the remarks that we made earlier: an important part of the impact of the credit squeeze process is not felt immediately; it is going to be felt in 1959 to 1960. We have tried to express in our report that we are apprehensive that this country, through too long a continuation of the credit squeeze as it affects fixed capital, is going to damage its productive efficiency.

6353. *Professor Sayers*: The decline in the order books of the machine tool industry has been going on for some considerable time; in what month in 1957 did the machine tool industry begin to think that the shortening of order books was perhaps going rather far and that difficult times might be lying ahead?——I would say that severe apprehension coincided more or less with the Bank Rate increase.

6354. *Sir Oliver Franks*: Coincided or was caused by? How far do you recollect opinions expressed to you by your clients and others actually operating in the engineering industry?——*Mr. Mead*: I think that there had been a considerable slowing down before September last, which was accentuated by the crisis in September.—*Mr. Nelson*: Up to September there was, perhaps, an inquiring mind about the possibilities of recession rather than an acute anxiety; with the monetary measures taken in September there was some decline of activity.

6355. *Professor Sayers*: What had you in mind in using the phrase "and for forming a queue of eligible borrowers" in paragraph 9?——We had in mind that if any body, public or otherwise, desires to get capital on the market, it has to go through a procedure of being marshalled into a queue.

6356. Is this true of the medium and small sized engineer?——Not of the small engineer. We say here: "The decisions of the Capital Issues Committee generally affect only the larger manufacturers". Of course there are side effects which affect the small manufacturer; there is a genuine shortage of savings.

6357. Have you heard of any larger concern being put into a queue of eligible borrowers?——Yes. There is no question about that. I can assure you there are well known cases where public authorities have had to wait.

6358. *Chairman*: What sort of body do you mean by public authorities; the local authority?——That type, or public boards of one kind or another.

6359. *Sir John Woods*: You are not implying that the forming of the queue is a function of the Capital Issues Committee?——No, but the shortage of savings has a bearing on the Capital Issues Committee. The forming of the queue is done by the pressure of would-be borrowers.

6360. *Chairman*: On hire purchase, I want to see how much of your experience from your members lies behind this, in paragraph 11:

> "Frequent alterations of policy have had catastrophic results. They have caused violent fluctuations in the demand for finished goods, and these fluctuations have interfered with the smooth flow of production . . ."

Have you observed results which can be described as "catastrophic", or is that rather a vigorous way of approach?——It is a vigorous term, derived from a vigorous member of the association who is purely an engineer.

6361. What is his business?——Domestic heating appliances.

6362. What has happened to justify the general statement that "frequent alterations of policy have had catastrophic results"?——*Mr. Nelson*: The effect can show so much more rapidly than the effects of other monetary measures. The Bank Rate and credit restrictions take time to work out; but when hire purchase terms are altered, producers lose a lot of their sales and may get stock coming back from wholesalers and retailers.

6363. Are you speaking of purchase tax or hire purchase restrictions?——*Mr. Nelson*: Hire purchase restrictions.—*Mr. Mead*: The same applies to movements in purchase tax.

6364. You have observed among your members that when there is a change in the terms of repayment or the amount of deposit required, that has an immediate effect on the producing side?——*Mr. Nelson*: Yes. The effect may be temporary: when the public gets used to it, they may resume buying. But for the time being a change in hire purchase restrictions has an effect much the same as a change in the rate of purchase tax.

6365. Have the effects proved to be temporary in your experience?——*Mr. Mead*: Sometimes, yes. The hire purchase restrictions have been varied either way fairly frequently, so that the reactions are temporary; they tend to wear off, in my opinion. If the housewife, say, is suddenly asked to put down 40 per cent. on something tomorrow morning, she cannot stand that and she does not buy it. If it is still 40 per cent. three months later she has another talk with her husband. These dislocations tend to smooth out after a time, but they are quite violent when the alteration takes place. There is another aspect

of this hire purchase question: owing to the shortage of fixed capital facilities which we have been talking about, engineering firms have resorted to hire purchase for the acquisition of machinery.

6366. On a large scale?——On quite a large scale. As you probably know there were a number of hire purchase companies who acquired liquid resources as a result of nationalisation and have applied those resources to hire purchase facilities in a big way.

6367. You mean the wagon companies?——Yes; and the small and medium sized firms have used those companies to a very great extent. So the hire purchase restriction alterations have had an important effect on the capital equipment as well as the consumer goods industries.

6368. *Professor Sayers*: So that if the Government is looking round for measures that will have a quick effect while other measures are getting going, these have considerable attractions?——*Mr. Mead*: I would say so.—*Mr. Nelson*: I should not have used the word "attractions".

6369. From the point of view of getting those effects they are attractive?——*Mr. Mead*: Yes.

6370. *Chairman*: You have seen these dislocations on the producing side; have you seen disastrous effects in the sense that concerns have gone out of business because of this, or does it pick up after this awkward pause?——I cannot recall a case of a firm going out of business, but I have seen dislocation of sales caused through this reason, and the consequent piling up of stocks all along the chain from the manufacturer to the retailer. The retailer's stocks rise, and he cannot buy: therefore the wholesaler's stocks silt up, and he cannot buy: and so the manufacturer gets tied up. It has absorbed financial resources which might otherwise be available for capital projects.

6371. *Professor Sayers*: To the extent that it causes financial strain at all these stages surely it is not causing effects on production; if the two things are complementary, the more pressure there is of increasing stocks the less is production being interfered with by these measures. You cannot say that there is a double effect: is it not partly one, partly the other?——I think that you are probably right; they will, of course, put the brake on the production of that particular article at the manufacturer level.

6372. But the possibility of taking it out partly in one form and partly in another helps to avoid catastrophic results?——Yes.

6373. The effects are fairly widely spread, in fact?——Yes.

6374. *Lord Harcourt*: You said just now that if, after a sudden rise in the down payment on hire purchase, the terms remained the same over a period of months, the housewife then probably talked it over with her husband and bought after all. Do you think that that decision is due to a growing familiarity with the terms, or is it that that particular family has generally put aside the money to meet the extra deposit?——*Mr. Mead*: Both, I think. They have to save up that extra bit of deposit which would take them another month or two. That is probably more important than the growing familiarity, because they are only going to pay for the thing once whether they pay 30 or 40 per cent. deposit. It is an interesting problem to consider what particular articles a family will do without altogether because of the increased difficulty of hire purchase terms and what they are determined to have anyhow.—*Mr. Nelson*: It depends if the family purse has enough surplus money to buy with the increased deposit; if so, and if they think that the restrictions are likely to continue for some time, they will not gain by waiting.

6375. *Sir John Woods*: You say in paragraph 15: "In general, industry is not aware of the very flexible nature of the facilities offered by the I.C.F.C." Why is that? I.C.F.C. developments are no doubt talked about in the Board of Trade Journal and the literature of the National Union of Manufacturers, and indeed in your own Association?——*Mr. Gray*: The Chairman of the I.C.F.C. has been kind enough to write articles for our own journal, but the fact is that the average small engineer would not read, for instance, the Board of Trade Journal.

6376. He would read your own?——He would read ours; but he looks upon the I.C.F.C. rather as high finance and is a little bit worried about it. He is not close enough to it, as he is to the bank. He understands what a banker does; but he is rather afraid that if he comes to I.C.F.C. he will be faced with a borde of accountants. The smaller man does not really understand it.

6377. *Lord Harcourt*: If the local bank manager were to recommend that he went to I.C.F.C., would he go?——*Mr. Gray*: He probably would if the bank manager took him by the hand and led him there.—*Mr. Mead*: He would take his advice; there are a number of cases where the bank manager has recommended I.C.F.C. There is apprehension among the medium sized undertakings lest they lose control. They think I.C.F.C. are going to come in and appoint a director. Nothing can be further from the truth; I think the I.C.F.C. are doing their best to counter that, and it is very desirable that that sort of propaganda on behalf of I.C.F.C. should go on.

6378. *Chairman*: Do you think that that is breaking down this position?——I think a breaking down process is going on now.

6379. In paragraph 16 you say: "There seems to be no doubt whatever that now more credit is taken and more credit is given throughout the engineering industry." From what period does that expansion of trade credit begin to date?——There has been a steady and gradual expansion over the past three years or so.

6380. Who is taking the strain? If more credit is being given and taken, somebody must be providing it?——The small firm comes off worst, in my experience, in engineering. I can say from personal knowledge that very big firms in the Midlands employing a large number of subcontractors are owing for at least one month's supplies more now than they were, say, two years ago. That is a very vital thing to the small subcontractor who relies on their cheque coming in at the due date for payment of wages and for stocks. I know small engineering men who have to go and see their bank manager every Friday morning and say: "The cheque has not arrived. Please can I have my wages?" I am sure it will come on Monday." They then have to go back to the firm and say; "Please send my cheque by Monday so that I can pay my wages."

6381. *Sir Oliver Franks*: The Government has caused the banks to reduce credit; here is an extension of credit. Are the two phenomena related or not?——I think so. I have just said that this tendency has been apparent for roughly three years. The credit squeeze was first mentioned somewhere round about that time; the extension of credit taken has coincided with the credit squeeze. A company which had bank overdraft facilities which it was using for trading realised, when the credit squeeze came into operation, that it must conserve its bank resources for fixed capital requirements, because it was not going to be able to go to the bank and get additional facilities for fixed capital requirements, and so decided to conserve resources by paying monthly accounts a month later.

6382. Is that view which you have just expressed the result of your own reflection, or is it derived from your actual experience of what other people have done?——It is derived from actual experience, in a limited number of cases with which I have personal contact.

6383. And these are the reasons which led them to act as they did then?——I have in my mind two firms who have deliberately paid a bit later because they have said: "We have got to keep well within our overdraft, as we might want £10,000 to buy some new plant."

6384. Now may I ask you a more theoretical question? I suggested, and you agreed, that over this three-year period there has been a contrary movement of bank credit on the one hand and trade credit on the other. Do you think that, if the contraction of bank credit went far enough, you would find the two types of credit ceasing to work one against the other, but coming back into line?——*Mr. Mead*: I would say not necessarily. It is a very difficult question. You are really asking me, I think, whether, a rather revised credit term arrangement having been established, that is going to be a permanent arrangement or will adjust itself through other factors. I think it may well be far from permanent; but it may well extend far beyond the time when there is an amendment in the bank arrangements. Once people are used to giving and taking a couple of months' or three months' credit, that state of affairs may well continue.—*Mr.*

Nelson: I doubt whether there is any simple answer to your question. Two or three years ago, if a bank manager said: "You must bring down your overdraft by 10 per cent", the automatic reaction to that was: "Can we take longer credit from our customers?". That was the easiest thing to do. That process has continued for a lengthy period. It all depends on the state of the market. If materials are in short supply you will pay promptly. On the other hand, if there is a recession about and your supplier wants to sell to you, in that case you can pay him late. It all depends on supply and demand.—*Mr. Mead*: The trouble was that until comparatively recent times base metals and so on were in short supply, and the small firm had to pay promptly to get the goods. That is a position that has relaxed a bit recently. Reverting to the last question about whether this long-term credit fashion would prevail, I had second thoughts while Mr. Nelson was talking. I think there is still a lot of psychology in this. I have two clients in mind who like to get their bills paid if they can pay them. One in particular has become more liquid in recent months, since Christmas; I saw the managing director only last week, and he said: "We don't owe a hill. We have paid everybody spot off." He need not have done that, because he had established two months' credit last year, but he voluntarily paid up to date. That is sound psychology, which I think is still extant in the engineering industry, and which might counter my previous answer.—*Mr. Nelson*: You may get a special reason for paying up to date: for instance the possibility of a surtax direction. There is no simple answer to the question; there are so many factors involved.—*Mr. Mead*: Discounts, of course, have a big influence on it, and the discount procedure has been very erratic in the engineering industry; at one time nobody is giving discounts, and at other times they are offering discounts to try to get the money in.

6385. That would help particularly in Birmingham, and in the Black Country, would it not, where things do move with the market all the while? It is a genuine piece of the early nineteenth century still existing?——That is right.

6386. *Chairman*: In paragraph 19 you say: "There is a general complaint that the monetary restrictions have enforced reduction in stocks in many sectors of the engineering industry. This has had to be achieved by buying supplies in smaller quantities than is desirable, at prices that are less economical."—*Sir Oliver Franks*: The statements in this paragraph presuppose that before the monetary restrictions stocks held in many sectors of the engineering industries were right, and that therefore these inconveniences followed on reducing them. Do you think that that in fact is so?——No. In certain directions they were too high, as you will know, particularly in steel. A lot of stockpiling has gone on ever since the end of the war. We have not said so here; perhaps we should have.

6387. That sort of thinning of stocks is healthy to the economy?——Yes, I quite agree; and I think that, quite apart from the general discussions round this table, there has been a settling of stocks at a more sensible level over recent years. I would not associate that too much with the credit squeeze; but there was stockpiling, which has been cured.

6388. Looking at the last few months, can you recollect, again from your experience, any particular times at which you would say the tendency to reduce stocks either began or was accelerated, or would you say that that has not happened? Up to the end of the third quarter of 1957, according to published statistics, stocks did not go down; and there does not seem to have been any decline in the fourth quarter of 1957. In the engineering industry what is your experience?——I do not think my experience would coincide with the published statistics. I would have said that there had been a tendency for stocks to reduce over a period of two years. I will not say that it goes right back to the beginning of credit squeeze, but it would have followed some twelve months later. But that may be because certain basic commodities used in the engineering industry became in less short supply and therefore this stockpiling element went out of it.

6389. Thinking of two years ago, you just do not know whether it was having to pay 5½ per cent. on money, or metals coming into easier supply?——Both, I should imagine, were contributory.

6390. That could be, but do you think that both really did?——To some extent.

6391. You think that two years ago people were paying attention to the price of money in relation to stocks in the industry you are acquainted with?——Yes.

6392. *Professor Sayers*: To the price of money as distinct from the availability of bank credit?——*Mr. Nelson*: I should doubt whether the Bank Rate had very much to do with it.—*Mr. Mead*: I come back to what I said before: the availability of money is a more important factor than the easing of supplies, but you cannot disregard either.

6393. You would place most emphasis on the difficulty about getting credit?——Yes.

6394. But not exclusively on that?——No.

6395. *Sir John Woods*: If we accept that there was a good deal of overstocking, then the reduction of stocks, buying supplies in smaller quantities, would not have these effects you mention here?——No, they would not have that effect during the period in which the stocks were being reduced from an unduly high level to a reasonably high level; but I think we would go on to say that as a result of the stringent credit squeeze conditions since September last some engineers would say that they cannot afford to carry the stocks which they would like to, even under the revised conditions.

6396. They cannot afford to carry the stock necessary for normal production?——That is right.

6397. In this paragraph you are saying that the total effect of monetary measures is tending to put costs up, which is contrary to the classic view of the situation. Would you agree that, apart from the question of stocks of raw materials, the effect of these restrictions would make everybody look hard at their work in progress and try and reduce the amount of that, particularly by pushing their production through faster?——Yes.

6398. And if so is there not a considerable increase in productive efficiency, leading, if anything, to lower costs?——Provided they can push their production through faster by managerial efficiency. But we had in mind here that you can always buy in bulk cheaper than you can buy in small quantities. Some of the manufacturers have been reduced, through lack of financial resources, to buying in small quantities and working on shorter schedules, and that goes right through the chain of subcontractors in which we as an association are so interested. For instance, one might have a subcontractor for a motor car firm who was given big orders with good runs and good delivery schedules, and he was therefore able to buy economically in bulk. Nowadays they do not get those runs; they get shorter runs, and they dare not buy the bulk quantities on the most economical terms (*a*) because they have not got the money available and (*b*) because they are not sure that they are going to get a repeat order, which will get them out of trouble if they overbuy. As a result their whole tempo tends to decrease. Through that they do not necessarily get more efficient production; they are not pushing the processes through their factory quicker. They are pushing them through at the same speed. But they are more apprehensive about the whole position, because their order book is not the same.

6399. Is it your judgment from what you have observed in those parts of industry with which you are concerned that the total effect of these monetary measures is to lead to higher costs?——*Mr. Mead*: No, I do not think so, other than through wage increases and increased prices of raw materials, which I think are outside the terms of reference of the question. I do not think that the cost of manufacture within the factory and within the control of the engineer has been affected.—*Mr. Nelson*: The short-term effect may result in at least some expenditure and lead to better productivity, but the long-term effect may be the reverse; if one cannot increase one's plant as one ought to do the long-term effect of monetary measures may be to reduce the efficiency of the industry.

6400. *Chairman*: Then we pass on to your more general comments.—*Sir John Woods*: In paragraph 29 you say: "Although these firms are willing to stabilise their profits and their dividends, it is impossible for them

to finance higher production costs if the profit margin is to be subject to limitations." Are they willing to stabilise their profits and their dividends?—*Professor Sayers*: Or did you perhaps mean 'even if'?——*Mr. Mead*: If the value of money stayed constant I think these people would be satisfied to stabilise their profits and dividends.—*Mr. Nelson*: Many firms do not expect a very great increase in profit per annum. As long as it is just about the same, they pay the same dividends, and they are content to plough the rest back into reserves for future development. But when monetary values change, then the problem gets much more difficult.

6401. *Sir John Woods*: They are content to stay in that walk of life to which God has called them; they do not look to expansion?——They look to expansion, but they are content with a fairly stabilised dividend and for any balance which is available to go either to reducing prices or into capital developments for the future.

6402. *Chairman*: Then in paragraph 31 (ii) you throw out the idea: "The main need now is probably for a body which can provide relatively small sums (say, up to £10,000) on a three to seven years loan, to aid a developing business."—*Sir Oliver Franks*: Does what is said here really fit with what you were saying earlier about the general willingness of banks, when the credit squeeze was not on, to advance money for five to ten years for capital purposes, to be repaid on a reducing basis year by year?——*Mr. Mead*: This is to replace the facility that one used to be able to get from the bank.

6403. So that, if the credit squeeze came back and the banks reverted to what used to be normal, something additional would not be required? Is that reading your thought rightly, or is it reading too much into it?——I would be inclined to agree with you. I believe there is a tendency now for precisely that facility to be obtainable from an insurance company, for buildings, not for plant, buildings; even for as low a figure as less than £10,000. Right up until this moment, for a good firm with a good project, for factory building it is far easier to borrow £40,000 than £4,000. That is my practical experience.

6404. *Chairman*: Why do you think that difference arises?——*Mr. Mead*: They do not know where to go for £4,000, because the institutions that might be interested in a £40,000 project, possibly buying the freehold and leasing it back, are not interested in the £4,000 job.—*Mr. Nelson*: Thirty years ago the small man with the well-established business, where there were possibilities of growth and considerable finance was required, would perhaps have had three or four wealthy friends who would back him; the wealthy friends no longer exist. If he goes to his bank he will get some temporary facilities, but they will not see him through. In Scotland they have finance houses to deal with this sort of thing, but these have not grown up in provincial England, and there is probably some room for the small finance houses.

6405. *Lord Harcourt*: When you talk about the rich friend, who had great and intimate personal knowledge, surely that backing was normally in the form of equity financing?——In the initial stage it would be a personal loan; and then it would probably become a private company, and he would take some equity capital.

6406. In trying to substitute a corporation for the private friend, one comes back immediately to the difficulty of the man running the business being afraid that, if he sells any of his equity to this corporation, the business may lose its family characteristics; yet I do not see how you can quite replace that by a corporation which is merely expected to make loans?——*Mr. Nelson*: I agree. The corporation must have some interest in the equity.—*Mr. Mead*: Is that not one of the difficulties underlying the propaganda about the flexibility of the I.C.F.C.? The I.C.F.C. do take equity interests in some of their projects, but I can quite see that a corporation of that kind could not in practice have an enormous number of holdings in equities in an enormous number of quite small companies who wanted £4,000 or £5,000. That seems to be a particular type of requirement that is terribly difficult to cater for.

6407. There are one or two specialised investment trust companies which have really gone out to do this very thing, and who are prepared to hold a multitude of very small investments?——*Mr. Mead*: Yes; the solution may be to extend that.—*Lord Harcourt*: It may well be a contribution towards it, if we can get that better known to the people you have in mind.

6408. *Professor Sayers*: In paragraph 32 you refer to: "a new monetary policy, a policy which will encourage higher savings." Does this mean a monetary policy which will encourage higher savings?——*Mr. Nelson*: It means a general policy.

6409. You were thinking of other measures, not monetary measures?——Yes.

6410. *Chairman*: Then on exports you make some suggestions in paragraph 36. Are not (i) and (ii) in fact existing policy and practice?——Yes.

6411. You say in (v): "Medium-sized engineering companies should be encouraged to make increasing use of promissory notes". Is not the real question who would take them? What they want is some body who will buy them from them at a reasonable discount?——*Mr. Mead*: Yes. I think the banking practice is somewhat restricted at the moment; I believe there is a restriction on three to six month notes.

Chairman: I think that concludes our questions; thank you very much, Mr. Mead. We are very grateful to you and your colleagues.

(*The witnesses withdrew*)

(*Adjourned until* 2.15 *p.m.*)

LIEUTENANT-COLONEL R. B. VERDIN, O.B.E., T.D., D.L., Deputy President and Chairman of the Executive Committee, BRIGADIER A. F. L. CLIVE, D.S.O., M.C., Chairman, Finance Committee, and JOHN WATERS, ESQ., Finance Officer, representing The Country Landowners' Association, called and examined.

6412. *Chairman*: Would you have your memorandum* in front of you, Colonel Verdin, so that we can run through it with you? We shall have a few questions as we go through, and at some points I expect you can enlarge upon it for us. The first paragraph is introductory; then in paragraph 2 you say:

"This Association is concerned in the matter of credit primarily from the point of view of the agricultural landowner, upon whom devolves the obligation to provide and improve the fixed equipment of the land. To fulfil these obligations satisfactorily the landowner needs to be able to borrow at a rate of interest which is both reasonable and stable."

This is your experience up to date, I take it?——*Lt.-Col. Verdin*: There is the fact that it fluctuates. Our complaint is that ten years ago it was 3½ per cent., and now it is 7 per cent. for exactly the same improvement; and the return we get from it under the Agriculture Act has no bearing on what we are paying for it.

6413. You represent the landowner, who is either the owner-occupier or else the person who has let out the farm to tenants?——Yes.

6414. Am I right in thinking that throughout you have found that credit is available; it is the terms that are the difficulty?——That is right. There is no complaint about the way the Agricultural Mortgage Corporation and the Lands Improvement Company operate.

6415. The Agricultural Mortgage Corporation and the Lands Improvement Company and the banks, I suppose, are your normal credit sources?——The banks do not profess to lend money for long-term improvement.

6416. Would you like to differentiate between what they profess to do and what they have done? Obviously a bank has to maintain that point of view in general, but in practice I imagine landowners have found a rather different relationship between themselves and the banks?——Yes.

* Memoranda of Evidence Part VIII No. 2.

6417. Are the Agricultural Mortgage Corporation and the Land Improvement Company easy to get at? How far are they spread with offices all over the country?——They have only got London offices.

6418. Then you say:

"The rates of interest charged by these bodies are, however, influenced by the Bank Rate in force at the time a loan is made. Both are at present asking 7 per cent., and the rate agreed when the loan is negotiated operates throughout the whole repayment period which varies between 10 and 40 years for improvement loans or 20 and 60 years for mortgage loans."

As the general rate of interest rises or falls, which may be marked by the movement of the Bank Rate, the terms which these special bodies ask for a loan rise or fall with it?——That is correct.

6419. They do not ask you to pay interest throughout the period at rates which vary with the rise and fall of the Bank Rate?——No. Whatever rate is in force at the time one instigates the loan remains good for the whole time, even if it is forty years.

6420. *Professor Sayers*: And they change their rates whenever the Bank Rate changes?——*Lt.-Col. Verdin*: More or less so; it does not automatically follow on the Bank Rate, but in practice it does.—*Brigadier Clive*: There is sometimes a slight timelag.

6421. *Sir John Woods*: Is it normally at Bank Rate? It is now 7 per cent.?——*Lt.-Col. Verdin*: No, I do not think it is fair to say that it is normally at Bank Rate. It is normally not far off Bank Rate. It is usually a little cheaper than the banks.

6422. *Chairman*: If you go to a bank for anything which looks like being a continuous line of credit you will find yourself paying probably 1 per cent. above Bank Rate, whatever it is from time to time?——Yes; at some banks it is half per cent. if you are a good client, but 1 per cent. would be normal.

6423. But from the Agricultural Mortgage Corporation and the Lands Improvement Company it is at whatever happens to be the ruling rate at the time of the negotiation of the loan, and you are fixed with that. How would you work it otherwise, without a subsidised rate of interest which would save you from the consequences of the general rate of interest being high when you took your loan?——We rather thought that it was for the financial experts to provide the answer, and for us to make the complaint that it was unfair.

6424. Why is it unfair?——*Brigadier Clive*: I am not quite sure about unfair, but I think that it is not at all economic. Suppose that I do an improvement, and I borrow the money at 7 per cent.; the rate may fall to 3 per cent. but I continue paying 7 per cent. for forty years. That, I think, is not right. But, what is more important, I would say, is that I must work out whether it is worth while doing that improvement and whether the farm can pay interest to me for that money. I may work out that I am going to borrow that money at 4 per cent. During the course of negotiations, which may take a year to get the approval of the Ministry, to get the deeds through and the plans out, I may then find I have to borrow the money 2 or 3 per cent. higher than I had estimated. Since one works on a very narrow margin, that might quite easily make that improvement impossible for the tenant to pay for. In fact I am not improving the full capability of that land, because it has become uneconomic during that period.

6425. *Mr. Jones*: What would be the difference between a landlord in the agricultural industry borrowing money at 6½ per cent. to build new farm buildings or to build a new farmhouse, and somebody going to a building society to borrow money at 6½ per cent. over a period of twenty to forty years?——I believe that with a building society the interest demanded varies roughly according to the Bank Rate; one may start at 6½ per cent. and if things go well one may find oneself later on paying less: say 3½ per cent. That is not the case for us if we are raising a mortgage or borrowing money for a long-term improvement which has a twenty, thirty or forty year life. There is no change in that. One difficulty is that, if the rate of interest charged goes up during the period of the paying up of that thing, and it is starting to earn money in the way of cheaper or more reasonable food, you may find you are paying 3 or 4 per cent. more for your money than the farmer can get from his farm and repay you.

6426. *Professor Sayers*: Equally, you may get the benefit of a fall in the rate?——But you do not borrow money at 7 per cent. to make improvements, because it is not possible for the tenant or the owner-occupier to get that money out of the improvement in the way of return.

6427. That is to say, a rise of interest rates against you tends to check the amount of improvement that is done?——Very definitely.

6428. *Chairman*: That is your experience in the land-owning world?——Yes.

6429. *Professor Sayers*: Is that check a substantial one? Does it mean that 5 per cent. or 10 per cent. of improvement schemes are held back?——*Lt.-Col. Verdin*: I should have said that at the moment it is fairly substantial; I think that has been shown by the evidence on the farm improvement scheme. It is remarkable, if you look at the statistics, what a small amount of money has been lent. The figures are very much less than was anticipated. From enquiries we have made it appears that the smaller owners, perhaps some of the more impecunious landowners, the people who have to borrow the money rather than get it from outside sources, are being deterred at the moment.

6430. *Chairman*: Is the improvement scheme a statutory scheme under which you get one-third grant?——Yes; a one-third grant for certain specified improvements. The high rate of interest is bound to affect it.

6431. Because the other two-thirds have got to be found?——Yes.

6432. *Mr. Jones*: With what impetus did farm improvements proceed when money was cheaper than it is now: say, up to 1954 when you would have been borrowing money at 3½ per cent. or less?——The capital invested in agriculture by landowners and farmers has not increased, although the cost has gone up, since 1949 or 1950; which shows that when it was cheaper there was more inclination to invest.

6433. *Professor Sayers*: On what grounds do you suggest that your part of the community should be insulated from the effects of rising interest rates?——That is always a difficult one to answer; it is because we have to commit ourselves for that large number of years, and because there is no known way at the moment of recouping the cost. Whether we borrow the money at 3½ or 7 per cent., the only increased rent we are allowed on our capital is the increased rental value of the holding due to the improvement. But the increased rental value does not differ at all according to the rate of interest charged. In the farm price review farm prices are fixed, as you know, after the costs of the industry are assessed, and among the costs of the industry is an item "Rent and Interest". That "interest" does not relate to mortgage interest in any way at all; it only relates to the farmers' trading interest, that is, interest on overdrafts. All mortgage interests (that is all owner-occupiers' interest on money borrowed to buy their farms, or landowners' interest on money borrowed to make improvements) is compensated in the rental figure, which is merely assessed according to the amount the tenant farmers are paying in rent.

6434. *Chairman*: When you make an improvement which is going to vary the tenants' rent, how is the new rent fixed? Is it by arbitration?——It is nearly always agreed, but if we do not agree it goes to arbitration, and the arbitrator is instructed to fix the increased rent due to the improvement as the increased rental value of the holding. That really means the extra value in farming the holding with the improvement that has been made. It is the value to the holding; not to the owner or occupier, but to the holding.

6435. *Professor Sayers*: You have explained the circumstances that render you exposed to the effects of changes in the rate of interest, but you have not explained why you should be insulated?——We feel that we should be insulated because we can be compelled to carry out these improvements. If rates of interest are high the ordinary private individual need not spend money; he can wait until there is some favourable time. But we have Part II of the Agriculture Act, which can be used

to compel a landowner to carry out an improvement. This has been in existence but has very seldom been used against the landowner; it has achieved its object by persuasion in most cases. On the whole it has not worried us a great deal; but there is a new clause in the Bill at present before Parliament, which is to take the place of Part II of the 1947 Act, which gives the tenants the right to go to the Agricultural Land Tribunal, and the Agricultural Land Tribunal the power to direct the owner to carry out any improvement which is required on the holding in order to comply with any existing or future enactment; that includes all the milk and dairy regulations and the safety, health and welfare regulations.

6436. *Chairman*: You have always been exposed?——In theory we have always been exposed under Part II of the 1947 Act, but in practice it has not been very vigorously implemented. It has only been implemented when it has been a case of a bad landowner, which we would support in every way. But under this new Bill the tenant will have this power to compel his landlord to carry out all this work required, for instance, to comply with the milk and dairy regulations, without any economic safeguard as far as we can see at the moment. There is no doubt that it is going to be used a tremendous amount. Obviously, if it is a smallholding on which we may think it rather uneconomic to comply with the milk and dairy regulations the tenant is going to be very anxious that we should spend the money and is going to make many applications. If the Land Tribunal so direct, then we are compelled to carry it out, whatever the rate of interest is.

6437. *Mr. Jones*: How do you fix the rent of a farming hereditament? Do you say that the farm has so much arable land, so much dairy farming, and therefore it should be let at so much per acre? Would that include the buildings plus an amount for the house? How would you proceed, because all these are interdependent?——The rent is fixed nominally by an arbitrator. In the past the only instructions they had were "Rent properly payable". There is a new instruction which, if it goes through, will be based on the open market letting. All those things you mentioned are taken into consideration. The farm with a good farmhouse is likely to fetch a larger rent, and the buildings have some influence. But the main influence is undoubtedly the quality of the land. Considering that a very high proportion of the value of the land is contained in the buildings and farmhouse, it does not have a proportionate effect on the rent. It is the quality of the land which is the main factor in determining the rent.

6438. *Professor Sayers*: The ground on which you claim insulation from interest rates is that you can be compelled to carry out the work; is not this a reason which refers not to anything which has happened in the past but to a proposal now before Parliament?——Theoretically to what has happened in the past as well; and also we have tried to be good landlords. We come under criticism if we do not put our farms right. It is no excuse under the rules of good estate management to wait until interest rates fall.

6439. *Lord Harcourt*: Is not your complaint really that when you make these improvements you are unable, because of circumstantial restrictions on rent, to ensure that the tenant farmer pays you adequate interest?——*Brigadier Clive*: I think that is true. We borrow the money, say, at 7 per cent.; we have to add to that, to get a fair and proper return to which we are entitled under the Act, depreciation (at 30 years that takes 3 per cent.), and something for redundancy: there is always a fear that your new pigstys or silage pit or covered yard will in the course of its lifetime become redundant because of changes in farming ideas as to what is required. Finally there is the upkeep, which could mean 3 per cent. That adds up, probably, to 14 per cent. which has to be repaid as interest from that improvement. If we put in £1,000 worth of improvement, we have to get an increase of £140 from that rent; it has to produce that much more reasonably priced food. On a smallholding of 140 acres that means £1 an acre. Can the tenant find that and leave himself with a reasonable livelihood?

6440. *Mr. Jones*: Supposing that was a scheduled improvement and the landowner was required by some sort of direction to carry it into operation, would it cost you £1,000 or £666?——£666.

6441. So in those circumstances you would have to have 14 per cent. of £666 and not of £1,000?——*Brigadier Clive*: But that did not obtain until the other day.—*Lt.-Col. Verdin*: Even if we could get the 14 per cent., eventually the rental value of that farm is still the same. The fact that we got a higher rent at one moment would only mean that it would reduce the amount of rent that could be paid, so to speak, for the rest of the farm.

6442. *Chairman*: You seem to me to be saying that many of these holdings are not capable of justifying the capital put into them because you cannot get an economic return?——That is true of many of the smaller holdings on the poorer land. I was also trying to put over that a farm is only capable of paying a certain rent; it is only capable of producing a certain amount of food. It has its total rental value, which may be £1,000; and if I reckon £140 on the improvement the rest of the farm rental value is reduced to £860, but if I can get the money at 4 per cent. and need only charge 7 per cent., the return on the rest of the farm rises to £930. Even if I could always get the economic rent on what I had to spend, it would still level itself out in the end. It does not increase the rental value of the holding as a whole.

6443. That is the point which paragraph 3 is putting?——Yes.

6444. *Lord Harcourt*: In that paragraph are you talking about the rental value as would be determined by arbitration or are you talking about the rental value on the re-letting of a farm with vacant possession?——I am not talking about the re-letting of a farm with vacant possession, because we have not sufficient statistics and information to give a concrete answer on that. But although there is a very small percentage of rents that go to arbitration, the negotiated rents follow them very closely. That is one of the things that I think will come out of the Cambridge survey at the present moment being carried out on rents.

6445. So you are complaining about the arbitrated rent and not the value of the holdings in the open market; in other words, it is the statutory limitation in rents which is really the difficulty from the landowners' point of view?——Yes.

6446. *Chairman*: I do not see what the statutory limitation is?——There are the instructions to arbitrators. Theoretically it should not be different whether it is done through an arbitrator or open market letting, and it may be that it is not; we have not sufficient statistics to give a definite answer.

6447. If the current return on investment in farming land and buildings fluctuated with the current return on other forms of investment, so that it went up and down with the current rate of interest, is there anything in the statutory requirement about the return from the holding which would stand in your way?——No, I suppose that is correct. But in practice it does not allow the tenant to pay any more because it has been taken into account at the price review. These fluctuations in the assessment of farm costs are not being taken into account.

6448. *Mr. Jones*: Is there an arbitration after every improvement scheme has been carried out?——Remarkably few, because up to date landowners have in most cases probably not carried out improvements unless they have agreed the rent with the tenant first.

6449. *Lord Harcourt*: The agreed extra rent will not be 14 per cent.?——*Brigadier Clive*: Nothing like it.—*Lt.-Col. Verdin*: Of course there are tax rebates, which do help in practice.—*Brigadier Clive*: The normal figure charged in my part of the country, which is Herefordshire, is round about 8 per cent. No farmer would dream of paying more than 8 per cent. no matter what the landlord does; and that hardly covers the cost of borrowing the money.

6450. *Chairman*: Who makes up these Arbitration Tribunals?——*Lt.-Col. Verdin*: At present the Lord Chief Justice appoints the arbitrators, but under the new Bill the Lord Chancellor is going to do so.

6451. What sort of realm are they drawn from?——All the related professions: surveyors, land agents and auctioneers. But that is not quite the point we are making here; it is the way of assessing the rent and interest figure in the price review that we are complaining about.

6452. *Lord Harcourt*: Is it your experience that, once there have been one or two or three arbitrations in a district, that will tend to fix the rental value of land in that area for a considerable time, irrespective of what condition the other farms are in?——Undoubtedly. Most people know the results of arbitrations, and they fix their rent according to what they think the arbitration would have been if it had been on their farm. I think they follow the pattern set very closely.

6453. *Mr. Jones*: Supposing you had got three farms equal in area and equal in quality, but not similar in farm buildings and modernisation, would the Arbitration Tribunal in dealing with those three simultaneously be likely to fix the same standard of rents for the whole three?——No. The one with the worst building would be set lowest. Good buildings would tend to increase the rent, but nowhere near by the amount of the interest that would be payable on the cost of carrying out similar work on the other holdings.

6454. Are rents fixed on land, including buildings and the house, or are they fixed separately on land and buildings and house?——They are fixed simultaneously on the whole lot; there is just one rent for all three. As I said earlier, the question of whether the buildings are good or bad is not nearly sufficiently taken into account in fixing the rents.

6455. In calculating what the tenants have to pay, do arbitrators make a build-up on the basis of the economic value of the land, on the basis of the economic value of the buildings and on the quality and type of house?——A number of arbitrators have told us how they arrive at the rents. Most of them have some sort of system: so much for the farmhouses, so much for the land, and then a plus or minus adjustment according to the buildings. But there is no fixed or recognised method of doing it.

6456. *Chairman*: But what a holding of that size working efficiently would get out of annual farm prices and the amount of money that may have gone into any particular installation which makes up that unit are not regarded as relevant?——Not really, only that it may help the costs of production by reducing the cost of labour or possibly that of feeding stuffs.

6457. At the end of paragraph 6 you say:

"It, therefore, seems reasonable for landowners to expect protection from the repercussions of a high Bank rate."

That, of course, is a question of policy; either you have protection or else you defer the borrowing for improvement until the rate of interest comes down?——*Brigadier Clive*: Which we cannot always do.

6458. You are threatened with a statutory danger of being compelled to carry out the work?——*Lt.-Col. Verdin*: We have had threats in the last ten years but the new clause is obviously going to be used a great deal more than the one in the past.

6459. In paragraph 7 you say that the Government should give the Agricultural Mortgage Corporation and the Lands Improvement Company "some form of financial assistance so as to enable them to offer more reasonable and stable terms for agricultural loans, in particular for Improvement Loans which are such a useful complement to the Farm Improvement Scheme." By "stable" there you mean unvarying over the years?——I do not think we could probably go so far as to say completely unvarying. We have obviously passed into a very different era today from 1947. But we would not want them to fluctuate every six months or every year according to the Bank Rate. The fluctuation should be narrower than it is at the moment. We should like to see a firm statutory rate for all time; that would probably be unreasonable, but if it could be confined so that it only altered very occasionally if there was a definite change in the trend of long term interest rates that would be better.

6460. *Professor Sayers*: You are referring to fluctuations in the rates at which new loans are available? It is not a matter of fluctuations during the term of the loan? All loans are at fixed rates all their lives?——That is right.

6461. *Chairman*: And you are asking us to consider that the Government ought to make it possible for these reasonably low fixed rates of interest to be offered to landowners on improvement loan regardless of the rate at which the Government may be having to borrow money?——Yes, as regards any temporary fluctuations in rates. There is a great difference between improvement loans and mortgages. Ordinarily from either of these companies we can get a mortgage or an improvement loan. With a mortgage one can ordinarily spend the money how you like, though we have not been able to recently because there have been restrictions attached to them. We are not asking, therefore, that we should have any special type of preference with that type of mortgage. But the improvement projects have to be inspected and valued and approved by the Ministry before we can get the loan, and therefore it is very easy to confine them to prudent expenditure; it would be very easy even to confine them to expenditure necessary in order to comply with the farm improvement scheme. There would be no question of giving preferential rates for money that was not being wisely expended on loan. It could be an administrative rather than financial control.

6462. Would I be right in thinking that the kind of thing for which you borrow money under the improvement scheme is the kind of expenditure on which you would get some tax benefit?——Yes, either in a maintenance claim or a capital expenditure claim.

6463. I was thinking of a capital expenditure claim.——Occasionally you can get the maintenance claim if it is replacement.

6464. *Professor Sayers*: The element of compulsion would seem to provide a possible reason for special assistance for this improvement work at all times, and no doubt that has been considered by the Government; but why should financial assistance to such schemes be increased at a time when circumstances have made a rise in interest rate necessary? What is the reason for that suggestion?——*Brigadier Clive*: That this is a primary industry; it is in the interest of the country to provide food at a reasonable price.

6465. Is not that always so, whether rates of interest are high or low?——*Brigadier Clive*: We have been led to understand that it is even more important at the present time. We have been encouraged in every sort of way, and we are really asking that it should be made possible for us to do our job, which we can be compelled to do, which is to provide the capital for these improvements. It is much more difficult when we have to borrow at high rates.—*Lt.-Col. Verdin*: I am quite sure it would pay. There are these support prices for agriculture, costing £290 million, and on top of that this £50 million spread over ten years for farm improvement schemes; if we had a preferential rate of interest you would get the money put into the land, I believe, even cheaper than the £5 million a year that the farm improvement scheme is costing.

6466. Is not that a case for more financial assistance to farm improvement?——For a different method, perhaps: injecting through cheap credit rather than by some other means.

Chairman: I think you have put the point quite clearly for us. I think that completes our questions, gentlemen; thank you very much for your assistance.

(*The witnesses withdrew.*)

ARTHUR W. BLAIR, ESQ., W.S., Chairman, Parliamentary Bills Committee, LIEUTENANT-COLONEL DONALD CAMERON OF LOCHIEL, T.D., D.L., Member, Executive Committee, and MICHAEL LORIMER, ESQ., W.S., Secretary and Treasurer, representing The Scottish Landowners' Federation, called and examined.

6467. *Chairman*: Mr. Blair, may we go through your memorandum* paragraph by paragraph and see what questions come up? In the first paragraph you say: "Before the second world war agriculture had been—with the exception of the period of the first world war—in a general state of depression for many years"; and you draw the inference from that: "Consequently agriculture is probably more under-capitalised than any other industry". I have not always seen it stated in those terms. How do you approach a statement of that kind?——*Mr. Lorimer*: There was not the money or the profit-earning capacity in the industry to finance the capital investment that was required; during the thirties large scale capital investment in fixed equipment of agricultural land was not justified on economic grounds.

6468. You mean that one could not get a return from the land to justify putting one's money into it?——Yes; rents were low and there was no surplus out of revenue to invest, and no attraction to invest either.

6469. *Lord Harcourt*: Therefore the standard of maintenance fell very seriously?——*Mr. Lorimer*: Yes, I think so; but much was done, as I think we have said, although the money was not really there directly.—*Lieut.-Colonel Cameron*: In many cases death duties had taken such a toll that with a lot of landowners in Scotland this money just was not there.

6470. *Mr. Jones*: Was land profitable in those circumstances to the landlord himself? Was he earning money from his farm lettings?——*Lieut.-Colonel Cameron*: Not in those days, in the thirties.—*Mr. Blair*: Broadly speaking in those days the average landlord would be earning very little return indeed from his investment in agricultural land.

6471. *Chairman*: But do you think this is partly a reflection of some economic defect in the size of the holding?——*Mr. Lorimer*: I do not think so; I would say it was a general economic condition of agriculture between the wars. Perhaps the size of the holding might have some bearing on it: if you have an estate with, say, 30 small farms the percentage costs of maintenance and improvement work per acre will be very much heavier than in the case of an estate with perhaps ten large farms. The tendency now, which is being encouraged by Government policy, is to try and amalgamate these uneconomic small places.

6472. *Mr. Jones*: Would you say that the average farm in Scotland was very much less in size, and that the capacity of the farms in terms of efficiency was less in Scotland, than in England?——No; I think in terms of efficiency the standard of farming is better in Scotland than in England.

6473. Yet you say in paragraph 1 that you have an under-capitalised land system?——Yes. I think that is a question of degree. For all we know the position may be worse in England than in Scotland, from the point of view of under-capitalisation.

6474. *Chairman*: What would you regard as the satisfactory unit to work for, in a case first of all of dairy farming and then of arable farming?——It is not a point on which one can generalise. Conditions over Scotland are so different that what might be an economic sized dairy unit in one part of the country would be considered uneconomic elsewhere. So much depends on the quality of the land. In the highland parts of Scotland we have sheep farms ranging from 5,000 to 20,000 acres and more.

6475. What would you regard as being the undesirably small unit?——*Mr. Lorimer*: A farm of perhaps 100 acres or a little under presents considerable difficulties. I am thinking of the small dairy farm where there is no hired labour; the standard of living of these farmers is low and is probably less than the average farm worker. On the other hand the farmer there has the satisfaction of being his own master and so on, which one cannot assess in terms of money.—*Mr. Blair*: It is very difficult to generalise on this question of size. In Aberdeenshire, for instance, the average size of the holdings is very small, as far as arable farms are concerned; at a guess probably about 70 acres. But there again there is the independence of spirit and view, and the fact that the family has been the holder for some time, and there would be great alarm and disapproval if there were any suggestion of amalgamating farms into bigger size. In answer to your question as to what would be the minimum size which a farm should be, as I say it is very difficult to generalise, but I should say certainly not very much less than 100 acres. —*Mr. Lorimer*: I would agree with that. If one is going to take on hired labour one probably wants something about double the size.—*Mr. Blair*: The independent family farmer with a son working can perfectly well carry on a farm of about 100 acres.—*Lt.-Col. Cameron*: If you are dealing with a sheep farm of course you want something very much bigger.

6476. *Mr. Jones*: Suppose that you had a farm of 100 acres, paying a rent of, shall we say, £2 an acre; how much of that would you regard, as a landlord, as being required for depreciation of the holding itself; of the buildings and the things that do depreciate?——*Mr. Lorimer*: It depends very much on the condition of the fixed equipment. If it is in need of repair it might easily use the whole of the rent, and might even show a deficiency; whereas if it had been modernised perhaps 25 per cent. or so might be a fair figure.

6477. Suppose that you were making the return for income tax purposes, and you were dealing with a specific farm earning £200; what would you think was fair and reasonable to set against the earning of that £200 to you as landlord?——It is difficult to generalise, because the circumstances of each individual farm will vary so much; but taking an estate as a whole with a number of farms, it is a well known fact that in many cases the expenditure on maintenance, repairs, improvements and so on will exceed the total rental of the estate. If you apply that to the individual farm the answer might be much the same, although of course it will vary from farm to farm. After all work is done on a routine basis; one tries to tackle something one year and something else the next.

6478. *Chairman*: In paragraph 3 you say:

"Under existing conditions the accumulation of capital either to stock and/or buy a farm is very difficult. The question of whether the existing monetary and credit system is sufficiently flexible to enable a man with a relatively small amount of capital to make a start in the agricultural industry should be thoroughly examined".

Quite apart from the operations of the credit squeeze in the last year or two, where would a new entrant look for the finance which would enable him to start? To the local bank?——The bank would probably help to some extent, and local auctioneers would probably help. I have heard of cases (it was probably more common before the war than now) where the landowner who had let a small farm might himself stand good for some credit whilst the man got on his feet.

6479. Have not the banks been good friends to farmers in Scotland?——*Lt.-Col. Cameron*: It is generally accepted that they have.

6480. *Professor Sayers*: When you say the auctioneers would help, do you mean that the auctioneer would in effect act as a broker, putting the man in touch with monied people who would lend, or do you mean that the auctioneer would lend out of his own capital?——*Mr. Lorimer*: He might actually give a credit.

6481. Out of his own capital?——Yes.

6482. *Lord Harcourt*: Is that quite a common practice? ——*Mr. Lorimer*: Yes; it would be on condition that the man sold all his stock through that auction mart.— *Mr. Blair*: It is a common practice, but it is not a very good one, because it ties the particular farmer to the particular auctioneering firm. That can have dangerous results.

6483. *Chairman*: Has all this become much more difficult in the last two or three years, under the credit squeeze?——*Mr. Lorimer*: I would say so. I think since 1955 farmers as a whole have relied much more on auctioneers and their feeding stuff merchants and so on for credit than was the case immediately after the war.

6484. *Professor Sayers*: Do you mean the banks are lending less to farmers in Scotland?——I would not say

* Memoranda of Evidence Part VIII No. 3.

that they are lending less, but I think farmers are in need of more credit.

6485. Are they finding that the banks will not lend them the extra credit they need?——They may get credit from an auctioneer free of interest; that is sometimes done, provided that the farmer sells all his stock through the auction mart.

6486. Has this increased reliance on auctioneers' credit and so on continued or been accelerated during the last three years?——It probably would be fair to say that it has been; but it was pretty prevalent, I understand, before the war.

6487. Have not the auctioneers felt the credit squeeze?——*Mr. Lorimer*: I should think the leading auctioneers have probably been able to build up fairly substantial reserves, but I speak without knowledge of the details—*Mr. Blair*: In the last three years most auctioneer firms will have made substantial profits, because of the high prices of agricultural products.

6488. *Chairman*: Your general impression is that they have been able to step in to help in this particular field, to the extent to which the banks have had to draw in their horns?——*Mr. Lorimer*: I would not say that the position has been met wholly or satisfactorily by reliance on auctioneers or feeding stuff merchants.

6489. *Professor Sayers*: Has there been any difficulty at all about short term credit for farmers in the last three years?—*Chairman*: I think this really applies to capital to stock or buy a farm?——*Mr. Lorimer*: Yes, but I think we deal with Professor Sayers's point later. —*Mr. Blair*: On the question of capital to stock and buy a farm, although one knows that the banks are well disposed towards the farming community, since the credit squeeze they have looked with more close scrutiny, and rather negatively than positively, on applications for loans for buying and stocking a farm—*Lt.-Col. Cameron*: For purchase of a farm they have not been nearly so ready in the last year or two to lend. If it is a question of helping for improvements, that is a different matter.

6490. In paragraph 6, when you speak of the falling trend of capital investment in agriculture and forestry, what period are you asking us to think of there? The post-war period?——*Mr. Lorimer*: Yes. Over the last four or five years official figures have borne out that capital investment in agriculture has been falling as compared with the rise in investment in other industries, although that is not necessarily correct with regard to other industries over the last year or so.

6491. *Professor Sayers*: What are the reasons for this falling trend? Is it because agriculture has already been so well stocked up with capital in the earlier years that there is not the incentive to invest so much now?——*Mr. Lorimer*: I would have thought that it was more due to farming being less profitable than it was.—*Mr. Blair*: It is really the landlord's lack of incentive to invest capital in agriculture because his return is so poor. He does not get sufficient return from his agricultural investment to be able to save enough capital to put back into it; and he is disinclined to put new capital into it when he is getting very little return from the money.

6492. *Chairman*: Are we to think of this particular point that he cannot pass on the costs as being a product of the last three or four years?——I should think it has been general; as costs of everything have gone up, so the inclination to invest capital in farm development has diminished.

6493. *Professor Sayers*: You mentioned that the rates of interest were rising against the investing landlord; would you say that has been an important factor in causing this falling trend?——*Mr. Blair*: Certainly I would.—*Mr. Lorimer*: In a sense rents are inflexible in regard to the rate of interest on money. We are now in a period of high interest rates, and there is no way of adjusting rents to meet these high rates of interest, if you want to borrow money for landlord's improvements. Rents are fixed over a period of years, and what might be a realistic additional rent a few years ago for some improvement which the landlord undertakes to carry out has very little relation to current conditions today.

6494. *Chairman*: How inflexible are the rents for this purpose? They are not actually 7, 14, 21 year rents, or anything like that?——In Scotland, where the system is quite different from England, quite a number of farm leases are for periods of 7, 14 and 21 years.

6495. We are to think of that as quite a typical form of rental tie-up?——Fairly typical, although it is less typical than it used to be. There are a lot of leases now in Scotland on a yearly basis, but it has always been the traditional system in Scotland to have these long leases.

6496. Is a landlord under an obligation to execute additional improvements, or is he free to negotiate with the tenant that, if he is to do it, he must have so much more rent out of it?——If a landlord carries out an improvement during the currency of a lease of, say, seven years, at the request of or in agreement with the tenant, he would be entitled to some additional rent; but it is very difficult to negotiate an additional rent with a tenant which will mean that the landlord is not out of pocket on interest and the cost of carrying out that improvement. It is difficult to put across to the average tenant farmer that it costs around 7½ per cent. to borrow money and that it is also necessary to have something to amortise the cost of improvement. The tenant farmer just does not seem to be receptive to that.

6497. *Mr. Jones*: Would a landowner have to borrow money at 7½ per cent. for improvement, and if he was undertaking an improvement would he have to find the full capital cost?——He probably would, yes. The money has got to come from somewhere.

6498. But is there not any provision for grants?——Yes, there is a 33⅓ per cent. grant, but on the net cost of the improvement it is difficult to get that rate of interest plus amortisation.

6499. *Professor Sayers*: If rates of interest were to fall over the next five years, would you expect that to stimulate investment in improvements?——*Mr. Lorimer*: I think it would.—*Mr. Blair*: I should have thought that that would undoubtedly be a stimulant in encouraging landlords to accept requests from tenants for improvements.

6500. *Chairman*: Is there some traditional rate of interest which a tenant regards as reasonable and acceptable for him to pay on the additional improvement?——*Mr. Blair*: Yes, 5 per cent.; and any attempt on the part of a landlord to try and encourage his tenant to give a higher rate than 5 per cent. has in my experience been completely useless.—*Lt.-Col. Cameron*: It is often very difficult to get anything like 5 per cent. Costs have been going up and the rates of borrowing going up, but the tenant feels he should pay the same sort of proportion as he has always paid, and we find it very difficult to get him to pay even 5 per cent. on the net cost of the improvement the landlord feels he is bound to make.

6501. Five per cent. is the figure you try to get, and depreciation and such refinements as obsolescence do not get any consideration at all?——None at all.

6502. We ought to distinguish for this purpose between the position of the owner-occupier and the position of the landowner with tenants, and the inflexibility arises out of the general attitude of tenants towards the cost of improvements?——*Mr. Blair*: Yes.

6503. Then, passing on to paragraph 10, you have observed a considerable growth in the use of hire purchase in the provision of agricultural machinery?——*Mr. Lorimer*: Yes.

6504. *Professor Sayers*: Is this to be associated at all with the difficulty of getting credit in other directions, or is this a growth which has been going on for some time and has just continued?——It has been going on for some time, and has possibly been accelerated by the credit squeeze.

6505. When the farmer wants credit of this kind, how does he get it? Does he get it through the supplier of the equipment?——Sometimes through the supplier. The Federation sponsor a scheme for hire purchase which is being made use of to some extent, by which farmers can get equipment at a slightly cheaper rate than by going direct to a hire purchase company.

6506. *Mr. Jones*: Have you some sort of banking arrangement?——No, it is purely an arrangement with the Scottish Midland Guarantee Trust Company. Instead of the supplier getting the commission, the Federa-

tion gets the benefit of the commission and passes it on to the member concerned.

6507. *Professor Sayers*: You say that you do it at a slightly cheaper rate. Farmers are generally said to be very fussy about rates of interest. Suppose that they were able to get hire purchase finance 2 or 3 per cent. cheaper than they now can; would you expect that to lead to an appreciable increase in hire purchase credit outstanding?——*Mr. Lorimer*: I would not like to express an opinion one way or the other.—*Mr. Blair*: As I understand it the farmer can get it broadly speaking in two ways, one through this Scottish Midland Guarantee Trust Company, which is a respectable offshoot of one of the Scottish banks, and otherwise by going direct to the seller of equipment. It would be a great improvement if the period within which he has to repay his instalments were extended beyond the present two years. That is in many cases a hardship; he has to pay back his money before he has really had time to get the fullest use out of the equipment and get some profit out of it.

6508. *Chairman*: Do you think that this two year limit has stemmed back a good deal of purchasing which would otherwise have been done of this kind of machinery?——*Mr. Blair*: That would be my impression, but it is not any more than an impression.—*Mr. Lorimer*: I think it is a definite defect in the credit system as far as agriculture and forestry are concerned that there is not really any adequate facility for medium term loans. By some form of extension of the hire purchase system it might be possible to fill that gap.

6509. *Lord Harcourt*: Are you thinking in terms of five to ten years?——Yes.

6510. *Chairman*: Do not some of the manufacturers do a big hire purchase business in this field?——*Mr. Lorimer*: Yes.

6511. *Professor Sayers*: Does the farmer ever ask his banker to lend him money on terms comparable to these, that is to say, for a period of years on a reducing basis?——*Lieut.-Colonel Cameron*: Not to my knowledge. I do not think the banks would deal with that sort of thing. I do not think they would like it very much; they prefer farmers to go direct to these hire purchase companies.—*Mr. Lorimer*: I think a bank would either grant a straight overdraft without any time limit, or they would refuse credit altogether.—*Mr. Blair*: One of the reasons why the banks would not go in for anything like that is that in Scotland one cannot pledge movables.

6512. *Chairman*: You have not altered the law of Scotland to make it possible?——Unfortunately not, no; or perhaps it is a good thing that we have not!

6513. *Professor Sayers*: Does this not imply some difficulty for the hire purchase companies?——*Mr. Lorimer*: In that case the goods are only hired and the purchase does not become effective until the final instalment has been paid; ownership does not pass.

6514. *Sir John Woods*: You say in paragraph 12: "the rates of interest at which these two companies lend money are governed by the Bank Rate", and in the next paragraph there are certain phrases which make me wonder whether they vary with Bank Rate?——Yes, they do.

6515. For what sort of period do these loans run?——The Scottish Agricultural Securities Corporation will lend on the security of land, and they will lend for varying periods, similar to a building society, five or ten years; even twenty years is not unusual if you borrow the money to buy a farm.

6516. *Lord Harcourt*: What is the longest term for which they will lend?——Forty years.

6517. *Chairman*: If I understand it, when a man goes to one of these corporations the rate at which he can borrow is roughly speaking the current rate of interest of the day; therefore it is affected by the movements of interest which have taken place. Once he has borrowed he gets a fixed rate for the whole period of the loan?——*Mr. Blair*: Yes.

6518. You do not want him to have the kind of loan which says: "You shall pay at a rate which is equivalent to the current Bank Rate" or 1 per cent. or ½ per cent. over?——*Mr. Lorimer*: We are asking for a uniform rate, and a cheaper rate than the present rate, which I think a lot of people find embarrassing and extremely expensive.

6519. You mean that year in and year out any landlord would be able to go to one of these corporations, and whatever might be the rate of interest for the time being, he would be entitled to get the same rate of interest as they were offering last year to another landowner?——*Lt.-Col. Cameron*: Yes, a fixed rate.—*Mr. Blair*: Admittedly one cannot visualise that it should be fixed at a certain figure always, but it should be something which does not always fluctuate automatically with the Bank Rate.

6520. *Professor Sayers*: Is there any reason why this rate should be insulated from the general movement of interest rates?——*Mr. Lorimer*: I think the reason is that agricultural improvements or investment in forestry are much longer term investment than a lot of industrial investment; the money takes longer to turn over. In the case of forestry it takes perhaps the lifetime of the person who planted the trees. On that premise I think there probably is a case for a slightly lower rate.

6521. But is not that a general case for subsidy of capital investment of that kind, whatever the rate of interest happens to be in the market? It is not a case for higher subsidies just when capital happens to be short in the community in general, and therefore rates of interest are higher?——I would not say it is so much as a subsidy as a question of priority for certain forms of investment. If we want to encourage agricultural investment, then perhaps it should be given a slightly preferential rate.

6522. But is not that an argument which applies year in, year out?——Following the argument out to its logical conclusion, it is conceivable, I suppose, that in an era of very cheap money we might be paying at something slightly above the Bank Rate, if we had a fixed rate of 4 per cent. year in and year out.

6523. That would seem to be not meeting your requirement that investment of this kind should be encouraged as a normal thing?——*Lt.-Col. Cameron*: Would not a fixed rate of interest be the sort of encouragement needed? If one knew where one stood, and that one was going to pay a regular 5 per cent., or whatever it might be, for a certain number of years, perhaps one would feel that after that number of years one would see some return on that money, instead of having to borrow money on a fluctuating rate and being very uncertain of the terms one was going to get. That is a discouragement to investing money in agriculture, and we feel that as a very long term venture there should be some encouragement by means of a fixed rate of interest to people to put money into the agricultural industry.—*Mr. Blair*: The long term nature of the investment is an important point. One does not want to visualise having to wait until one may have a Bank Rate of, say, 4 per cent. or less, to go in for a loan for agricultural purposes or for landlords' fixed equipment. The landlord would be happier if he could have a lower rate of interest than the present existing high rate, spread over a period of years.

6524. That is surely true of anyhody who is thinking of borrowing, not just farmers? What is peculiar about the land situation?——*Mr. Lorimer*: The long term nature of investment in land; it is a long time until you get any return on it.—*Mr. Blair*: In the case of industry a company does not very much mind whether they have to pay 6 per cent. or 7½ per cent. on the cost of borrowed money, because they lose half of it in their income tax. I am not sure that that really applies so favourably in the case of a farmer or in the case of a landlord, who cannot set off the amortisation of his capital investment in his accounts for income tax purposes.

6525. If you put the argument that way you are arguing that the rate of interest should only be allowed to fluctuate where fluctuation does not matter, and wherever it does any work it should be prevented from working. I am trying to find something which is peculiar to the investment in land. You have produced an argument which is peculiar to all very long term investment. It has always been recognised, that it is just that kind of investment which is exposed particularly to changes in the rate of interest. That is nothing to do with the difference between farming and landowning on one side, and other things?——*Mr. Blair*: But is not the impact

of the effect of high interest rates much more acute in investment of money in land and farming than it is in industry?—*Mr. Lorimer*: As we mentioned earlier, one just cannot get Scottish tenants to pay 7½ per cent. plus something for amortisation.

6526. *Chairman*: Whenever the current rate of interest for borrowing rises above some norm like 5 per cent., it becomes uneconomic for the landlord to borrow for improvements?——Yes.

6527. *Lord Harcourt*: The differential between the norm and the current rate is entirely at the landowners' expense?——Yes, and if a landowner goes on with improvements now he will not be getting it back in the form of additional rent, because he just will not get it out of the tenants.

6528. *Chairman*: But what is the connection between that point and the point we were on just now, that landowners ought really to be allowed always to borrow, year in and year out, roughly speaking at the same fixed rate regardless of what the current rate of interest may be?——*Lt.-Col. Cameron*: Is not the landlord's duty a continuous duty? We cannot put off our improvements until a suitable time when borrowing is cheaper. We have to continue with improvements, because otherwise buildings and so on get more and more dilapidated, and a landowner is forced to spend money on improvements, quite irrespective of the rate at which he has to borrow money. Most landowners in Scotland have very little liquid resources; they have to borrow the money to do this sort of work, and it would be much more satisfactory for them if they could foresee some more fixed rate of interest.

6529. Can one take it as a generalisation that this kind of expenditure is not capable of being deferred until times when, for good general reasons, the rate of interest is lower?——Not over a period of years; they might perhaps defer it for a year.

6530. *Sir John Woods*: Is there any particular reason why exactly the same considerations should not apply to a manufacturer's buildings and plant and machinery?——*Mr. Blair*: I think so; surely the difference is that the landlord is bound under statute to provide the fixed equipment. Unless he is able to negotiate with a tenant who is able to afford a reasonable rent, he is very largely in the hands of the arbiter to fix that rent, which may be a completely inadequate return on the interest which he has to pay to borrow the money to spend on the fixed equipment. That position does not really relate to borrowing in industry.

6531. *Chairman*: What is this statutory obligation to provide fixed equipment?——*Mr. Lorimer*: Under the present law, which may possibly he changed, a direction can be served on a landlord to provide additional fixed equipment, if the Agricultural Executive Committee considers that the fixed equipment is inadequate for the proper cultivation of the farm. If a direction is served and confirmed, that fixed equipment has got to be provided.

6532. Who serves the direction?——The Secretary of State. If a direction is confirmed, it entitles a landlord to go to arbitration as to what additional rent he should be paid in respect of the provision of that particular improvement, unless he can negotiate the additional rent with his tenant. The arbiter is given no direction as to how he is to fix that rent; he might in an extreme case say: "I do not think this farm is worth any more rent than you are being paid now". The landlord might have had to invest a considerable sum of capital and get no return on it at all. Alternatively the arbiter might fix an additional rent which perhaps represented 3 per cent. on the capital expenditure.

6533. *Professor Sayers*: Has not this its parallel in the directions which a factory inspector can serve on an industrial employer, or a sanitary inspector on a house owner?——Yes.

6534. *Sir John Woods*: Have there been many such directions?——Quite a number; and sometimes they issue a warning notice which is more or less equivalent to a direction. If this change in the law goes through, the provision of fixed equipment will be regulated by the terms of the lease. We have very detailed leases in Scotland dealing with provision of fixed equipment by the landlord, and what the obligations of the tenant are in regard to maintenance, and so forth; if the landlord is not providing what he ought to under the lease then the tenant will be able to go to arbitration, and if an arbiter issues an award saying that something must be provided, it will have to be provided. The same procedure will follow in regard to rent fixing, to represent interest on the cost of whatever has been provided.

6535. *Mr. Jones*: What proportion of arbitrations are there in this particular field as against negotiated agreements between the landowner and the tenant?——Negotiated agreements are very much more frequent than arbitration, because experiences of landowners generally with arbiters on the question of rental values have not been very happy in Scotland.

6536. You feel you get more out of direct negotiations than you do out of arbitration?——Yes; and in the majority of cases the relationship between landlord and tenant is good and some sort of compromise solution can usually be arrived at.

6537. To what extent did you keep up with the sort of improvements which were necessary to farming in Scotland, when interest rates were much lower?——A great deal was done during the war and the immediate post-war period. Not as much is being done now generally as was done in the years between the war and 1955.

6538. But you have been feeling the strain of higher interest rates since about 1954-55?——Yes.

6539. You are doing less now than you were doing before 1954/55; in retrospect do you consider that you might have done more before 1954-55 in this particular field?——I do not, because there was a lot of accumulation of arrears, which could not be dealt with during the war and were being dealt with after the war. So there was a great amount of work in that immediate post-war period, which also coincided with lower interest rates.

6540. *Chairman*. Turning now to paragraph 20 on special planting loans, that relates to the particular area of the derelict woodlands in Scotland, some of which are derelict as a result of wartime deforestation?——*Mr. Lorimer*: Yes, to quite a considerable extent. The Zuckerman Report recommends the improvement and development of forestry in the marginal bill areas, as a social problem.—*Mr Blair*: One of the points which we do find is important is where we say: "Many timber merchants, and particularly the smaller merchants, rely on bank credit for financing their operations". The effect of that has been that with these high interest rates merchants are laying off buying timber from timber producers, proprietors and others in Scotland. That tendency has been apparent more noticeably since high interest rates have been in force.—*Lieut.-Colonel Cameron*: That is so. The smaller merchants especially may find it a little bit harder to get credit from their banks, and may be overstocked themselves, or for other reasons are finding things a little difficult. It reacts very hardly on the forest owner, who is finding it very difficult at the moment to dispose of his thinnings and so on.

6541. Were the timber merchants in general overstocked before this movement set in?——I think it varies a lot. They seem at times to be overstocked, and other times not. I think they probably were, but I would not like to be categorical on that; I do not know enough about it.

6542. *Lord Harcourt*: Are they trying deliberately to reduce their stocks? Is that one of the reasons why they are not buying?——*Mr. Lorimer*: They certainly would not want to carry heavy stocks at the moment, because they are not certain which way the market is likely to go. If prices are more likely to come back further, obviously they do not want to carry heavy stocks.

6543. *Professor Sayers*: Is this related rather to changing market conditions than to changes in credit conditions?——*Mr. Blair*: I should think it is a combination of both.

6544. Can you date it more exactly? Is it since September, or was it apparent in the summer?——*Lt.-Col. Cameron*: I should say since September; it started, I think, just before that, but it has certainly been accentuated lately.—*Mr. Blair*: It certainly has been more noticeable since September. I think I am right in saying that the timber merchant does not have the same treatment from the banks that agricultural tenants would have; he is treated more as a commercial venture, and he therefore cannot be financed to carry greater stocks.—*Mr. Lorimer*: The Federation feels that this is particularly unfortunate

When there is a forestry expansion scheme and a dedication scheme for forestry which all Governments since the war have been trying to push as hard as they can with a view to making this country by the end of this century dependent to the extent of one-third on home timber, it does not get off to a very good start if the economic condition of the industry is allowed to deteriorate.

6545. *Chairman*: Would the current recession in the demand for timber by timber merchants have much effect upon these long term schemes?——I understand that that is so; I am informed that the rate of planting by private woodland owners will probably fall quite a bit this year, due to these conditions.

6546. *Lord Harcourt*: Is that due to an inability to sell thinnings from young plantations? Is it, in other words, that the cash is not there?——*Mr. Lorimer*: I would say both thinnings and selection fellings. The cash is just not there to carry on with the planting programme at the rate that many owners would like to do it.—*Lt.-Col. Cameron*: There is uncertainty about the future market in timber, and a lot of smaller people, particularly, who have had it in mind to go in for forestry and to start planting, and have been encouraged to do so, are holding back at the moment because of the difficulty of getting the money, and particularly because of the uncertainty of the market. Until that uncertainty is resolved it is very difficult to foresee any increase in planting.

6547 There are two rather different problems: one is the problem of credit, and the other is anticipation of the future trend of timber prices in the world?——*Lt.-Col. Cameron*: I think they are both combined.—*Mr. Lorimer*: They reinforce our argument that there should be a stable form of credit available for agriculture and forestry, and then landowners would know where they were.

6548. Would they know where the future price of timber was going to be?——*Mr. Lorimer*: No, quite.—*Mr. Blair*: It is tied up with uncertainty about the future price of timber and the high interest rates on money. The encouragement given by the Forestry Commission to the small owner to replant land available for timber planting contrasts with the small woodland owner's lack of confidence in the future. He does not know where he is going to stand as regards timber prices, and he has even less encouragement if he has to pay such a high rate of interest on any development money that he is going to put into the timber.

6549. *Chairman*: Then in paragraph 29 you come to short-term credit. Have you observed any drift of this nature from bank credit to other terms of credit in the last year?——I do not know whether I would put it quite as high as that; but I think the tendency has been for more carrying of farmers by auctioneers, and more carrying of purchases of farm equipment through hire purchase companies.

Chairman: You then come to medium-term credit, and you end with reference again to the importance from your point of view of stability in rates of interest. I think that completes our questions. Thank you very much for your help, gentlemen.

(*Adjourned until Tuesday, 1st April, 1958, at 11 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-SIXTH DAY

Tuesday, 1st April, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E. (*Chairman*)

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 6688 to 6835 only)
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

PAUL MAY, ESQ., Deputy Chairman and Director of Trading, the John Lewis Partnership, R. K. ROWNTREE, ESQ., Chairman, W. Rowntree & Sons Ltd., and J. DUNSE, ESQ., D.S.C., Chairman, Past Chairman and Director respectively of and representing The Retail Distributors Association Incorporated, called and examined.

6550. *Chairman*: We have read your memorandum* carefully; if I may say so, it is a very carefully thought out paper. Would it be convenient if we worked through it with you, to see what questions we want you to enlarge upon?——*Mr. May*: Yes, Sir. I would like, if I may, to apologise for the fact that the memorandum is not backed up more in the way of statistics but unfortunately Mr. Barber, who was the Director of our Association, died in the early part of last year, and Mr. Dunse did not join us until the autumn; we were not able, therefore, to do as much work on this as we ought to have done.

6551. You say in your memorandum that the views of your Association reflect the experience of the large department stores in the United Kingdom. How far ought we to regard you as confined to the large department stores?——We are not confined entirely to the large department stores. A substantial part of our membership consists of the large groups, but we have many individual stores as well which are mainly of the larger department store type.

6552. In paragraph 3 you say:

"In general, therefore, among the members of the Association, the restrictions on bank credit have had little effect on stock levels; indeed over the period under review, although the total bank advances to the retail trade has steadily fallen, the monetary value of the stocks held has almost as steadily increased."

Can you enlarge on the process by which bank advances to the retail trade have steadily fallen? Is that for the period of the credit squeeze?——Yes. These are total retail trade figures, not department store figures. We have no separate figures for bank advances to department stores.

6553. Would it be your impression that over this period the stores whose experience you reflect have steadily taken less bank credit?——*Mr. Rowntree*: The smaller ones have probably remained more or less the same; the larger ones I would not know about.—*Mr. May*: The larger ones have been about the same again. This, I am afraid, was a contrast between general retail trade and our own experience; we have no separate figures for department stores.

6554. *Professor Sayers*: Do your members depend much on bank overdrafts?——For a long time it has been the general practice to finance peaks of requirements in that way; the main use in our trade of bank overdrafts has been for that purpose.

6555. You mean seasonal fluctuations?——Yes; they mean pretty considerable fluctuations in working capital requirements.

6556. *Chairman*: Any store expects to have an agreed line of credit with a bank?——Most stores have a limit on their bank overdraft, but they do not necessarily use it all, certainly not all the time.

6557. You would expect it to approach the agreed limit at the time of your seasonal pressure?——Yes. It does not always go up then, but March and April, and again about October and November, approaching the Christmas trade, are when we expect the department stores to have their overdrafts up to the maximum.

6558. *Lord Harcourt*: Do you know if your members use acceptance credits for the peak periods?——*Mr. May*: I do not think they do.—*Mr. Rowntree*: I know of no cases of that.

6559. *Professor Sayers*: Have many of the overdraft limits been reduced?——*Mr. May*: I do not know of any cases.

6560. Is that true not merely of the period before September, 1957, but also after September, 1957?——*Mr. Rowntree*: There may perhaps have been marginal reductions in response to requests for, broadly speaking, a 10 per cent. cut, but I would not think there is anything else that has been done.—*Mr. May*: I do not know of any cases, but it is a matter which we have not questioned our members on individually.

6561. *Sir John Woods*: In paragraph 4 you say:—

"It may be, however, that had the restrictions not existed, among the smaller firms at least, plans for expansion, which have not been entertained, would have been proceeded with. . . ."

Is that a bit of intelligent theorising or have you actual knowledge of expansion plans being abandoned or deferred because of the restrictions?——We are talking about the pre-September period here. I have personal knowledge of one or two minor projects; that is all. I would say it was marginal.

6562. *Professor Sayers*: Have you anything to say in modification of this in the light of experience since September?——Yes. I would still say that there has been no noticeable effect on the carrying of stocks, but I would say that there has been an appreciably tighter position about the cancellation or not starting of capital expenditure projects since last September.

6563. *Chairman*: Because of bank advances being under any particular pressure, or for some other general reasons?——Partly because of bank advances being under pressure and partly for other reasons, such as the general economic effect of the September measures. In our trade I think the general effects are more important than the specific measures.

6564. *Sir John Woods*: You would not say that it was particularly the Bank Rate?——I think the Bank Rate is of relatively minor importance as far as we are concerned.

6565. *Sir Oliver Franks*: There must be a point at which that view would have to be modified?——Yes, but if one takes the interest rate in isolation it is not a factor that worries us very much: it is the general economic effect and the general outlook that is our concern. If there was a continued inflationary outlook generally, then it might be worth while paying 8 per cent.

* Memoranda of Evidence Part VII No. 13.

6566. I understand that, but one could not, I think, apply your argument at all levels of rates of interest in quite the same way. There must be a point at which the rate of interest by itself bites, I think, for everyone?——Certainly; it depends on the length for which you tie yourself up. That must be true.

6567. *Sir Reginald Verdon Smith*: You were speaking just now of variations in stock levels due to seasonal changes; what sort of range of variation is there in stock levels other than for seasonal purposes? Is the range one of 10 per cent. either way on a norm, or 50 per cent.?——*Mr. May*: I should have said something about 5 per cent. on either side of the figure that one was wanting to be at.—*Mr. Rowntree*: I would have thought perhaps slightly wider than that: between 5 and 10 per cent.

6568. Would that be a great deal less than the variation for seasonal purposes?——Yes, a great deal less.

6569. *Sir Oliver Franks*: When a department store is ordering, it must be very much influenced in what and how much it orders by its estimates of trading demand. What is the period in time which would normally separate the ordering from the effective sale?——*Mr. Rowntree*: It would vary with the class of trade.—*Mr. May*: The average rate of stock turnover is something over five times a year, so that the average period would be between two and two and a half months from the time of delivery until the time of sale. The time between ordering until delivery depends very much on one's business; one may be ordering for delivery a year or fifteen months ahead or for delivery tomorrow. The average, I should say, would be of the order of three months. Do you agree, Mr. Rowntree?—*Mr. Rowntree*: Yes.

6570. If we take five or six months as being the average, how does a department store come to a view of what the likely level of consumer demand for its products will be? What factors does it take into consideration, or what measures does it look to? Or is it essentially hunch and flair based on experience?——*Mr. May*: As far as my own business is concerned, every six months we have a sales estimate conference; we get together the trading side, the financial side and our economic experts, and in the end we usually come to an agreement on what we think demand is going to be like on the basis of the previous year's experience. We are generally within a few per cent. of the results.

6571. Is the effect of this paragraph 6 really to say that in the process of determining what you will order and, therefore, what your stock level will be, the rate of interest at any level which we have known over the last six years is not a very important factor?——*Mr. May*: I would have said so, yes.—*Mr. Rowntree*: I would agree with that.

6572. *Chairman*: Does your experience of the last six months, with a higher rate of interest than we have had since the war, alter your outlook?——*Mr. May*: Not if one isolates the rate of interest as a single factor. It is the indirect effects rather than the direct effects.

6573. So far as one can isolate the rate of interest as a factor, your view remains as you have said?——Yes.

6574. *Professor Sayers*: Suppose that the Government had taken all the various measures it did take last September except the change in the rate of interest; what do you think the effect would have been on your trade? Would you have still felt this necessity to tighten belts a little?——*Mr. May*: We certainly should so far as capital expenditure projects were concerned, but we should not have felt it necessary yet to drop our stock levels—*Mr. Rowntree*: The question for us is rather: if the Bank Rate had not been included in the measures, what effect that would have had on the public. Their interpretation of the measures would, I think, have affected our attitude towards stocks and the future level of trade. It is rather an indirect effect than a direct one.—*Mr. May*: One cannot dissociate from this, moreover, the effect of the measures on the general level of prices. For instance, the future course of building prices and the prices of equipment is a very considerable factor in some of our decisions about whether to proceed with special plans now or to wait for a little while. All that is part of the general effect of the monetary rates.

6575. *Chairman*: In Section (*b*) you go on to analyse several reasons why in all your experience up to now the cost of borrowing has not been a dominant factor in decisions either on stock levels or capital investment plans.—*Professor Sayers*: Which rates of interest are most relevant for your business purposes, bank overdraft rates, or the rates at which debentures can be sold, or what?—*Mr. May*: It varies from business to business. It depends whether the business is of a type which would normally go to the money market or finance itself in some other way. Most of the larger businesses would normally use bank overdrafts only on a short term basis. They must have long term finance if they are going to expand and there is much more a question of the rates of interest on a capital issue than the rate on bank overdrafts.—*Mr. Rowntree*: I think that is broadly true, but in the small department stores they would be more concerned with the bank overdraft rate.

6576. Do the smaller stores normally look to help from the banks in financing capital development?——I think normally not, except for very short periods; but I think it would be true to say (though the evidence I have for this is a little patchy, to say the least) that the amount of bank borrowing which is used to finance stocks has somewhat increased in the last four or five years.

6577. *Chairman*: You make the point in paragraph 6 of your memorandum that "firms do not generally contrast the profitability of internal and external investment when determining the disposal of reserves." That is a general observation, but is it from what you have seen?——Yes.

6578. *Professor Sayers*: Where do the small stores go for their money for capital development?——*Mr. May*: to a very considerable extent the trade has financed itself out of retained profits as well as out of bank advances. In retail trade and department store trade as a whole, there is a tendency to have recourse much less to the making of issues and to the money market than there is in industry generally. We have some figures on that in paragraph 15 which show that, at any rate, up to 1953, the retail trade sought finance this way to a much lesser extent than industry in general; 7 per cent. of new funds for the retail trade against an average of 14 per cent. for manufacturing and distribution firms.

6579. Where does the rest of the money come from?——I think they must finance themselves almost completely out of retained profits.

6580. *Chairman*: You mention in paragraph 10 certain expedients which have been resorted to, such as raising money on property, which has been quite a feature. Can you enlarge on that?——*Mr. May*: I should have thought that that applied more to the larger stores than to the smaller ones; the previous question was with regard to the smaller firms.—*Mr. Dunse*: I have knowledge of one case where a substantial development, having regard to the size of the store, has so far been financed entirely out of bank advances, the redemption of the bank advances coming out of retained profits.

6581. *Professor Sayers*: Over a period of years?——Since about 1952.

6582. *Lord Harcourt*: Has there been a great increase in the financing of department stores by the sale and the leasing back of their properties?——*Mr. May*: I should not have called it a great increase but there has certainly been an increase. I know of a number of cases where it has been done in the last six or seven years.

6583. Is that because of the credit squeeze, or is it a change of climate in that the stores think that there is no advantage in owning real property?——*Mr. May*: I do not think department stores as a whole have reached the point where they would sooner not own their buildings. I think that in those cases where it has occurred it has been purely a capital raising operation.—*Mr. Rowntree*: In some cases, because some of the smaller businesses are family businesses, considerations of death duties have come into the question.

6584. *Chairman*: Is the resort normally to an insurance company?——*Mr. May*: Yes.—*Mr. Rowntree*: To pension schemes in some cases.—*Mr. May*: And certain big charities have done it in the past. I believe it has been true even of some of the pension funds of some of the nationalised undertakings, though I do not know of any recent cases.

6585. *Professor Sayers*: Do the building societies come into this field at all?——*Mr. Rowntree*: I do not know

of a case.—*Mr. May*: I have not heard of any. It is rather outside their field, I think.

6586. *Chairman*: Passing now to the Capital Issues Committee in paragraph 8 of your memorandum, I take it that the stores for whom you speak have not had any great experience of having to apply to the Capital Issues Committee?——*Mr. May*: That is true of the smaller stores, is it not, Mr. Rowntree?—*Mr. Rowntree*: Yes.

6587. Simply because the capital market is not their normal point of resort?——*Mr. May*: Yes.

6588. *Professor Sayers*: Have the larger stores been to the Capital Issues Committee?——Some of them have.

6589. What has been the result?——In most cases they have got what they asked for; but I think they have mostly only gone when they were pretty confident that they would get consent.

6590. *Chairman*: What do you think that confidence is founded on: soundings somewhere beforehand?——Not soundings of the Capital Issues Committee. I can only speak about our own organisation, but we should not dream of going without having all the professional advice that we ought to have.

6591. That would mean referring it to a firm of accountants who were experienced in capital issue applications?——Yes, bankers, accountants, solicitors and stockbrokers.

6592. *Sir Oliver Franks*: Would your professional advisers in turn tend to see what the views of the Government department responsible for the general interests of retail trade would be? I suppose it would be the Board of Trade; are you in touch with them at the point at which you decide whether to go forward or not directly or indirectly through your professional advisers?——*Mr. May*: To the best of my knowledge, no.—*Mr. Rowntree*: Since the end of the post-war restrictions I do not think we have been in touch with the Board of Trade at all on these things. Previously, we were in fairly frequent contact on various things.

6593. It would be right to assume that in this important section of trade people contemplating capital expansion and faced with the C.I.C. control would not normally go round to talk to someone in some branch of the Board of Trade, to see whether they thought it was a reasonable proposition?——Broadly speaking, I think that would be true.

6594. *Professor Sayers*: And yet paragraph 9 would seem to indicate that the C.I.C. has been a very considerable deterrent. What has been the basis of this shyness?——*Mr. Dunse*: I do not really know the basis, partly because I am new in this sphere of activity; but there is a definite conviction amongst many retailers, particularly the smaller firms, that applications to the Capital Issues Committee are a waste of time because consent will not be forthcoming. It has stemmed largely, so far as I can trace it, from people who have had applications turned down talking to their colleagues and to people in other firms, and because there is a lack of explanation, in many cases, or detailed knowledge as to how the C.I.C. arrives at its conclusions.

6595. *Sir John Woods*: You do in fact give one reason:—

"There is a feeling among retailers that the Capital Issues Committee places a very low priority on the capital requirements of the retail trade. . . ."

Is that what you are referring to?——Whether that is true or not we do not know, but that is the belief we find on talking to many people.

6596. It is a fact that that is the belief; but you do not know what the reasons are?——Yes.

6597. *Professor Sayers*: It would seem implicit in this also that, if there had not been this fear of refusal by the Capital Issues Committee, a great many applications would have come forward and a great many plans would have come forward. Is that so?——I think more would have come forward, but whether it would be a great many or not I do not know.

6598. You say the Committee's impact is "very much greater" than the number of applications would seem to suggest?——*Mr. Rowntree*: It is a very difficult thing to get down to. This may be used in conversation as the reason why people do not go ahead, but it may not in fact be the real reason.

6599. *Lord Harcourt*: The effect of this unwillingness to go to the Capital Issues Committee must have been a tendency to distribute a smaller proportion of profits, and to plough back more for future development?——I think so, yes.

6600. You are not suggesting that the retail trade as a whole has given up ideas of expansion because of the difficulty with the C.I.C.?——No.

6601. *Chairman*: This paragraph deals mainly with two things: the impact of the C.I.C. and its attitude upon an application or a likely application, and the other expedients which have been resorted to because of that. Can you marry one with the other? Do you think there has been for one reason or another a number of expansion plans abandoned for lack of finance?——*Mr. May*: I think that that is true since last September, but I do not think it was true before last September. There were some, I know, but not a high proportion. I think that retained profits have been used in certain cases: freeholds have been sold and other special arrangements have been made.

6602. This share exchange device, although it attracts attention, is not very widespread, is it?——*Mr. Rowntree*: I do not think so.

6603. I take it that paragraph 11 covers questions of capitalisation of reserves?——*Mr. Dunse*: Yes.

6604. *Professor Sayers*: That has had no repercussion on plans for capital development?——It does not have repercussions on plans for capital development directly, but it might be argued that it has an indirect effect. For example, I have been told by several firms that their inability to capitalise reserves and redress their balance sheets makes life more difficult for them. I am talking now of private companies as regards the surtax legislation on closed corporations. It has some effect on their ability to plough back; they might feel it prudent to distribute more than they would do if they did not feel it a risk from the point of view of the surtax direction.

6605. *Chairman*: And it introduces the complication of take-over bids?——Yes.

6606. We then come to Section (*d*) "Change in the terms on which Hire Purchase Finance is available".—*Sir Reginald Verdon Smith*: In paragraph 13 you say that many of the Association's members finance their own hire purchase trade; can you give us a general indication of the way in which this is done? Is it done by special subsidiary companies?——*Mr. May*: Most of the members finance it within their own company. Some of us have had separate hire purchase companies, but they have been financed from the general pool of the group's finances so there was no special advantage; we have stopped that now.

6607. *Lord Harcourt*: With hire purchase has there been an additional strain on the working capital of these firms?——*Mr. May*: Not very much; but there has been some. Hire purchase balances as such, leaving out of account for the moment extended credit, are, I am sure, lower today than they were two or three years ago, when we had a period without any restriction of any sort.—*Mr. Rowntree*: The normal picture would be that any store which did find itself having difficulty in financing hire purchase would tend to re-finance a portion with the hire purchase companies by the block discounting system just to tide it over the period of the strain.

6608. *Professor Sayers*: Is there a seasonal swing in the amount of hire purchase outstanding?——*Mr. Rowntree*: Not very much, I think.—*Mr. May*: It usually drops back a bit in the first half of the year and rises in the second half of the year, but it is not a very large swing. Department store trade generally is larger in the second half of the year than it is in the first half of the year.

6609. *Chairman*: In section (*e*) you deal with the "Availability of finance other than Banks and Hire Purchase Finance Companies". You say in paragraph 14:—

"Where it has been necessary to go to the market for funds, the general experience of the large firms has been that these funds have been readily forthcoming. Any change which has been detected has been that of a greater market sensitivity to terms."

What do you think is the cause of that?——Here again, we are speaking about the period before last September.

It depends what sort of security one is issuing, of course; some of us were finding that there was a greater sensitivity on fixed interest issues.

6610. Does that mean reluctance to take them?——Nobody goes to the market unless he is pretty confident that he is going to get his terms accepted; but we found no ease before September where anybody got to the point of wanting to make an issue and had not found that money would be available.

6611. We now pass on to section (f): "Changes in the use and organisation of Consumer's Credit". You say that the usual practice of stores has not been modified; and then you say:—

"As regards credit given, the average length of credit to customers on normal accounts in the period under review has probably shortened slightly; but this is due to improvements in office systems rather than to any impetus from monetary measures to reduce the amount of credit granted."

Has there been any change in that general pattern since September, 1957?——No. There have been one or two odd cases where the amount of balances outstanding from customers has gone up, but I think that has been as much due to the 'flu epidemic in the autumn, which made it difficult to maintain staff in credit offices, as to anything else. Generally speaking, the proportion of balances outstanding has remained extremely constant over the last two or three years.

6612. And on the supply side; has there been any change in your practice of trying to settle your suppliers' accounts promptly?——It is much too profitable a business for us to go back on that if we can possibly help it.

6613. *Professor Sayers*: Can you tell us anything about the really long-term trends in this, both as between you and your suppliers and between you and your customers? Has the trading basis become more a cash basis, or has credit trading tended to increase, if one looks back not just over years, but over decades?——*Mr. Rowntree*: If there is still time, it seems to me that it would be better for some of the facts to be got out, because the impressions that one retains at the end of a period of that sort are very often apt to be misleading. The most characteristic experience since the war has been the change in the type of person who uses a monthly credit account. Very many of our account customers are now people in the middle ranges of income who before the war would not have allowed themselves to enter anything to an account and prided themselves on the fact that they never owed a penny to anyone. They would have been predominantly cash customers pre-war, but some of them do have monthly accounts now, and many more of them use hire purchase and other forms of extended credit.

6614. Are you referring to the same individuals, or is it the new generation that is growing up that has different habits?——I think it is the new generation that is growing up, though they may also be influencing their parents in their habits.

6615. The tendency is for credit trading with customers to increase?——*Mr. Rowntree*: Credit has stayed about the same in proportion but I think it would otherwise have shown a very sharp decrease. That would be my guess; I do not know whether I would be borne out by the figures on that.——*Mr. May*: I should not like to give a firm opinion without getting hold of the figures. I should have said that the monthly credit had probably either stayed round about the same or perhaps dropped back a little, but there has been a considerable increase in forms of long term credit. That is purely guesswork, and if a firm answer is wanted to this, I should be grateful if we could have notice, and we could try and get some figures out.

6616. *Lord Harcourt*: When you talk about a monthly credit account, is that the account that is rendered monthly?——Yes.

6617. How long after the rendering of the account do you reckon to receive your payment?——*Mr. May*: I would say that one has roughly six to eight weeks of credit sales on one's books at a time. That is an average figure; there are tremendous variations. Would you agree, Mr. Rowntree?—*Mr. Rowntree*: Yes.

6618. *Professor Sayers*: What about the suppliers' end? ——*Mr. May*: Guessing again, I would have thought that the general practice had been to pay more promptly, if anything.—*Mr. Rowntree*: I think that is so. That would need some study, because there is a change in the terms which our suppliers characteristically give. It tends to run by trades. My impression would be that the trades which now give a discount for prompt settlement are slightly larger in number than they were pre-war. In other words, the practice has extended a little. That would again be an impression, and I do not recollect any figures to prove it.

6619. But neither at the customer end nor the supply end has there been any such marked change as impresses itself upon your notice and makes detailed investigation quite unnecessary?——*Mr. Rowntree*: I think that is true. What changes there have been have perhaps been in the direction of shortening rather than lengthening.—*Mr. May*: But over a long period this is very much guesswork. We none of us really look at pre-war figures. If you would like a real answer to these questions perhaps we can get some information for you.

6620. *Sir Oliver Franks*: In relation to the post-war period, would you say that the reason why you have been able to give the answers that you have just given is really that the demand of your consumers has been so steadily buoyant, apart from quite minor variations, that the flow of trade through the department stores and from the suppliers has really been uninterrupted, so that these questions of the level of stocks, the methods of financing, the degree of credit extended to customers, or obtained from suppliers, have more or less gone along relatively unexamined because you were borne up on the tide of consumer spending?——In common with other people we have been borne along very comfortably, except for 1952. I would not like it to be suggested that we do not watch these figures fairly carefully as we go along, especially in recent years; it is difficult to look back before the war.

6621. *Professor Sayers*: You said: ". . . except for 1952". I wonder if you would tell us very shortly something of that experience, and particularly whether in your experience the 1952 upset related at all to changes in credit conditions at that time?——I would not have thought at all.

6622. It was purely a demand phenomenon?——*Mr. May*: I would have thought that it was the obverse of the preceding boom and the rapid fall of raw material prices.—*Mr. Rowntree*: Particularly wool prices.—*Mr. May*: There was a very great change in the retail trade; business was booming in 1951, but in August, 1951, it moved right round.

6623. *Lord Harcourt*: Can you tell us at all what proportion of your suppliers would be wholesalers and what proportion would be manufacturers? How much of the department stores' ordering is done direct?——*Mr. May*: It varies to some extent according to the type of store, but the amount purchased from wholesalers is relatively modest now.—*Mr. Rowntree*: I think it is small.

6624. The bulk would be direct ordering from the manufacturer?——*Mr. May*: Yes.

6625. *Professor Sayers*: Would it be too much trouble to make a small inquiry, on the results of which one could rely, about the trends in credit from suppliers and to customers? If we could take a few points, not necessarily a continuous line, starting from 1925, I think it would be useful: say, 1925, 1930, 1935, 1950 and 1955?——We will certainly see what we can do. It is a question of the records being still available. We have not got such figures, and we shall have to go to our members.

6626. A few firms that could give a representative sample would be sufficient.——Do you want both credit from suppliers and credit extended to customers in all forms in a single figure, or instalment credit in one and monthly credit in another?

6627. If the hire purchase business could be separated, it would be useful?——*Mr. May*: That will be difficult but we will try and see what we can do.—*Mr. Rowntree*: I think we can separate hire purchase in the later years, but possibly not in the earlier years.*

6628. *Chairman*: There is nothing new about the practice of settling with suppliers under discount terms, is there?——No.

* See Appendix to Minutes of Evidence.

6629. You say that it may have spread to one or two new trades in the course of time?——Yes.

6630. *Professor Sayers*: Do the rates of discount in such cases change at all as interest rates in the financial world change?——*Mr. Rowntree*: They have been extraordinarily steady.—*Mr. May*: It might be so if there was a general change in the level of interest rates which was likely to last over a very long period; but by and large it is no more directly dependent on real interest rates than are the service charges in hire purchase or other forms of credit.

6631. *Chairman*: Does each trade have an accepted discount rate, or is there a general trade rate for this purpose?——There are two or three sets of rates. With any supplier there is usually more than one rate according to the period of credit taken.

6632. *Sir Oliver Franks*: Could you tell us what they are?——*Mr. May*: The normal rate is 2½ per cent. for monthly settlement.—*Mr. Rowntree*: Very often coupled with 3¾ per cent. for settlement within seven days.

6633. *Chairman*: We now pass on to consumer demand. You say in paragraph 18:—

"The Association's impression is that in the main the restriction of bank advances has had little overall effect on the level of consumer demand."

Then in paragraph 19 you go on:—

"Taking first the case of restrictions on hire purchase, undoubtedly when initial payments are raised and the periods of repayment shortened there is an immediate fall in hire purchase sales. But whether this fall is permanent, or represents an overall cut in consumer spending in favour of savings, is questionable. In part it appears that the expenditure is diverted to other classes of merchandise in the form of either cash sales or of hire purchase sales for goods of lower value; in part it appears that the fall is merely a postponement until such time as the increase in the required deposit has been saved."

How far can one put one's finger on points like that? Is it just a general impression?——*Mr. May*: It is partly a general impression. One can put one's hands on the figures for hire purchase, but the extent to which money is being diverted into cash sales must, I think, remain a general impression from the movement of turnover figures.

6634. Was this "down trading" and purchase of goods of lower value but still on hire purchase terms a noticeable phenomenon?——*Mr. May*: Not so much in our own experience, but I believe some others have found it. Have you any details of this, Mr. Dunse?—*Mr. Dunse*: I have no concrete figures; it is a view which has been strongly expressed by some people to whom I have talked, but it flows in part, I think, from their knowledge of their own hire purchase sales, when there has been something like the restrictions imposed this time last year, when the impact on the higher value goods was noticeably greater than on the lower. Nobody can say definitely whether the fact that the hire purchase sales of lower value goods do not react quite so sharply is because of that switch from higher to lower value goods, but the belief in the trader's mind is that it is. Beyond that I cannot take you.

6635. Is this subject covered by consumer research inquiries?——No.

6636. *Sir Reginald Verdon Smith*: But the effect in the change of restrictions would be so marked in the minds of traders that there would be an immediate reappraisal of inventories and orders in order to move into a different price category?——*Mr. May*: Before the last restrictions were brought in there was a period of quite free hire purchase trading and something of a hire purchase boom. The immediate effect of introducing the restrictions was to bring down hire purchase sales by anything up to 50 per cent. Hire purchase affects particularly heavily a certain class of goods, so that there naturally would be a slowing down in the placing of orders and a tendency to keep stocks not too high immediately thereafter.

6637. *Chairman*: Since you are very much in touch with manufacturers as your suppliers, can you tell us the effect of these dislocations on the manufacturers?——The tendency must be surely that they get stocks piling up a little bit and replan their production.

6638. I wondered how much you had seen of it?——Not very much.

6639. *Professor Sayers*: Do you pass the fluctuation pretty completely back to the suppliers?——*Mr. Rowntree*: It is passed back only at one jump. Our orders will be decreased for that type of thing fairly immediately, but we do not pass it back to the extent that we cancel outstanding orders, or anything of that sort. Existing commitments with a manufacturer would usually be run off.

6640. So that when there is a fall in consumer buying due to some sudden change of this kind, your stock does tend to run up?——Yes, the effect is for it to run up and that has to be dealt with.

6641. *Lord Harcourt*: But you do not normally cancel orders with manufacturers; you accept the extra burden?——We take that burden.

6642. When you say that there is a tendency to switch to goods of lower value, are you meaning there that a man wanting to buy on hire purchase and only having a certain amount of money available will buy a smaller or cheaper ice-box, or that he will say: "I have so much money which I was going to put down for an ice-box, but it is not now sufficient for the deposit, and therefore I will buy something else"?——The answer to that must be guesswork. I think that the standard picture, at least in the North, is that of a household setting aside a sum for hire purchase repayments in relation to weekly income. Therefore they will choose one of the two alternatives, but I do not think it is typically one alternative. They may either buy a cheaper ice-box or something different.

6643. *Chairman*: Then you go on in paragraph 20 to the distortions in the pattern of consumer demand; and you speak of the credit sale which is not controlled so long as it does not exceed nine months. Is this growth of credit sales a major phenomenon?——*Mr. May*: No. It has tended to do this on each occasion when hire purchase has been restricted; it has done so more this time because the restriction has been heavy. This is one of the longest periods in which we have had such a heavy restriction.

6644. *Sir Reginald Verdon Smith*: So that it is cumulative in its incidence?——*Mr. Rowntree*: Yes.

6645. *Sir John Woods*: If the hire purchase restrictions are taken off, does the credit sale tend to fall again and the ordinary hire purchase take over?——I would expect it to, the controlling factor being the amount the customer has to find for the deposit or the first instalment.

6646. *Chairman*: Which would the department stores prefer to have, hire purchase or credit sales? Does it make much difference?——*Mr. May*: It takes less capital to finance a given volume of credit sales than hire purchase sales, because the credit sale is completed in nine months. Clearly we should prefer at the present moment anything which occupied capital for a lesser time, but if there was plenty of capital available for all of us we should want to have both to the maximum extent we could. There is this difference, that in the case of hire purchase the ownership of the goods does not pass until a final instalment, whereas in credit sales it passes at the outset of the transaction.—*Mr. Rowntree*: It has become the practice to make a credit examination before granting credit loans, but repossession is an academic problem.

6647. *Lord Harcourt*: What is your experience of repossession?——*Mr. May*: It very seldom happens. I think there has been rather more at the lower level of trade; I have no information and cannot speak about that. In the department store world it has been a weapon in reserve that is used just occasionally.

6648. *Professor Sayers*: You said just now that, if there were not the difficulties of capital, then you would want to have both credit sales and hire purchase business to the maximum extent you could. You prefaced that by some remark about the present state of the capital market or the credit market, indicating that you felt at present restricted. Did that imply that one of the effects of this feeling of restriction is the inability to extend credit sales and hire purchase finance generally, even if the regulations permitted it?——I think the question we were trying to answer was which we would prefer. I said that at

present, because we had not all the capital in the world, we preferred to see extended credit sales going ahead, because the credit sale is all over in nine months.

6649. This is an indication of the way in which the present state of the capital market is influencing your minds?——It would influence us, I think, if we were allowed to drop our deposits on hire purchase; but we are not to the best of my knowledge, restricting facilities in extended credit and hire purchase which we are offering our customers within the limits of the present statutory regulations.

6650. Suppose that those regulations were taken off, but the present credit and capital difficulties more generally remained; would you then feel restricted by inability to get sufficient funds?——*Mr. May*: There may be a possibility of that, I am afraid. We should have to think very hard.—*Mr. Rowntree*: If there were an equivalent hire purchase boom to 1955 or if there was a big swing-over to hire purchase, we should.—*Mr. May*: On your assumptions business might not be so good.

6651. I am trying to envisage a situation in which the special restrictions of hire purchase, credit sales and all that have been taken off, but business conditions in general are booming; and I am wondering what would be in such circumstances the effects of a more general credit restriction, not directed at hire purchase transactions or any particular transactions, but a restriction that you would feel as an inability to get much credit at the bank, or to sell debentures on attractive terms. How effective would such a general restriction of credit be in hampering your trade?——Are you assuming that there would be no credit available to finance houses?

6652. I am assuming that you would find difficulties and would have to pay high interest rates?——The fact that we had to pay high rates would not matter.

6653. But the difficulty of getting money from the banks, or from finance houses or insurance companies, might seriously affect your business?——If we were in a state of affairs where generally speaking the country was very prosperous, but for some reason the retail trade was debarred from getting capital, then we should obviously have difficulty in financing all we wanted to do, and might have to choose between different alternatives.

6654. You would put the difficulty entirely on the lack of availability and not at all on the rate of interest?——*Mr. May*: Not at all on rates of interest, unless the rates were very high.—*Mr. Rowntree*: There would come a point: what that point is, I do not know. It certainly has not been in the background of our minds even since September.—*Mr. May*: It would be a pretty queer economy, would it not?—*Professor Sayers*: It would be a different one from what we have had lately.

6655. *Chairman*: Then you go on to the effects of purchase tax; and then we come on to our question whether you had any suggestions for improving present arrangements for short-medium and long-term finance. You say that the large firm would say that existing arrangements are quite adequate, and that what is required is not new arrangements for finance but an increase in the overall supply of capital funds and the removal of all arbitrary restrictions on the capital market; but that for the smaller firm "existing arrangements are probably less than adequate"; that "taxation bears especially heavily on their ability to plough back profits, since many are liable to a surtax direction if they do not distribute what the Special Commissioners consider to be a reasonable amount". We know this point about the peculiar position of the tightly held concerns that may come under this special jurisdiction, but are there many examples in this field of directions which have actually been made, or is it just a general shadow, as it were?——*Mr. Dunse*: I have certainly spoken to quite a number of people under this shadow, but I could not quantify it for you.

6656. Then you say that estate duty is a severe handicap. What firms "cannot go to the open market as, by their nature, they are unable to offer suitable terms and conditions"?—*Professor Sayers*: They can go to the insurance companies; do they?——*Mr. Dunse*: The short answer is that they go nowhere. They can; but again I am advised by those that have been searching for capital in the last few years that it is often very difficult to get capital in any significant quantities without some term or condition which involves participation and control.—*Mr. May*: One remedy that has been sought is the sale of the frechold.

6657. Do they ever go to the I.C.F.C.? This institution was set up to supply just this kind of requirement, and the word "Commercial" appears in its title?——*Mr. Dunse*: I do not think they have been; I do not know why not.

6658. *Chairman*: What kind of remedy have you in mind? If they have a ring of family connections round them which have money to spare, they can look for financial help without the question of control which always seems to come in at this point. But if that social situation has changed, can they hope to get finance in the way they want it without having to concede some form of partnership or participation?——We have not gone so far as thinking what the answer might be; we just saw the problem. I should have thought that it would be a good thing, if there was an answer, to find the answer, because quite often these firms are at the stage where participation of outside interests and control in the management of the firm is not necessarily going to be a good idea; the firm is not yet large enough to have that outside intervention. This is all rather theoretical, I am afraid; but there does seem to be a ring of truth and justification about their arguments and complaints.

6659. *Professor Sayers*: But these are arguments of which the I.C.F.C. is very much aware, and in its dealings with small concerns it makes very considerable concessions in order to overcome the difficulty. What is the inadequacy of this existing arrangement?——*Mr. Dunse*: The probable reason for the lack of approaches to I.C.F.C. from the retail side may stem from the wartime conditions in which retailing obviously had a very low level of priority; it is assumed that while capital generally is short the I.C.F.C.'s acceptances of proposals will tend to be on things that have a higher priority than retailing.

6660. *Chairman*: You cannot help us further because nobody has tried his luck?——So far as I know: we could find out whether that had been done.

6661. *Sir Reginald Verdon Smith*: You are dealing in this paper with the monetary, and in particular, the capital factors affecting the smaller firm. One is familiar with problems affecting smaller firms in manufacturing, small farmers and small traders in your line of business. I am rather left with the impression that this is part of a phenomenon affecting the general character of business in manufacturing industry, and that the small man has many problems. Is it in fact the case that in retail business there is a marked general change in the character of organisations and the size of firms, and that a variety of reasons, capital and monetary, have created a trend which is difficult for the small trader?——I think that perhaps there is this tendency; in many cases the smaller trader has had a very expensive site and buildings, and it is doubtful whether in present day conditions he is really making an adequate profit to service the present day values of it. When those problems overcome him he tends to get taken over. But I would have thought that, in retailing in particular perhaps, the small business more or less adapted to the size of its local community is able to make quite a reasonable profit, and probably to plough back sufficient to deal with most of its capital requirements.

6662. *Lord Harcourt*: Leaving a takeover bid out of account, has there been a marked tendency since the war towards amalgamation?——There has been a fairly steady stream since 1953; it slowed down just after the war.

6663. Was that amalgamation by way of absorption of the family business by bigger businesses, or the amalgamation of several family businesses designed to make an economic unit?——Absorption was the typical picture.

6664. *Chairman*: Then we have your general observations on the use of monetary measures. Are there any questions on that?—*Sir John Woods*: Is it your impression in this that monetary measures ought to have been taken both earlier and in a more drastic fashion, or would you say it is the one or the other? Is it your impression that this was a case of too little too late, or was it primarily a question of timing?——I think we felt that it was on the late side; not necessarily too late to judge from the effects since, but it would have been much more helpful to have had it earlier.

6665. I do not mean the 7 per cent. of September, 1957. I was recalling that we had the first warnings of inflationary tendencies in 1954, but nothing happened, I think, until January, 1955, when there was a relatively small rise in the Bank Rate. Do you think that, if measures had been taken earlier than they were taken, they need not have been so severe, or that they should have been both earlier and severer, or what?——I think we felt that if they had been taken earlier they need not have been so severe, but they ought to have been severer than they were. There was a moment when hire purchase restrictions, for instance, were suddenly taken off, only to be reimposed much more heavily about nine months later. At the time we found it difficult to see why we had complete relaxation.

6666. In other words, you feel there was rather a gingerly approach?——Certainly, yes.

6667. *Professor Sayers*: You mentioned the hire purchase restrictions just now. Have you in mind that there could advantageously have been greater severity in using other measures? If so, which?——Yes; in making less credit generally available through monetary measures of one kind or another.

6668. *Chairman*: Your general observations are, I think, wholly devoted to the use of interest rates; you say that they really are the true measure if properly applied, but they have not been properly applied and therefore have not been effective. Effective, to do what, in your view (forgetting last September)?——*Mr. Dunse*: Bank Rate had been moving by jumps of one half and 1 per cent. I think we would say that moves of 1 per cent., even assuming that that was going to jack up the general rate of interest, were not, for the reasons we have given, going to influence anyone's thinking very much. In so far as people look at the Bank Rate as an indicator and an earnest of the Government's intention, a move of 1 per cent. never convinced anybody. There was no very drastic result, in so far as it failed to influence people's thinking and to convince them there was going to be any drastic result. It failed to have any effect upon their commercial decision.

6669. Could you say what are the conditions which show that a use of the interest rate has been fully effective? Is it stability of price which demonstrates its effectiveness?——Stability of prices would be one fact. The effect of the 2 per cent. rise last September has been to cause people to review their ideas much more seriously than in the past.

6670. *Professor Sayers*: Was it the 2 per cent., or was it Mr. Thorneycroft's reference to the supply of money?——I think it was probably the accumulation of most factors, but I am thinking largely out loud, and not perhaps reflecting the views of members of the Association; the 2 per cent. Bank Rate, a greater rigidity on bank advances than there had been in the past, or in the way it was going to be secured, various other statements of intention and steps taken, and an indication of the results as they started to emerge; I should think all those played a part.

6671. Why do you persistently refer to the rise in Bank Rate as one of the things that impress people, although in your own businesses you say that the rate of interest in this sort of range just does not matter at all?——*Mr. Rowntree*: The distinction in our minds is that we in the main, in the business, are considering our estimate of what the customer is going to want from us, rather than the direct impact of a changed Bank Rate on the financing of our stocks.

6672. You are in no peculiar position in this, are you?——No. It perhaps is that the rates have not yet reached the point at which we have taken them into account. Maybe we ought to have taken them into account more than we have done; but in fact retailers generally have not given this factor any high priority. It has been our estimate of what our customers would want that has been the guiding factor.

6673. *Sir John Woods*: Did the increase of Bank Rate to 7 per cent. last September make you say: "We think this may have a real effect on our customers"? Was it effective on your minds in that sense?——*Mr. May*: It was effective, I think, as an indication that in that way and all the other ways it did look as if the Government were intending to reduce inflation. It was the size of the movement.

6674. Plus all the other measures; but the particular size of the movement was one element in your minds?——*Mr. Rowntree*: Yes.

6675. *Chairman*: I would deduce from that that what is effective is whatever measure or set of measures the Government of the day can take which make people believe that demand is going to be reduced, and that there is nothing peculiar about the rate of interest. Is that an unfair deduction?——I think that the rate of interest by itself, without other measures of some sort to bring it right home, would not by itself achieve results.

6676. *Professor Sayers*: Would you put it the other way round, and say that all the other measures taken without a change in the rate of interest would have been sufficient evidence of the Government's determination to have the effect for which people were looking? I find it very difficult to reconcile your view that the rate of interest does not matter in your business with the view that it is an important ingredient in the Government's announcement?——*Mr. May*: We are talking parochially about business of our own type. The extra amounts of money which we want are relatively marginal as against an overall increase of 2 per cent.

6677. Are you peculiar in that?——No; with other businesses presumably the same thing applies.

6678. Then why suppose anybody will be affected by the rate of interest even with other measures? I was asking you to compare the two situations, one in which all the measures taken last September are taken, and the other in which all the measures are taken except the change in the interest rate?——One would want a controlled experiment to get the answer to that.

6679. You did give an answer, in that you said you took notice of this rise in Bank Rate. You thought it was an indication of the Government's determination. We have had the experiment?——We have not had all these measures without it and also with it. That is what I meant by a controlled experiment. It is very difficult to disentangle any action from its psychological effect. It is also difficult to disentangle actions from the circumstances of the time when they are taken. But a 2 per cent. rise in the Bank Rate did certainly make a very great impact on the business world. It was taken seriously and in our view produced results.

6680. *Sir Reginald Verdon Smith*: Did members of the Association notice a reduction in the Bank Rate a fortnight ago?——We noted it, yes.

6681. Did it appear to have any significance?——It is still a pretty high rate.

6682. Would the change in itself have affected your thinking?——No.

6683. *Sir Oliver Franks*: You said that your own considerations about the levels of stocks you would hold, how you would finance your business and so on, had not been affected by the different levels of Bank Rate we have experienced over the last six years; and that you did pay attention to the 2 per cent. move on 19th September last, but in what you called the indirect way, because you thought it would affect the economy in which your customers live and therefore the demand coming back on you. Now it seems to me that saying these two things should lead you perhaps to the one or the other of two possible consequences. One is a point of view which I think you rejected, that this retailing business is peculiar and therefore immune from effects which the rest of the community notices, so that you go on as it were unscathed with the right to take into account the rest of the community not being unscathed by the 2 per cent. The other is that it might be the case that the effect on the rest of the community was essentially not a real difference in their calculations of what to do and what not to do, but a difference in their expectations of the determination of the Government, that this was not taken as anything but a symbol that the Government at least intended to be effective. Do you agree with that?——*Mr. Rowntree*: I think it is as a symbolical and intangible factor that we take it into account. I do not know whether it is fair to say we pay no direct attention to it. What we are trying to say is that the direct effects on us do not carry as much weight as these other considerations in our normal thinking. We are not saying whether we are right or wrong in that.

6684. You think that the community generally takes a large movement of the Bank Rate up and down to be a very important indication of the Government's intentions?——I would not like to say they do as a regular thing. I think they did in September last, where that was the thing that caught their minds. I am sure there was a change in the feeling of people; they thought that this time the Government was really going to check the inflationary tendencies.

6685. It was that rather than any noticeable and observable change in the world as a whole at that time which influenced people's minds? If you remember, the fact that the American economy was running down began to be noticeable about then?——*Mr. May*: Yes. That was really what I meant when I said you could not dissociate it from those circumstances.

6686. One might try to dissociate; do you think it would be unprofitable to do so?——Not unprofitable, but rather too difficult for us. I think we should still have thought very hard, if there had been a 2 per cent. increase of the Bank Rate plus a general look as though the Government were determined to do something, even if it had not been for the American position and the concurrent circumstances in Western Europe and this country.

6687. *Sir Reginald Verdon Smith*: With these impressions in your minds did you in fact do anything different in your policies?——I do not know what the trading policies of all my colleagues in the Association were, but I called a meeting of all my directors of buying immediately after that, and issued fresh instructions about our buying policy: not materially different but slightly different from the previous ones. I think that probably there would have been generally a very slight change of climate.

Chairman: The matters with which we have been dealing are right in the centre of our problem. We are very grateful to you, gentlemen, for answering our questions.

(*The witnesses withdrew*)

(*Adjourned until* 2.15 *p.m.*)

C. HORTON, ESQ., President, J. DIAMOND, ESQ., Vice President, A. WHITTLE, ESQ., P. B. ETHERIDGE, ESQ., and MISS G. S. PAGE, Secretary, representing The Federation of Wholesale Organisations, called and examined.

6688. *Chairman*: Mr. Horton, we have all read your memorandum* through; you have argued it so well that we do not think there are a great many questions which will arise on it. May we just go through it paragraph by paragraph? You tell us that you are representative of those organisations which are concerned with the wholesale distribution in Great Britain and Northern Ireland of basic consumer goods, and you give us the constituent member organisations in the second paragraph. Then you give us the background of the views you express. How are they built up? What kind of discussion or questionnaire have you used to get this material?——*Mr. Horton*: When we had your original invitation and the list of questions on which you wanted our views, we dealt with it in two ways. We had a preliminary discussion with our own council, and then we sent it to our individual constituent organisations and asked them for the views that they might have on the particular aspects of the question. The views we have received from them have been welded together in the report which you now have.

6689. So all your members had our list of questions to express their views on?——That is right.

6690. Then you give us a description of the build-up of the wholesale organisation; and the main functions of the wholesaler are summarised in paragraph 8. In paragraph 6 you say:

"Furthermore, the fact is inescapable that even where manufacturers distribute directly to the retailers an important measure of wholesale organisation has to be maintained and operated by the manufacturer concerned within his framework."

How common a practice is it for the manufacturer to distribute direct to retailers?——It varies according to the industry. If I may take, for example, the radio industry, with which Mr. Diamond and I are particularly concerned, the tendency there is for quite a number of manufacturers to distribute direct to the retailer. On the other hand quite a number also go through the wholesaler.

6691. How do these things build themselves up?——*Mr. Horton*: If I may again quote the radio industry as an example, when the radio industry first came into being there were no manufacturers, wholesalers, or retailers as such, and the industry developed from the bits and pieces which were supplied particularly as constructor kits. The chief line of distribution in that case was through the motor wholesaler, and, there being no retail outlets, he used his motor trade retailer as the outlet in that connection. With the development of the industry certain manufacturers first of all became constructors of sets; in other words, they bought the components from the wholesaler and assembled the set, and then marketed it under their own name. From that developed the radio manufacturer as we now know him. At that time the whole of the distribution was through the wholesaler. But just prior to the war some of the manufacturers felt that they could do better by cutting out the wholesaler and going direct to the retailer, and there has been a tendency that way. On the other hand there have been cases of manufacturers who, having tried direct representation, have come back to the wholesaler.—*Mr. Etheridge*: I represent the electrical wholesalers' side. In the minds of many of the members of the public the electrical and radio side are synonymous, but in fact the pattern of distribution is very different on the purely electrical side which covers the installation of materials, the equipment which a contractor uses in installing lighting and wirings and the industrial equipment, and also to a certain extent the domestic appliance side. In that case it has very largely been built up on wholesale distribution. A manufacturing firm which is a household name, at a recent conference celebrating its fortieth anniversary, paid tribute to the fact that without wholesale distribution it would never have established its name as a national name as it has now. The point we are making in paragraph 6 is that whoever distributes, be it the manufacturer or the wholesaler, somebody has to perform the wholesale function.

6692. Is there a tendency for the wholesale function to be carried by the manufacturer in the old established trades, like textiles or hardware?——*Mr. Whittle*: If I may speak on behalf of the hardware side of the industry, hardware wholesalers stock a vast range of lines; in the normal way between 6,000 and 10,000 different types of lines. So it is more general for the wholesaler to perform the function of distribution rather than the manufacturer. It is only in the case of goods where the appliance is costly, for example a powered lawn mower, that the manufacturer would think it more desirable to go direct. Direct representation would be necessary where the manufacturer has to provide an after-sales service.—*Mr. Diamond*: The tendency has been for the manufacturer to go direct in the case of goods of large unit values. In the radio trade components are invariably distributed by the wholesaler; and the same applies in the electrical industry.

6693. In paragraph 8 (i) you say:

"The wholesaler assists manufacturers by giving them a prompt cash settlement. Similarly, he helps retailers by credit which he allows them. Indeed a very substantial proportion of the capital employed in the wholesale trade is required for credit facilities."

I suppose that is rather a simplified statement of the whole situation. What qualifications are there of the statement that the wholesaler assists manufacturers by giving them a prompt cash settlement? Presumably there is some rule in this. When you find some difficulty about financing yourselves, and bank overdrafts more difficult to obtain than other forms of credit, is there no extension of the credit as between the wholesaler and the manufacturer?——The only time when there is any real extension between the manufacturer and the wholesaler is in times of difficulty when there is a fall off in sales. Then frequently the manufacturer will try and prevail upon the wholesaler to take larger stocks, and make a very big effort to clear his own stocks, and

* Memoranda of Evidence Part VII No. 16.

be will combine that with an advertising programme as well. In such instances when manufacturers ask for that extra co-operation they do prescribe an extra month or two of credit, if necessary; but by and large specified terms are 3½ per cent. discount for settlement in seven days or 2½ per cent. for monthly settlement. There are exceptions, of course; some manufacturers demand net terms whether they are paid monthly or in seven days.

6694. When sales get difficult, and things do not move so freely into the hands of the consumer, who in your opinion holds the burden of carrying the stocks, the retailer, the wholesaler or the manufacturer?——Usually all three.

6695. Impartially distributed between them?——It is fairly well spread, but if there is serious over-production, then it is the manufacturers who carry the heaviest weight. Then they usually get rid of stocks through the big stores or the multiple chain shops; in the last emergency you find that.

6696. Is that at a knock-down price?——*Mr. Diamond*: Usually a knock-down price, yes.—*Mr. Whittle*: Certain commodities are susceptible to seasonal influences, particularly in the hardware trade: for example, oil heaters. If one has a mild winter the wholesaler is left with very substantial stocks on his hands, and he will bear the burden.

6697. *Mr. Jones*: You have indicated the terms of the supplier to the wholesaler: 3½ per cent. discount for settlement in seven days and 2½ per cent. for monthly settlement. What are the terms between you and your customers, the retailers?——*Mr. Horton*: The same.

6698. What is involved in the latter part of this paragraph under "financing", where you say:

> "Indeed a very substantial proportion of the capital employed in the wholesale trade is required for credit facilities."

How much would you say is required because of extended credit, and for how long?——It is difficult to say exactly how much. In times of trade recession and difficulty the retailer tends to take considerably longer than a month to pay for his account. The normal trading period in most trades is that the account is payable thirty days after delivery of the goods, and the wholesaler, if he is to maintain the distribution of the manufacturer, has to keep pretty closely to those limits; but the retailer does tend to require extended credit. We find that in serious times the credit taken may be up to two months or more.

6699. Have you any sort of rough calculation of the amount of your accounts that are settled within thirty days, and are therefore earning trade discounts, and those that are not settled within that period under present conditions, and how the present compares with the past before we reached the recession?——I have no actual statistics

6700. Is it worse now than it was twelve months ago?——*Mr. Diamond*: Yes, it is somewhat worse. I would say there has been a falling off of trade, but I do not think I would say there is a decided recession yet.

6701. As wholesalers, you are requiring more working capital?——Yes.

6702. Why are you requiring more working capital in April, 1958, than you were requiring in April, 1957?——Because the seasonal demand for most goods has come to an end quicker during the period from January until now than it did, for example, last year. There has been a smaller demand from the beginning of January to the end of March than there was last year.

6703. You do not associate that with any form of recession?——I would not say it is a serious recession; it is a falling off of demand. I can only talk about some industries; but one of the reasons why dealers have been requiring bigger credit has been that they have not been able to secure overdrafts themselves, and have gone to their wholesalers to ask for a longer time to pay. Their overdrafts have been shortened by their bankers, and they are asking for more credit from us. Also they have to carry the burden of purchase tax on their shoulders, and that is quite a heavy burden in many industries.

6704. *Chairman*: The next section is fairly general: then we come to the section on "Effect of the authorities use of monetary measures".—*Sir Oliver Franks*: You say in paragraph 20 that there has been an attempt in general to limit the supply of money by restrictions imposed or threatened and that these restrictions have not proved efficacious. What does that mean? Had you in mind that they were not efficacious, in the sense that the supply of money was not limited, or did you have in mind that, while the supply of money was limited, the wider objectives which the Government had in view were not attained?——*Mr. Horton*: The spending power is still there, so that the supply of money has not really been restricted.

6705. And "not efficacious" means?——That the restrictions have not really achieved the object which the Government had in mind in imposing them.

6706. The object being?——To restrict spending power.

6707. You feel that the various things which the Government has done, whether by increasing the Bank Rate or imposing restrictions on hire purchase, or whatever it may have been, really have not altered the readiness of the supply of money at all?——We feel that the demand for the goods has still been there; as we say in paragraph 20 the demand for consumer goods has shown no serious tendency to fall off until recently. I read only yesterday that in hire purchase the fall off has been about 43 per cent. as compared with a year ago; but during the year there has certainly been no slackening off in the demand for goods. Therefore we feel that the effect aimed at has not really been achieved.

6708. *Professor Sayers*: But at the end of paragraph 23 you refer to the restriction of stock due to credit measures. Who has been restricting stock on account of credit measures?——Both the retailer and the wholesaler.

6709. Have you evidence of specific cases?——Yes. Our experience is that retailers in particular are tending to buy hand to mouth instead of putting goods in stock.

6710. Has that been due in your knowledge to the credit measures?——We assume that it must have been because they have not got the financial resources to put goods into stock.

6711. It is no more than an assumption on your part?——Yes.

6712. *Sir Oliver Franks*: When you say "assumption", I take it to mean that you think that that is what must have been the case; but if you said you knew it as a matter of fact, then you would be aware of certain individual cases of customers who were ordering from hand to mouth and had told you that it was because they had no cash to do otherwise?——*Mr. Horton*: We can only speak from our experience; orders placed, added to the long period taken over payment, must have some bearing on the question we are discussing.—*Mr. Diamond*: There is a decided tendency for retailers to order more frequently but in far smaller numbers. They hesitate before buying in any quantity at all these days, and they virtually buy according to the demand they are experiencing.

6713. *Chairman*: So in your experience the smaller numbers covered by each single order is matched by a greater frequency of orders?——There is a greater frequency of orders, but they are all very much smaller.

6714. *Professor Sayers*: Since when has this been?——Since last September approximately.

6715. Was it noticeable at all before September?——Not to anything like the same degree. There was an approaching drift.

6716. *Sir Oliver Franks*: When you talk with your customers, do you get any information from them about why over this six months period they have behaved differently from the way in which they behaved before, and why orders are more frequent and smaller in this last six months?——I have the opportunity of speaking virtually all day long to clients, either at our Trade counters or over the telephone. Their explanation is that the public are far more critical and cautious in their buying, and the dealer is therefore hesitant to take a chance on his purchasing. He will buy what he is able to sell readily.

6717. Your customers, the dealers, might be drawing in their horns as a result of the announcements of Government policy that were made on September 19th last, not because they affected them directly but because they felt that demand was likely to be different: they were thinking that the measures might have altered the expectations of

their customers. Are you saying that your dealers have altered their behaviour in relation to you because of the feeling that their customers' demands are changing, and not directly because of what the Government announced, and that the relevance of the Government announcements to you is that they are indirectly reflected in customers' demand?——What occurred in the latter part of September cast a very dark shadow over buying in general. At the Radio Exhibition, which took place the last week in August and the first week in September, dealers came from the length and breadth of Great Britain in a very buoyant mood. They had not a large carry-over stock from last summer and were very optimistic. Then in the middle of September that dark shadow came.

6718. But did the shadow put the dealer directly in the shade or did it fall over the customers, and because the customers' views had changed make the dealers alter theirs?——I would say a combination of the two.

6719. Can you point to what, in the Government's announcements, was more important than other things in making this change of mood or casting the shadow? Was it what they said about bank advances, or what they said about the Bank Rate, or was it what they said about Government expenditure?——I would say all these things, plus the fact that there was also a veiled threat that if those measures did not succeed even sterner measures would be taken.

6720. Would it have made any difference to the length or darkness of the shadow if the Government had said all the rest, including the suggestion that if this was not enough more would be done, but had not said anything about the Bank Rate?——*Mr. Horton*: I think the Bank Rate was probably the final thing that hastened the shadow, because that presupposed a tightening of money resources and the difficulty of getting advances and that sort of thing, and the hint that that was possibly only a stage.

6721. Could we put it in a form to which you and your colleagues could answer yes or no to this? Do you think that the marginal element in the change of mind of your dealers or their customers was the sudden change of the Bank Rate to 7 per cent. in September last?——*Mr. Horton*: Yes, plus the difficulty of hire purchase.—*Mr. Diamond*: I think that jump frightened a lot of people. Had it been done by degrees, 1 per cent. at a time, it might not have had so decided an influence.

6722. *Mr. Jones*: Have the wholesalers, and has trade generally, been affected by the controls on credit from the banks?——*Mr. Horton*: Yes. The principal use which the wholesaler makes of bank advances is to meet his commitments in regard to purchase tax, and the tendency at the bank has been to make less credit available to him in that respect.

6723. Then your difficulties, in the situation of a damping down of trade, have been attributable to two factors: an increase in the rate you had to pay for any credit advanced, and in the second place, a reduction of the working capital that was normally made available on a short-term basis by the banks?——Yes; we could not get the loan, and if we could get the loan we had to pay more for it.

6724. *Professor Sayers*: You gave a very decided answer when you were asked if the jump in the Bank Rate had anything to do with it; and you have added since that this meant that you had to pay more for your bank credit. Would you put more directly why do you attach such importance to the jump in the Bank Rate?——I think the jump in the Bank Rate was first put to us by Sir Oliver Franks as to the effect of that upon our customer, either the retailer or the public. The answer that we should have to pay more was related to the effects of the Government's policy on bank advances to the wholesalers as such. The wholesaler, as I have said, normally carries quite a big bank overdraft, which is largely, though not entirely, to meet his quarterly commitments in regard to purchase tax. That is being made more difficult for us because, where formerly the bank was prepared to advance the money, they are becoming more difficult in view of the Government's instruction; and because, where the money is also available, we have to pay a higher rate of interest for it. So the wholesaler has to pay more for the accommodation he temporarily requires to meet his commitments on purchase tax, and at the same time he gets nothing for the collection of the tax. Under normal conditions it costs him quite a big percentage to act as the tax collector, but he is having to pay even more under present conditions. Added to that is the fact that, as we have mentioned previously, the retailer is now taking longer to meet his commitments; the money accruing to the wholesaler during the period of purchase tax is coming slower and slower into his possession.

6725. *Chairman*: Where does all this get us to? The wholesaler has his line of credit from the bank, mainly used for purchase tax, restricted, and he has also to pay more for accommodation from the banks; the retailer has had his credit cut down; the customer is reported to be more cautious and critical in whether he will make a purchase or not; but in spite of all that there has only been a slight slackening in the ultimate demand from the customer?——*Mr. Diamond*: No. When I said there was not a recession, I was thinking in terms of a recession like the one we read so much about in the papers today in America. I do not want to go so far as to view it as a really serious recession, but there has definitely been a slackening in the demand. Dealers are continually emphasising that the public has not as large an amount of spending money today. They are not working overtime at week ends and during the week. A lot of the luxury or semi-luxury articles they were able to purchase a year ago they are not able to purchase now. That has caused the dealers to become more cautious and not to take a chance in putting in larger stocks than they deem essential.

6726. That is the radio trade. What about the others?——I put that as far as radio, electrical and musical trades are concerned.

6727. *Sir Oliver Franks*: That is not the case with soft goods?——*Mr. Horton*: No.

6728. That is why we are interested in what the range of trade is. Can you tell us about hardware?——*Mr. Whittle*: The tendency in the latter months has been very similar to that outlined by Mr. Diamond. During 1957 the graph of sales followed very closely the 1956 pattern; in the peak month it was a little higher. Then there was a drastic falling away during November, December and January. Sales should now begin to improve according to our trade pattern, but in the latter few months I should say that trade is not so good as in the early part of 1957.

6729. *Professor Sayers*: That is of sales by the wholesaler to the retailer?——Quite so.

6730. *Chairman*: And the electrical trade?——*Mr. Etheridge*: I do not wish to comment on Mr. Diamond's remarks; Mr. Diamond is interested in the electrical and radio trades.

6731. *Professor Sayers*: Suppose that last September when your trades had been fairly buoyant the Government had done nothing except make a very steep increase in Bank Rate; what would have been the effects on your trades?——That is a hypothetical question, and it is awfully difficult to know the effect of a hypothetical question on a trade. Is not the answer that the psychological effect on trade generally of the sudden jump in the Bank Rate was sufficient to jolt trade as a whole in this country into a knowledge of the financial difficulty in which the country was, on the balance of payments? I do not think one can say what would have been the effect on trade of one individual thing; but I would say, speaking personally, that the psychological effect of this would have been sufficient, because it was the psychological effect of the 7 per cent. which shook trade generally into realising the difficulties.

6732. You stress that it would be a psychological effect and it would be general; nothing peculiar to the wholesale trade?——I am not suggesting that it was.

6733. And why do you think people would be so impressed by this measure?——*Mr. Diamond*: I think it spreads a little further. There was a series of events. There was the resignation of the Chancellor very shortly afterwards, and the talk about this country *vis-à-vis* other countries; that had an ill effect, and the papers made so much of it at the time. People became somewhat cloudy in their outlooks; they were confused in their minds; they were worried as to the future. They just did not know how to interpret it all or what the effect of it was going

to be. That seemed to be the general consensus of opinion.

6734. Coming to paragraph 25, in your experience was capital expenditure abandoned or postponed as a result of the September measures?——*Mr. Horton*: In so far as certain of our own members are concerned, definitely. They have had to postpone plans for extension of premises, and so on. In some cases they are still using premises that are entirely unsuitable, which they have perhaps outgrown, and which in normal times they would have rebuilt or enlarged; but for the time being they have to put that into cold storage.

6735. *Chairman*: But you would not have looked to your banks to finance that kind of expenditure, would you?——Partly we might have done.

6736. Temporarily?——Temporarily and partly.

6737. *Professor Sayers*: Which part of the Government's measures had this effect?——The instruction to the banks and the increase in the Bank Rate; the fact that the money now is not there for them.

6738. *Sir Reginald Verdon Smith*: What sort of capital expenditure do wholesalers incur?——Premises, facilities generally, vehicles.

6739. *Lord Harcourt*: Handling equipment?——Yes, and invoicing and calculating machines, and servicing.

6740. *Sir Reginald Verdon Smith*: Do fixed assets form a substantial part of the capital employed, or a small part?——Quite a big part.

6741. *Professor Sayers*: Paragraph 42 refers to small concerns. Would you say that the small concerns are discouraged because the level of interest rates is now so high that their profits cannot bear these rates of interest, or is it that they expect interest rates to fall?——I think it is the former, Sir; so far as most industries are concerned the wholesaler is the small concern. There are very few wholesalers who are public companies.

6742. When you say "present rates of interest" are you thinking of any particular range? At what rate of interest, does the wholesaler begin to sit up and say: "I cannot afford this"?——*Mr. Diamond*: The Bank Rate had remained fairly static for a goodly period of time. I would say above 6 per cent., just speaking broadly.

6743. That is to say, when he has to pay 6 per cent.?——No; when Bank Rate goes above 6 per cent. he becomes really concerned.

6744. In 1955 and 1956, the Bank Rate was moving up but it was still below 6 per cent. Were wholesalers then not at all worried by the rises in the Bank Rate?——I think they were always concerned. Interest on borrowing was always part of their everyday expenses and they had to try and keep that down to as low a level as possible. Probably a slight increase would have made them more cautious, and they would probably stock less and would try to carry it from that angle; but it is rather hard to say.

6745. But I am going back to the actual facts of 1955-56; do you remember?——I do not think they were unduly worried, but they were concerned, as a passing phase, shall we say.

6746. But the concern becomes altogether greater when the Bank Rate goes above 6 per cent.?——*Mr. Etheridge*: Then there is serious concern.

6747. *Chairman*: Would it be that in 1955 and 1956 you were not concerned about the level of demand in the way you have been during the last six months?——*Mr. Diamond*: As far as my particular trade was concerned, in 1955 and 1956 the summers were not so good, but the other parts of the year were quite good. But this last year, 1957, the summer was very good indeed as far as the radio, electrical and musical trades were concerned, and gave that buoyant outlook at the time of the radio exhibition which was not fulfilled later. The summer trade was definitely better than that of the previous year; I think there was a certain amount of caution because trade had fallen off in that period of the year in the previous year.—*Mr. Whittle*: Perhaps I can give you an indication as to the state of concern experienced by the wholesalers in the hardware trade on the question of interest on borrowed moneys. From our statistics we see that the average gross margin of a wholesaler in our particular line of trade is 18 per cent. His net profit after paying his administration, occupancy, selling cost, warehousing, etc., totals approximately 3 per cent. Out of that 3 per cent. he pays 1·4 per cent. in tax; 0·03 per cent. in dividends; and 0·4 per cent. on interest for borrowed monies. Out of a net profit of approximately 3 per cent. that is a considerable proportion. That is the sales experience of 1956, which was a very good year.

6748. *Lord Harcourt*: In paragraph 60 you say: "Forward dating of invoices in order to keep factories clear of stock. . . ." What are the implications of that?——*Mr. Diamond*: When production exceeds demand the manufacturers will get together with the wholesalers and with the retailers, and come to some arrangement, or make a suggestion that, if they will take in stock and try to activate the sale of that stock, and push it for all they are worth, instead of dating the invoice, say, for 1st April they will date it for 1st May or even 1st June. Also, for example, suppose that in an industry in which seasonal demand really manifests itself, manufacturers find that they habitually build up stocks in the month of September; they will frequently go to the wholesaler or retailer in July or June and say: "You can have your invoices dated two months ahead if you will take delivery now".

6749. The wholesaler or retailer gets a longer term of credit without losing his rate of discount?——Yes.

6750. *Sir John Woods*: In paragraph 58 you say:

"Mortgages for 20 years have been extended, in some cases for a further seven years, as an alternative to repaying the enhanced interest demanded. Such action by the building societies is damaging to morale and causes loss of confidence in the sanctity of contract."

I am afraid I do not follow that; what contract is not being honoured?——*Mr. Horton*: This is not solely a wholesaler's problem. We took this opportunity of dealing with the question of loans, and so on. The building societies have increased their terms to borrowers, or given them the opportunity of extending the period of their mortgage. There is a contract, implied, if not actual, between the building society and the borrower, and the period is according to the length of time that the borrower agreed. This is not a wholesaler's problem as such, but it does seem a little hard that the building society should be able, particularly in the case of middle-aged people, to extend the mortgage for a further period or require an enhanced interest. That is what we mean by the sanctity of contract. A borrower undertakes to abide by certain commitments when he goes to the building society, and the building society on their part undertake certain commitments to him as a member of the public and a borrower. The building society are perfectly entitled to it, I presume, since they are having to pay more for the money that they are borrowing; but it does seem an almost endless sparring if a contract entered into can be set aside by one party.

Chairman: I see the point. I think that completes our questions. We are very much obliged to you.——*Mr. Horton*: Thank you for giving us the opportunity both of putting forward the memorandum and of appearing before you.

(*The witnesses withdrew.*)

1 *April*, 1958] [*Continued*

The following witnesses, representing The Farmers' Unions of the United Kingdom, called and examined:

J. A. MONTGOMERY, ESQ., Chairman, Economics and Taxation Committee, the National Farmers' Union.
D. A. CARTER, ESQ., Vice-Chairman, Economics and Taxation Committee, the National Farmers' Union.
F. VINCENT, ESQ., Chairman, Milk and Dairy Produce Committee, the National Farmers' Union.
J. KNOWLES, ESQ., General Secretary, the National Farmers' Union.
A. WINEGARTEN, ESQ., Chief Economist, the National Farmers' Union.

6751. *Chairman*: We have all read your memorandum,* Mr. Montgomery; may we take it through paragraph by paragraph to see what questions arise out of your material that we want you to enlarge upon?——*Mr. Montgomery*: If you would wish it that way, my Lord Chairman. I had not thought that we would go through some of the statistical work which you have had the opportunity of studying. All your people are bankers and specialists in economics and finance and that sort of thing, and have been on this job a good while and know the background to these matters. We are farmers; we are not specialists in these other things. I thought perhaps we could help you best by telling you, as we see them, the needs of agriculture for extra money to come in from outside into our businesses, and going through the present sources, giving you some guidance as to where they fall somewhat short of the needs of the industry in the particular categories in which they fall.

6752. We have had it very conveniently set out in your memorandum, divided into the main headings of "Long-Term Credit Institutions", and "Short and Medium Term Credit Institutions". We will just see what questions arise from us which we may want you to enlarge upon. I can assure you that we will not trouble you with statistics too much. In paragraph 2 you give us your definition of long-term credit institutions as "those which are prepared to advance money for the purchase or improvement of land and buildings for a period of ten years or longer." Then in paragraph 3 you go on: "Apart from the banks, the two main sources of long-term credit in England and Wales are the Agricultural Mortgage Corporation and the Lands Improvement Company", the Scottish Agricultural Securities Corporation Ltd. doing a comparable job in Scotland. In Northern Ireland you have the special arrangements for government loans under the Development Loans (N.I.) Act, 1945. The A.M.C. makes loans to owners and owner-occupiers for the purchase or improvement of farms and buildings for a minimum period of twenty years, and a maximum period of sixty years. The present interest rate is 7 per cent. The Corporation is prepared to make loans to landlords and owner-occupiers for certain specified improvements to land and buildings on the basis of terminable rents charged on the land improved, repayable half-yearly for a period not exceeding forty years. When you get a terminable rent charged in that way on a loan made to a landlord, does it form part of the charge which falls on the farming tenant?——Yes, it becomes a rent on the land; it is usually included as part of the rent, but should the farm change ownership, it is of course a standing charge on the property.

6753. It is part of the annual sum the tenant has to meet?——It would be calculated either as an extra factor to the rent or within the rent. It would be the landlord's decision whether he showed it separately or not.

6754. Is the tenant's consent needed before a landlord puts in an improvement of this kind? It is going to carry interest, I take it, on the current rates at 7 per cent.?——That is the problem of all these long-term loans; they carry a fixed interest charge over a period of years with severe penalty clauses if one wishes to pay off earlier. That is one of the points on which we think there is an opportunity to make an improvement.

6755. If the landlord wants to put in a farming improvement under this scheme, does the tenant have to be consulted before it is put in?——*Mr. Montgomery*: More frequently it would be the tenant's wish that some improvement would be made.—*Mr. Vincent*: The difficulty, in my experience, is to get the landlord to do it; even if the tenant is willing to pay the extra rent concerned it is difficult to get the landlord to spend the money.—*Mr. Montgomery*: The tenant would not be able to do it on his own; it is a landlord's scheme.

6756. *Sir John Woods*: You have said that, if this was done, the cost of the improvement in terms of interest was a charge on the land; does that mean that for that tenant the rent is increased proportionately?——That would be so, whether the landlord does the improvement with his own money or on borrowed money. If he uses his own money it is a clear cut arrangement; if he borrows money from either of these bodies it becomes a fixed charge on the land until it is paid off, and the tenant would expect to pay.

6757. What happens if the tenant changes, and a new rent has to be negotiated with a new tenant? Is this improvement still more or less offered to the other tenant, or is it merely a question of negotiating a new rent in terms of the then market for agricultural land?——*Mr. Montgomery*: The latter would be the case. The landlord would have the opportunity to let the farm for the best rent that he could get in the light of getting a responsible tenant, and the fact that the tenant had to pay the interest on the improvement loan would be rather his affair.—*Mr. Winegarten*: The rent charge is, so to speak, the lender's security. The landlord is the only man who can borrow from either of these bodies for improvement purposes. If he carries out an improvement he will charge the tenant an increased rent, but it is the landlord who is responsible for the debt to the Lands Improvement Company or the Agricultural Mortgage Corporation, and that debt is secured on the land itself and not on the person occupying the land.

6758. *Chairman*: Does he get back the interest charge that he has to pay out of the tenant when rates are as high as they are at present?——*Mr. Montgomery*: If we were starting today, and I was your tenant and asked for improvements in the land, you would point out that this would mean an increased rent; I would say yes, and it would be my intention to pay. Times change, and perhaps land values change, and perhaps profitability in farming changes, and I depart. Someone else comes in in my place and you would have to take whatever the current value of rents would be.—*Mr. Vincent*: In many cases, even before the Bank Rate went up, the extra rent which the tenant would have to pay for any improvement has often been much higher than the Bank Rate; as much in some parts of the country as 8 per cent.

6759. I suppose it may have to take into account depreciation and obsolescence of the building?——*Mr. Vincent*: Yes.—*Mr. Montgomery*: Improvement loans are made by the Lands Improvement Company, and the Agricultural Mortgage Corporation operate the same system in a small section; but there is very little money being taken up under these heads. Most of the advances of the Agricultural Mortgage Corporation are direct loans on the security of the property and not on an improvement.

6760. Why do you think so comparatively little resort is being made to the improvement loan?——Possibly the straight loan from the A.M.C. was a more convenient way of doing it.

6761. Do both have to be inspected and approved by the Ministry of Agriculture?——The improvement loan does, but not the general loan.

6762. Do you think that has some bearing on the resort to one or the other?——*Mr. Montgomery*: Probably.—*Mr. Winegarten*: Our experience from the survey is that the complexities of the method of applying for the loan and the formalities of inspection have had a restrictive effect. The Lands Improvement Company lent £170,000 last year, according to their own figures; that is in the year ending December, 1957, which goes beyond the figure in our paper. Table 2 in our paper shows that the sums loaned have been very small over the years. The Agricultural Mortgage Corporation under the heading of improvement loans had only £115,000 outstanding at 31st March, 1957, as compared with a figure of £30m. on the mortgage side. It seems to be the impression of our county branches that the rather complicated way of getting a loan under the Improvement of Lands Act procedure has had a restrictive effect.

6763. *Professor Sayers*: Is there any evidence that the Agricultural Mortgage Corporation has been failing to satisfy the remaining part of the demand?——*Mr.*

* Memoranda of Evidence Part VIII No. 1.

Montgomery: The criticism we have had on the operation of that is that they are cumbersome in the way they operate. There is a good deal of formality which is rather putting off. There are fairly high initial charges for inspections and valuations and that sort of thing, which have to be borne by the individual; and by far and away the biggest deterrent at the moment is this high rate of interest which has to be carried over such a long period. At times like these, when borrowing is made twenty, forty or sixty years ahead, we know there are going to be changing rates of interest in the meantime, and it is a heavy burden for anybody to go in and borrow at present. In our opinion the Government ought to stand behind the A.M.C. at these particular times, when interest is out of relation to the true value of money for other reasons, in order to check inflation or for some other purpose, and then presently, when there was a change in the Bank Rate, and the rate of interest in the money market was lower, the A.M.C. would take up the money from that source and the Government would withdraw. This would be a cushioning effect, to prevent this big variation of interest rates impinging too hard on something which is of a long-term character.

6764. *Mr. Jones*: Does the Government make any grants towards these schemes either for land improvement or for improvement of capital buildings?——Not in the way of a remission of interest; but the Government at the moment are prepared to grant-aid improvements of fixed capital equipment in agriculture of certain types, which have to be approved, to the extent of one-third of the capital cost.

6765. *Chairman*: There is a wide range of things that can be approved for which one will get a grant; and that leaves the person who wants to do the improvement to find two-thirds from his own resources, or by borrowing?——That is right.

6766. *Mr. Jones*: Does that mean that every improvement scheme either for building a house or for land, costs the industry 66 per cent. of what is expended?——Yes, that is right; but dwellinghouses are not included as part of it. There are certain other things which would not be in it but, without going into a long story, it covers a good many of the normal buildings that a farm requires.

6767. So interest would be paid at 7 per cent. on 66⅔ per cent. of the total cost?——*Mr. Montgomery*: Yes.—*Mr. Vincent*: Another thing in connection with the A.M.C. which has an adverse effect on people taking up loans is the penal clause, if the borrower wants to redeem before the appropriate time. I do not know the exact scale, but he has to pay a penalty if he wants to pay off before the appropriate time.—*Mr. Montgomery*: If he came in now at 7 per cent., and he wanted to get out in five years' time because he could take up the money somewhere else at 3 per cent., there would be a heavy penalty. The A.M.C. say, not unreasonably: "We took up the money to finance your scheme when rates were high, and now you will have to pay to the end of the time or pay such a penalty as will recoup us." It is because of the long-term operation of this type of borrowing that we suggest the Government should stand behind this particular item. If it is their wish that this improvement should be done and they are willing to grant one-third of it, why saddle the other two-thirds with an interest charge if they could have promoted expansion at a lesser rate?

6768. *Professor Sayers*: Are you suggesting that all enterprises of capital development that involve borrowing for a very long period should be similarly subsidised at times of high interest rates?——I am not keen on big variations of interest rates at all. I do not think it is in the general interests of the community.

6769. Did you not suggest just now that the Government should stand behind and allow the industry to have the money at a lower rate of interest than the market rate, not on the ground that this is farming, but on the ground that these are long-term commitments?——Yes, my suggestion is that the Government should do it. I do not think it would be possible for them to do it for every industry.

6770. Then why for one?——There are exceptional things already in agriculture. We have a grant scheme already. They do not put up one-third of the money for industrial buildings, as far as I know.

6771. What is the case for adding further to the subsidy for agricultural improvement?——The only case I could make on that would be the place of agriculture in the national economy.

6772. But that is a thing that would apply year in, year out; you are now suggesting that there should be an extra subsidy at times of dear money, at times when the community seems to be short of capital. What is the special justification for some stability in the interest rate for agriculture?——*Mr. Winegarten*: The main justification, from our point of view, lies in the structure of agriculture and its access to the money market generally. Agriculture consists of a very large number of small units; the joint stock form of organisation is not particularly to be found in the industry. If industrial enterprises seek to borrow for permanent equipment they have access to a very highly organised money market. The Macmillan Committee in 1931 noticed there were gaps there, and an attempt was made to fill those gaps, I believe 25 years afterwards. In agriculture we feel there is this special difficulty of raising money, not only to buy farms but to put capital into restoring the equipment after roughly a century of neglect. The Government scheme, which is a ten-year scheme, launched as part of the long-term assurances in 1956, provides grant-aid of one-third of the capital cost on certain defined improvements on certain holdings; the criteria for eligibility are pretty stiff, as we know from the number of rejections. At the same time, the owner, or in some cases the tenant (it is much more difficult in the case of the tenant) has to find two-thirds of the finance. If he can find it out of his own resources there is no problem, and he can take advantage of the grant. But many people are deterred because they cannot raise the balance. Neither the A.M.C. nor the Lands Improvement Company are attractive sources because of these factors: the high rate of interest, particularly at the present time, the formalities, and the commitment of a fixed redemption period. It is submitted on our side that the rate for borrowing for a period which in the case of the A.M.C. can extend up to sixty years (I think in the Lands Improvement Company it is forty years) should not be influenced unduly by a rate of interest whose origin and impact are supposed to be perhaps of a temporary character. We have already seen a 7 per cent. Bank Rate; it is now 6 per cent.; tomorrow it may be 5 per cent. But the man who is under an obligation to improve his efficiency, and cut his unit costs of production, which is what the Government is asking the industry to do all the time, cannot get on with the job because of these rigidities, if I may use that term, in the money market in so far as agriculture is concerned. The basic justification lies in the structure of the industry itself.

6773. *Chairman*: If you had the fullest and easiest access to the capital market for long-term finance at a time when the interest rates for that kind of finance were high, you would be facing the same difficulty; you would be expected to commit yourself for thirty, forty or fifty years at the current high rate of interest. It is not the access to the capital market that makes the difference.—*Professor Sayers*: Mr. Winegarten made out a very full case for special facilities for access to the capital market at all times, but is not that something quite different from saying that agriculture should be protected from whatever happens to be the going rate when that going rate gets past a certain level?——*Mr. Montgomery*: We make no apology for this; we realise we are asking for a preferential arrangement for agriculture. The other day I was at a committee charged with advising the Government on the administration of these long-term improvement schemes. The Ministry are concerned about the number of applications put forward which have not been followed up. We were asked as a committee how it came about. All we could say was that people were not able to find the other two-thirds of the money, which is not altogether surprising. It is a long way from the harvest period now, in the dead of winter, and they just have not got the money.—*Mr. Winegarten*: Professor Sayers said that I was suggesting special access at all times. That is one way of looking at it; I would regard it as an attempt to place agriculture in the same position in regard to access to the savings of the country as industry. Whether you regard that as preferential treatment or special access is a matter of terminology. To us it is a case of levelling up.

6774. Yes, but is not that a quite different point from protecting agriculture from a particular phase in the interest rate?——I agree. I think on that that we have in mind that it might be necessary for the Government from time to time to use finance for the purpose of stabilising the interest rate, but at the same time we are not seeking an arbitrarily low rate of interest. We have in mind that it might be possible to average out the long-term rate for agricultural investment. In other words, if Bank Rate ever fell down to 2 per cent. again we would not expect this long-term rate to keep track with it. We recognise that this might involve occasionally special assistance.

6775. *Lord Harcourt*: You are really saying that, when Bank Rate is high and the object of the Government is to discourage capital investment, the agricultural industry should not be subject to that control, because the Government recognises the special needs of agriculture by the 33⅓ per cent. grant. But does not the Government also say that at the moment when they want to damp down total investment in the country they think agriculture should be a contributor to that damping down process, and therefore agriculture must pay a high rate of interest?——*Mr. Montgomery*: If that is the view, we would accept that as being so; we would accept that for agriculture there was going to be a 7 per cent. or 6 per cent. rate of interest as on the rest of the development projects of the country. But we look at it with slightly different eyes, maybe because we are associated with the price review procedure, where public money is closely associated with agriculture. This would be a way of spending public money in such a way that the interest rate would be low, and farmers would therefore not want such a big support price, in the years ahead. We do not see quite such a conflict between one thing and another as perhaps you gentlemen not in agriculture would see. I say that lest you should think we are looking at it oddly.—*Mr. Winegarten*: I think the Committee are trying to find out the special reasons which would justify this special sort of treatment. If I may make another attempt to deal with that question I would be grateful. As Mr. Montgomery has stated, we are faced with this price review annually, in which on the one hand the Government tries to minimise the cost to the taxpayer of support for agriculture and on the other hand we try to ensure a reasonable level of remuneration for the agricultural industry, in accordance with the Agriculture Act. The investment flow in agriculture differs, I think, from the flow in other industries. One of the objects of the Bank Rate is after all to affect the flow of stocks and so on; that hardly applies to the sort of investment which we are discussing in this particular context, which tends to be gradual and fairly steady. For years the industry has been faced with a challenge of decisively reducing its unit costs of production. The general object of that exercise is to put the industry in a position to sustain rather lower levels of support prices as compared with the present. The Government said to us at the latest price review: "You will take the cut of £19m. in the guarantees, and you will try to maintain your level of income by making further improvements in your efficiency." In part that requires investment in the short, medium and long-term fields. We are dealing here specifically with the long-term as regards this point of the rate of interest, and we would say that the industry is faced with this challenge not in six months' time, not in a year's time, not in two years' time, when the national position may perhaps be easier from an interest rate point of view, but today, when interest rates are at a high level. On the one hand the Government are placing this obligation on the farming industry, and on the other hand the facilities are not there to enable the job to be done to the degree it ought to be done. For that reason we suggest that there is a case, having regard to the long-term character of this investment, for achieving some averaging out of the interest rates, which might from time to time involve Government assistance.

6776. *Chairman*: It comes to this: you want to fit it into a whole social policy with regard to the treatment of agriculture. You say that, if you are expected to carry specially high interest rates such as the market carries, then it does not fit into the rest of the social policy the Government envisage towards agriculture?——I think that is a fair way of putting it, if you say "social and economic".

6777. *Sir John Woods*: A lot of discussion has ranged round the fact that these long-term loans are for such a long period, from forty to sixty years. You do not like the idea, and I can quite see why, that you should be saddled with a rate of interest which may be a temporary thing for as long as forty to sixty years. Why is it that these loans are of such a long duration? Is it because of the nature of the industry, the durability of the improvements, the length of time it takes for these improvements to come out in improved profits, and so on, or is it that the forty to sixty years is part of a social policy towards agriculture?——*Mr. Montgomery*: The recovery of capital put into agriculture is probably slower than it would be in other industries.

6778. Suppose that you had free access to the capital market in the same way as any other people, do you think you would get loans of forty to sixty years?——*Mr. Montgomery*: I do not know.—*Mr. Winegarten*: Industrial companies borrow indefinitely.

6779. Would it be economically justified?——*Mr. Montgomery*: If the rate of interest was level throughout the period, one would not be very far wrong, but it is having to take up the money at the present high rate which prejudices the future.

6780. Suppose that you had access to the capital market, what would the lender say? Would he lend you money for forty to sixty years, or would he say it should be ten, fifteen or twenty years?——There are more lenders on your side of the table than on this side!

6781. *Chairman*: In paragraph 9 you refer to joint stock banks as having been important providers of long-term credit to the industry. How far have farmers been accustomed, up to the recent period, to look to the banks for long-term credit?——They do not look with success any longer. We only have a rather broad assessment of the amounts of money as to which agriculture is indebted to the banks long-term and short-term. The figure is given here that 55 to 60 per cent. of the total bank advances were on account of farming operations; presumably the remainder was on long-term. We do know that banks at one time were prepared to entertain a mortgage on property.

6782. How much can you tell us from your experience about the banks' practice in that way?——*Mr. Vincent*: I had to buy two of my farms eighteen months ago; I wanted to have some bank accommodation and I was told there was none.

6783. Before the credit squeeze came on, was it normal to look to the bank as a likely provider of a line of long-term credit?——*Mr. Carter*: I was able to do that myself just before the credit squeeze came on; I bought farms on a bank overdraft. It is not a very pleasant position to be in today, when the only thing I can do other than carry on with the bank is to go to the Agricultural Mortgage Corporation and sign myself over for a minimum of twenty years or a maximum of sixty years at 7 per cent.

6784. Before the credit squeeze you would have been fairly happy to have bought or improved your farm on a bank overdraft?——*Mr. Carter*: I thought so about five or ten years ago; it may not be so good as I thought it was.—*Mr. Vincent*: I would have done it through the bank if I could. I had to take up a mortgage, not from the A.M.C. but through an insurance company.

6785. *Professor Sayers*: Is this change in the operations of banks a definite closing down on facilities for agriculture?——*Mr. Winegarten*: From 1951 onwards the banks have been under directives from the Chancellor of the Exchequer about lending. In the case of agriculture long-term, and even medium-term, lending has been frowned upon. That is not to say that one cannot find instances even in this period where banks have made special long-term arrangements for certain purposes, but by and large, according to the best information that we have, the big expansion of this sort of agricultural lending that occurred up until about 1951 came abruptly to an end. One would imagine from the very recent figures of bank advances to agriculture that there has been a substantial reduction in this kind of lending. For example, in February, 1957, advances to agriculture were £220m.; in February, 1958,

they had dropped to £207m. Although we can only infer the point, since the banks cannot provide statistics on this, we would imagine the bulk of that reduction has been on the long and medium-term loans; people have been asked to re-finance in one way or another. The only known figure of this is the Ministry of Agriculture's statement quoted in paragraph 9 of our paper that 55 to 60 per cent of bank advances for agriculture were for production operations, i.e. the finance of wages, fertilisers, and the other ordinary annual expenses. Of the balance of 40 to 45 per cent., according to information obtained by the Ministry of Agriculture, the bulk consists of lending for the purchase of farms or for permanent improvements, though there is a certain element of loans to livestock dealers and that sort of thing that creeps into this figure.—*Mr. Montgomery*: On the basic question as to what extent we expect that, when the credit squeeze is over, the banks will re-enter this field of long-term lending, I do not think we have any information.

6786. You would like the banks to re-enter this field?——Only if it was going to be a true mortgage. I do not think that an individual would be wise to take an advance repayable on demand on something that he intended to hold for a long time.

6787. One of your members said that he did do this and another that he would have done if he could?——*Mr. Montgomery*: I think neither of these gentlemen would have done it if they were not in the exceptional position of being well known to the bank.—*Mr. Vincent*: I think my bank would have done it, except for the fact that even before the credit squeeze there were restrictions on their credit facilities, and they were told they were not to take up any such commitments on long-term. As I said, I did it through insurance companies, which was cheaper and easier than through the A.M.C.—*Mr. Carter*: I realised that it was not very sensible to borrow long-term credit that could be recalled, at the end of each year at any rate, as the bank loan can be; but at that time I thought: "I can place it somewhere else." At the present moment I am wondering whether I could place it anywhere else at 7 per cent.—*Mr. Vincent*: I was not worried about that angle of it, because I have dealt with our particular bank for several years, and I do not think they would have been harsh in that respect.

6788. I thought farmers had been used to borrowing in this way from the banks for generations, and that it was of mutual benefit and convenience. I thought it was something that both the farmers and the banks would like to do again. Are you suggesting that this is an access to money that you are quite prepared to see go for good?——*Mr. Montgomery*: We should not like any access that people had found useful going for good. Presumably my colleagues would make use of this facility, and far be it from me to make a suggestion that would preclude them from a free choice. But we would not have thought it was the proper source of borrowed capital for the projects that they have in mind. If they thought they could presently take out a more favourable long-term loan, that is another question.—*Mr. Winegarten*: The order of magnitude of bank advances for long-term purposes is fairly substantial, even if we do not know the exact figures. We think that one of the reasons why it has grown, despite the fact that we are constantly being told by the banks that their main purpose is short-term seasonal lending, is that the difficulties in raising finance from the specialist institutions, in the main the Agricultural Mortgage Corporation, have persuaded farmers to go to the banks for this purpose. In the days of cheap credit there was no particular difficulty in renewing an overdraft, but technically it was subject to immediate recall. The man who borrows money either to buy a farm or to finance the erection of a building on a farm which is going to have a long life is placed in an awkward position, if in a period of credit squeeze the bank says it must be paid off at rather a quicker rate than was envisaged when the arrangement was first made. I know, from experience of our Credit Service Unit, where we try to help farmers to present their case to the banks better than they can do it themselves, that some banks have specific arrangements, and may advance money to the farmer for ten years on the basis of reducing the overdraft by so much a year; but I believe there is nothing to bind the bank whatever; the borrower might be obliged to re-finance by getting a mortgage in certain circumstances. Yet in the period of cheap credit this facility was used; the figures, which show quite an increase from about 1946 onwards, suggest that in that period a lot of this type of lending took place, although some of it dates back to pre-war years. At any rate, it is the uncertainty of that facility, despite the fact that it has other attractions, that suggests to our minds that, if the banks keep to their function of short-term lending, then the proper course is to improve the facilities for long-term and medium-term lending. Then we think we will use bank lending for its proper purpose, namely short-term finance.

6789. *Chairman*: It rather follows from what you have been saying that it is the experience of some years of credit difficulties that has brought home to the agricultural world that banking overdrafts are not permanent?——*Mr. Winegarten*: Regrettably so.—*Mr. Montgomery*: I suppose the Agricultural Mortgage Corporation is for the farmer what the building society is for the would-be buyer of his house. One would not advocate the taking up of money from a bank when the building society is there. But they have a different system of charging a different rate of interest at different times.

6790. In paragraph 12 you refer to the range of variation in interest rates according to the nature and period of the loan, the amount of risk, and the level of Bank Rate. Do you find there are sizeable variations according to the amount of risk?——*Mr. Winegarten*: I think sizeable would not be the right expression. It is extremely difficult to get reliable information on this point. We know that there is a minimum of 1 per cent. over Bank Rate. For the purpose of the price review we get some sort of average figures from the Ministry and also through our own questions to the banks. They suggest that the average per bank, if I can put it that way, could vary by as much as one half per cent., but within a particular bank's figure we do not know whether, say, at the present time when we know it is a minimum of 7 per cent., some banks will charge some clients 8 per cent. and other clients 6½ per cent.; we can get very little information. But we are told that the risk element enters into it.

6791. You are clear there is not a fixed tariff on which you get your money?——We are reasonably clear, but we cannot be precise on that.

6792. *Mr. Jones*: Is there any form of credit outside those we have been looking at that is made available to farmers and agriculturalists? We have learned in another connection that agricultural credit has been made available under certain circumstances by people associated with the industry. Is that sort of thing happening, so far as the National Union of Farmers is concerned? Are there business interests closely allied with the activities of the farming industry that make credits to farmers outside the banks and hire purchase companies and things like that?——*Mr. Montgomery*: Agricultural merchants offer credit in the way suggested. It is a peculiar arrangement; they put an additional charge on the invoice, with a discount if you pay within a month, and so much discount if you pay within two months. It is an addition to the purchase price for which a deduction can be made if payment is made within a certain time. Then a great many merchants charge on outstanding debts beyond that point. Then there are things like the Fatstock Marketing Corporation, which is just starting, with the idea of helping to finance producers in the beef industry.

6793. What about auctioneers, and people like that?——There are some cases where the auctioneer has an autumn sale and the farmer perhaps does not pay a proportion of the debt until the spring when he sells his stock, again through the same auctioneer, when presumably the stock has increased in value and he recoups himself.

6794. He builds his stock up, having bought it on the basis of credit that is made available to him by the auctioneer?——There is some financing of stock purchases in this way. Of course it is a fairly expensive form of borrowing; the auctioneer also has to borrow to finance him.

6795. Is it more or less advantageous than going to the banks? Or is this done because the banks do not make available these credits?——Our opinion is that it is the banks' job to finance this sort of seasonal requirement of

credit. We do not think that the farmers should be indebted to the merchants; they should pay their bills promptly and get their discounts, and should not have to pay interest to the merchants. We know the banks can do it more cheaply, and, looking at the figures, we think they should.

6796. *Sir John Woods*: You say the agricultural merchants rivals the banks, from which I assume they advance something not very unlike the banks' £200 million?——They rival the banks in magnitude as lenders; they are not competitive with the banks.

6797. What sort of terms do you get from merchants?——*Mr. Winegarten*: Out of the total of interest on debt calculated for the purpose of the price review, it is reckoned that about half represents payments by farmers to the banks and the other half represents interest on merchants' credits and hire purchase facilities. Hire purchase is a growing source, of course. It is extremely difficult to get an average rate of interest for merchants' debts, but we should say, on the basis of an inquiry which we carried out a year ago for the purpose of the price review, that it can in certain circumstances be as high as 25 per cent. That is not an average figure; it depends upon the period for which the credit is taken out and upon the commodity. If you were to ask me to name a mean figure, I should put it in the range of 15 to 20 per cent. on merchants' debts at the current level of Bank Rate. When the Bank Rate alters, that range would come down a bit. On hire purchase debt the impression we get is that the rate of interest would be of the same order of magnitude.

6798. *Sir Reginald Verdon Smith*: Is that a mark-up on the standard price, or is that an annual rate of interest?——*Mr. Montgomery*: To give you an example: I buy a ton of fertilizer or feedingstuff costing, say, £30. There would be an addition put on it of £1, or perhaps 30s. If I pay within a month there would be a permitted deduction. Perhaps if I pay within two months it will be somewhat less; but some merchants say just a month and nothing more. If I do not pay within the time, I have lost the discount. If I pay it within a month and a day, obviously that is a very high rate of interest but if I then did not have to pay any interest and I still owed him in three months' time and he did not charge any further interest, the pound I had lost would be spread over three months. That is why it is not easy to calculate. If one does not pay promptly, it makes no difference to the rates on borrowing from the banks; if one is unable to pay one's merchant promptly, then we reckon it is not the cheapest way to finance.—*Mr. Winegarten*: To give you a simple arithmetical example: if the mark-up is 30s. a ton on a ton of cattle food costing £30 a ton, which is not unrealistic, and that 30s. is lost because three months' credit is taken, the rate of interest is 20 per cent.

6799. *Sir John Woods*: And it is in fact a rate of interest on borrowed money? Presumably the original price includes a profit to the merchant?——Yes.

6800. *Professor Sayers*: Why does a farmer, in spite of these high rates, borrow from the merchants instead of from the banks?——*Mr. Montgomery*: We think that a lot of them probably have difficulty in obtaining any credit from their banks. Then there are cases like that of Mr. Carter, where the farmer is indebted to the banks for his farm and might hesitate to ask for more. Other people are already indebted in other ways on medium term borrowing, where they have bought machinery and used bank money to do it, or bought young livestock with the intention of selling it three years hence; and because they have taken up credit for a medium term period already from the banks, they are hunting for other sources of credit, and they find it easy and convenient to lean on the merchant instead of paying their bills promptly.—*Mr. Vincent*: With some of the smaller ones there is also the psychological aspect. In my younger days it used to be looked upon as something to be ashamed of, if one had nothing at the bank, in the same way as some people have refused to ask for National Assistance because it used to be looked upon as a stigma to come under the Poor Law. There is still some influence of that kind on some of the older members of the farming community and some of the smaller farmers.—*Mr. Knowles*: And a rather more intimate and personal relationship exists between the merchant and the farmer than between the farmer and the bank manager.

6801. *Chairman*: Do you not find that the bank manager in rural areas is in fairly close relationship with the farmer?——*Mr. Montgomery*: Supposing that he were, then I would say that the man's merchant would be even closer.—*Mr. Vincent*: It is an easy way of doing things as well, this "contra sales" business.—*Mr. Knowles*: There is the "contra" arrangement; if there is some corn to be harvested there is often a running balance, and an arrangement like this is convenient.—*Mr. Vincent*: The bank managers I have had to deal with and others that I know of have been most kind and helpful in their dealings, and most friendly in their relationships with me, at any rate.

6802. And understanding of your problems?——*Mr. Vincent*: Yes.—*Mr. Montgomery*: There is a difference in atmosphere; the farmer going to his bank to ask for an increase in his overdraft would have to take his hat off and wipe his feet, in a manner of speaking, whereas he can go straight into his provender merchant and say he wants five tons of cake, knowing quite well that he will not be paying for that for six months.—*Mr. Vincent*: Often these days he does it over the telephone and does not go over to his merchant at all. I do all my business over the telephone.

6803. You mention hire purchase as a source of credit. Have you observed a considerable growth of borrowing covering the purchase of farm machinery and so on?——And cattle, to some extent.

6804. Are we to look at that partly as the result of the difficulty of getting general finance from the bank?——*Mr. Montgomery*: Some banks will advise their clients to use this. This is very easy to get into, because the seller of the machine says: "You can easily get terms to pay over a period". And it is paid off in 3 or 4 years; the farmer knows that it will not be recalled provided that he keeps up the monthly payments. The bank loan is subject to recall.

6805. As regards getting machinery through hire purchase, has there been much effect from the requirement of a bigger deposit and the limitation of the term in which it has to be repaid?——*Mr. Winegarten*: February, 1956 to May, 1957 the minimum deposit was 50 per cent. The figures which Hire Purchase Information Ltd. got out on various aspects of these transactions showed a decline to such an extent that the Agricultural Engineers Association became very hot under the collar about the impact of this. In May, 1957, the minimum deposit requirement was reduced to one-third on agricultural machinery; I think the figures will show that there has been some upswing since then.—*Mr. Vincent*: The result of that has been that the people who sell agricultural machinery have had a lot more money owing to them. A friend of mine who runs such a business has a procedure whereby a bill is sent out at the end of a quarter or month to his clients, and a reminder goes out every succeeding month. They do not come to his personal attention until they have had four reminders. Previously he had had four people on his books in this position, and he added 40 people to that in the month of June.

6806. So that there was quite a strong immediate effect, but it may be only temporary?——We do not know.

6807. Then you go on to the Agricultural Goods and Services Scheme and the Agricultural Revolving Loan Fund.—*Sir Reginald Verdon Smith*: Is it true to say that it is really a means of providing a salvage operation?——*Mr. Montgomery*: Farmers cannot make use of it unless they can show that they cannot get credit elsewhere. This stipulation holds back would-be borrowers, for they do not wish to admit their financial position. I was talking to our County Agricultural Officer, and he spent quite a lot of time with me on this. Some of them borrow for two years and then swim away on their own perfectly well; others have just made use of it and did not ever get free.—*Mr. Knowles*: It is the last resort of the individual because he does not like the declaration that goes with it. It also brings in virtually the whole of his creditors.

6808. *Chairman*: How public is it?——It is recorded and all his other creditors have access to the knowledge.

6809. Is there anything more here?——*Mr. Winegarten*: Just one point: the Agricultural Revolving Loan Fund has been brought to an end, much to our chagrin.—*Mr. Montgomery*: It was started with counterpart funds from

American Aid; now that has been recalled and the Government are going to wind up the scheme.—*Mr. Winegarten*: There are no more applications from yesterday. This was in fact the only, and very limited and specialist, source of medium term credit in England, Wales and Scotland.

6810. *Sir Oliver Franks*: Was it fully used?——It started very slowly, but the latest figure that I have for February shows that the applications for loans had exceeded £600,000. The loans granted at 1st February amounted to £433,000.

6811. That does not mean that that much money was outstanding; that means that was the cumulative total of loans granted?——I think that is so. Some repayments have been coming in, of course, since 1953.

6812. Was there any period that you know of in the lifetime of the Revolving Loan Fund in which all the money available to it was in fact being taken up?——The Ministry's published statements do not enable me to answer that precisely. My impression is that, since loans were normally made for four years and in some cases for five years, and since this started in 1953, though it did not get under way till about 1955, we had about reached the point where all the money was used; but that, I am afraid, can only be an impression.

6813. *Chairman*: Then you pass on in paragraph 20 to give us a summary of County Branch views. Should I be right in thinking that what we are looking at is composed primarily of the views which you have outlined already, and that we are going in more detail over the same ground?——*Mr. Montgomery*: To some degree, yes.

6814. *Sir John Woods*: In paragraph 21 you say: "Whilst it is premature to attempt to assess the repercussions of these steps on agricultural borrowings, it should be noted that on this occasion [*sc.* September, 1957] the Government has not drawn the attention of the banks to the importance of farming operations." On previous occasions was there a special warning to the banks to look after farmers?——*Mr. Knowles*: Yes; we made representations on these occasions, and it was indicated that the intention was that the banks should continue with their existing treatment of agriculture.—*Mr. Winegarten*: In the latter part of 1951 and the beginning of 1952 advances for agricultural production were bracketed with the export and defence industries. Then in the summer of 1955, when the Chancellor asked the banks to make a "positive and significant" reduction in the amount of their outstanding advances, the Economic Secretary of the day indicated in a parliamentary reply that he hoped the banks would continue to recognise the importance of agricultural production. That was of a less specific character than what can aptly be called a directive in 1951. On the most recent occasion, however, there has been no such special reservation for agriculture.

6815. *Professor Sayers*: Did you make representations on the latest occasion?——Certainly.

6816. *Sir Reginald Verdon Smith*: On the end of the paragraph 27, is there evidence that sales of produce at lower prices has occurred on a large scale?——*Mr. Montgomery*: We think so. There is a rush of grain on to the market at harvest time to collect the money.

6817. *Professor Sayers*: You ascribe that in this sentence to the higher interest rates. Do you stick to that view?——It was more the need to get money than interest rates. Perhaps if the farmer could have borrowed the money from the bank, he might have held his crop a little longer; but he might find it easier to take less for his crops than to try to borrow money.

6818. *Mr. Jones*: How does it result in increased financial responsibility in these circumstances for the Exchequer?——With the deficiency payment system, where the Government makes up the difference between the market price and the guaranteed price level, if the market price is low, it makes a bigger gap to be filled with Treasury money.

6819. If farmers go into the market with their produce in order to get more adequate facilities for meeting their obligations, does the artificially low price in these circumstances qualify to be taken into account in fixing the amount that is payable by the Exchequer as a deficiency payment?——*Mr. Montgomery*: The lower the price, the bigger the deficiency payment and the greater the commitment for the Treasury.—*Mr. Vincent*: On the average price for the period.

6820. So that in circumstances where a farmer unloads his produce directly to the market, the amount of money that he has got for his produce is taken into account when the deficiency payments are reckoned up between the industry and the Exchequer?——*Mr. Montgomery*: All sales are taken into account. An individual farmer who unloaded his grain at once at a poor market price would get less for it in total than people who were in a better position financially and who could keep it until the market price was considerably higher, because each would get the same deficiency payment per cent. at the end of the period (for wheat the deficiency payment is calculated in five separate periods, and for barley the year). We feel that if farmers were able to keep this grain off the market at the harvest glut period then there could be a higher average market price for the crop, so that the deficiency payment would be reduced.—*Mr. Vincent*: In addition to that, the man who had to dump his grain might receive a price which was below the average, so that he would lose so much per ton even when he got his deficiency payment.

6821. *Professor Sayers*: But this results from tightness of credit and not from anything else?——*Mr. Montgomery*: He might not be able to borrow. People are less worried about the rate of interest than about their ability to get the credit.

6822. *Sir John Woods*: Might we know a little more about the credit organisation on the lines of a building society, which has been started in Scotland, and which you mention in paragraph 38?——*Mr. Montgomery*: It has only just started. I do not know whether there are many figures on it yet. It is a mortgage with a moving rate of interest, as far as I understand it.—*Mr. Knowles*: Yes. There is a great deal more flexibility than is available normally. I saw the Chairman of this only two days ago, and he said the demand was increasing quite substantially.

6823. *Chairman*: Is it mainly for long term credit?——*Mr. Winegarten*: It is called the Farmers' and General Investment Building Society. It has very broad terms of reference:—

> "A Building Society has now been formed under the above style whose primary purpose is to serve agriculture and its allied industries. It intends to devote itself to provide the medium of investment on traditional Building Society lines coupled with a specialised service to provide loans on security of heritable estate, which may consist of farms, farm buildings, smallholdings, dwellinghouses, etc."

6824. *Mr. Jones*: Who provides the capital, and who are its depositors?——Shares can be taken up by members to a maximum of £5,000. It is opening its doors to share capital, and will lend that money to people who want to buy farms or raise money by mortgage in order to improve the permanent equipment of their holdings.

6825. *Chairman*: Then in paragraph 44 you say: "In the Unions' view, the farmers' inability to take advantage of the modern, highly organised capital market brings with it the need for effective and flexible agricultural credit facilities", and you go on to enlarge upon that. Are there any questions?——*Mr. Vincent*: On the Farm Improvement Scheme mentioned in paragraph 45, a number of people, as Mr. Montgomery said, are not proceeding with the scheme because of lack of money. I had two or three improvement schemes on the stocks myself and had estimates for one or two of them. I had rather a backlog of neglect to make up: four cottages are in need of modernising. I had a scheme for those, and one for a permanent surface to a road, for a new dairy, and other schemes; and then last year when we only got half our normal yield for our spring sown crops I shelved all those until later on, because this year I am going to have to pay income tax on a profitable previous year. I am therefore in the position of not proceeding with these things which I ought to do on my farm, because there is no way in which I could raise the money on medium term in order to spread it over.

6826. You have not the available sources of medium-term credit you would like to have?——No; I had seasonal assistance from my bank but all the money has been tied up in buying the farm. It is only short-term credit, of course, and the extent of it is unknown. It

depends on all sorts of things, but I am not prepared to go and ask for medium-term credit at this stage until I see, in the light of Government policy and weather conditions, what sort of a year I am going to have this year. I shall wait till this year is over before I commit myself about improvements.

6827. In paragraph 47, you criticise the credit institutions for their "relative inflexibility". What had you in mind when you used this term? Did you mean that levels of interest rates followed, roughly speaking, the Bank Rate, or the current long-term rates of interest, or that they are rigid in their policies, or what?—*Mr. Montgomery*: We drew this information from the replies from the members in the branches.

6828. *Sir Oliver Franks*: You do not think the first two letters of "inflexibility" have crept in by mistake?—After what I have said you might nearly assume that! The inflexibilities are set out on the next page: the cumbrous procedure and formalities; low valuations, which means that the A.M.C. may not be prepared to lend what you thought the farm was worth and what you paid for it. They make a very conservative estimate of value, on which they will lend about two-thirds.

6829. *Chairman*: Do you support these complaints as representing the Unions' views?—*Mr. Winegarten*: The complaint is pretty widespread that the valuers tend to look at the farm not as an economic enterprise but at the break-up value. We can only tell you what a large number of our members say by way of criticism. This is not something which has just come to light. We were getting this sort of complaint about the A.M.C. within the relatively easier days.

6830. Do you think the subject of valuations is the main complaint?—*Mr. Winegarten*: I do not think it is the main complaint, but it is one of them.—*Mr. Vincent*: Another complaint is that an A.M.C. mortgage would cost more over the period than a mortgage from an insurance company. In my own case I worked it out over twenty years, and it would be a considerable amount of money.

6831. Because of the fees?—*Mr. Vincent*: Not necessarily just the fees, but the whole procedure right through. Whether it is a different way of calculating the amounts of repayment and interest, I do not know; but certainly it would have cost me much more by A.M.C. than it will do through the insurance market. As far as the amount was concerned, I got pretty well the amount I had in mind.—*Mr. Montgomery*: There is a sort of general disappointment about A.M.C. It was brought in with Government support with the object of "making money available at reasonable rates of interest to agriculture". Yet there has not been a lot of money loaned in all these years.—*Mr. Winegarten*: And nobody has ever defined "reasonable" in the 1928 Act, but in fact the Corporation has lent by reference to the cost of raising money on debentures in the money market; and it was rather unfortunate that they borrowed money at the very high rates just before the cheap money period.

6832. Are there any questions about short-term credit, in paragraph 50?—*Mr. Montgomery*: We have very little quarrel with the way in which the banks operate in the counties. Most of our people are leaning on the banks, and expect to be carried in the short term. We know that short term drifts into medium term: perhaps not with the wish of the bank; but it just happens that the overdraft carries on. We do know that a lot of people are borrowing with the banks short term and medium term where the situation I described has arisen, and that precludes future borrowing and so presses them into more expensive sources of credit elsewhere. I should like to say only one other thing about short-term borrowing. We have to allow for variations for weather conditions, the slow turnover process, (one crop a year and longer than that if you go into the fattening of bullocks or something like that); it is not easy either for a borrower to borrow or for a lender to lend on that basis. It is not like a shop, where you can pretty well calculate the monthly turnover and the rate of margin and the financial position of the enterprise is established. We know that quite a lot of people are reluctant to borrow from the banks; they lean heavily on their merchants when they should perhaps be borrowing from the banks to enable them to pay their bills promptly.

6833. Is the gap that weighs upon you most heavily the agricultural medium-term credit?—Yes, and we think that the banks are carrying more than they would willingly do in this particular field of credit. We have raised this question of medium term credit with the Government, as we had been invited to do after the 1957 price review. We showed them the proposal that we make in these paragraphs, and expanded it somewhat in their hearing; they were interested in the project, but said that they doubted whether the Government would be willing to support a scheme in the present atmosphere of a restricted credit policy, and that as your Committee was studying this particular subject and would be reporting to the Government in due course, they thought that Ministers would not wish to make any move till they heard from you. It is in this sphere that we think there is the greatest need, which would relieve the banks somewhat; and we think that at least part of the money could be found within the machinery of the price review, from funds that would be available to go into commodity prices but would instead be used in a credit scheme which would be for the long-term benefit of the industry through bringing up to date these particular pieces of machinery that would bring forth cheaper production later on.

6834. *Sir Oliver Franks*: Would that really be taxpayers' money in the end?—*Mr. Knowles*: There is an argument as to whose it is, that has not been resolved yet; but, if a grant has been made to the industry or an individual, presumably it becomes his at some time, if he likes to apply it himself for his own benefit and pull himself up by his own boot straps.

6835. You mean this money would be used this way instead of going on to the prices?—*Mr. Knowles*: Yes; after the global figure had been agreed.—*Mr. Montgomery*: If I remember aright, it was a point they said would be considered. I do not think they were prepared to give a decision.—*Mr. Knowles*: I really do not think we could answer yea or nay to that one, as to whether the money became the absolute property of the Corporation concerned.—*Mr. Winegarten*: Once the price of a particular review commodity has been determined, whether it be milk or wheat, the producer receives that price and that becomes his income. The fact that the Exchequer may be supporting it if the market price may fall below the guaranteed level is the taxpayer's end of it. But once the guarantee is on, the farmer's income is influenced accordingly.—*Mr. Knowles*: From what we see at the moment, there should be no real difficulty about establishing this, once we can get the nucleus of the resources to begin it; and they need not be over-substantial. May I mention one point before we close? My colleagues here have quoted some of their own experiences; I think the Committee should be warned that they are perhaps slightly above the average in the facilities they can command. I should not like you to take their general assumptions as applying absolutely all round.

Chairman: No; I think we would allow for that. I think that has brought us to the end of our questions. We are very much obliged to you and your colleagues, Mr. Montgomery.—*Mr. Montgomery*: Thank you, my Lord, for the very courteous reception you have given to us. Should there be any other information which we can provide at any time, we shall be very happy to do so.

(*Adjourned until Thursday, 17th April, 1958, at 11.00 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-SEVENTH DAY

Thursday, 17th April, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH

SIR JOHN WOODS, G.C.B., M.V.O. (Questions 6996 to 7074 only)

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

G. D. FRAZER, Esq., C.B.E., Director of Savings, Post Office Savings Department, called and examined.

6836. *Chairman*: Mr. Frazer, you have given us a mine of information in the document you have supplied,* which we have all found very interesting and informative. We should like to run through your main memorandum with you, and see what questions arise on it. In paragraph 2 you are giving us a general view of the services. Throughout your memorandum you draw our attention to the fact that the actual volume of the investment in these services has been declining from the high level at the end of the war?——*Mr. Frazer*: In the case of the Savings Bank and in the case of Defence Bonds, yes; not so much for Saving Certificates. Premium Saving Bonds are a completely new factor.

6837. What do you think is the main reason for the comparative drift away from these services into what we will assume for the moment are other forms of savings?——A large amount of the money put into the Savings Bank and Defence Bonds was put for specific purposes, and because opportunities for spending it did not arise during the war owing to restrictions in consumption and so on; obviously after the war, as soon as goods became more plentiful, and when people settled down to the ways of peace again, there were in fact imperative inducements to spend. It is quite likely that the expansion in business produced a desire for people to withdraw their money from Defence Bonds for investment in their own businesses; the Defence Bond is the small investment factor of the business man and the middle class man, to a much larger extent than the casual saver. In later years, when Bank Rate became an instrument of monetary policy, Defence Bonds were continually lagging in their rate as compared with outside rates of interest, although the rate was continually being increased, up to yesterday. The new Defence Bond, which goes against the trend of Bank Rate, may in my view reverse the trend of investment in Defence Bonds; I am looking forward to very good savings figures from the new Defence Bonds.

6838. I appreciate there are plenty of reasons for withdrawals over the years, but there are other competitive forms of savings which have not suffered a net decline in that sense. Of the three things which one can offer, which are I suppose the rate of interest, the service given, and the liquidity, which do you think is the important element which leads the new savings to go comparatively into other media and not into yours?——Building societies have been a great competitor of ours. Their interest commenced to go up from $1\frac{1}{2}$ per cent. somewhere round about 1952, and the interest to the saver has always been free of income tax. When they were only paying $1\frac{1}{2}$ per cent. they were not a very important competitor; but when they got to rates of 3 and $3\frac{1}{2}$ per cent., with certain of the smaller and more adventurous societies offering even higher figures than those, they became a much more important competitor. It may be, too (although I have no evidence to this effect), that the hire purchase finance companies, with their very high rates of 8 per cent. or more, which are freely advertised, have also to some extent been competitors with the Post Office Savings Bank rate of $2\frac{1}{2}$ per cent. and our other rates of interest.

6839. You think that the comparative rate of interest as between one of these opportunities and the other is important?——Newspaper publicity has been very much against small savings in recent years. We have repeatedly seen in the papers this sort of thing: "How can the Post Office, paying $2\frac{1}{2}$ per cent., compete with building societies offering 3 and $3\frac{1}{2}$ per cent. free of income tax, and with a general level of interest rate much higher than that?"

6840. You think the general savings public has become much more interest conscious?——In the last five years, yes.

6841. *Lord Harcourt*: Do you think that the vast growth in group life and pension schemes have had any effect on the small saver?——Not on the small saver, no. In fact I think that the vast sums which have been built up in small savings have really been the backbone of the higher investment in endowment and whole life insurance policies. The man who makes provision for his demise or for his descendants is normally the man who has got something behind him in some other forms of savings. I do not think that the insurance companies would have done so well, were it not that there is this reserve of £6,000 millions for people to fall back upon.

6842. Is that applicable to the big group schemes, where the employee is insured by his firm under a scheme drawn up by his firm, and where the premium is in fact deducted from his wages?——I should think that the numbers of those cases are relatively small. If my information is correct, it is only selected employees for whom the employer does that sort of thing, rather than for his workmen generally: for such people as a young accountant whom the employer wishes to keep with him, or a smart young executive whom the employer does not want to lose to a competitor, as an inducement to keep them in their service. At the same time employers have to some extent, I believe, assisted, and still are assisting, the generality of their employees to save for the purposes of reaping a lump sum in, say, Savings Certificates in ten or twenty years period, but that is not quite what you are referring to.

6843. *Professor Cairncross*: You mentioned a moment ago that in the past five years the public have become more interest conscious. Presumably that should be reflected in a more rapid run down in your deposits, but that has not been true in the Post Office Savings Bank?——No; in fact our deposits have increased. The trouble is that withdrawals have also increased. There has been a run down in the balance of the Post Office Savings Bank from a maximum of something like £1,980 million in 1946 to £1,680 million, despite the addition of some £41 million of interest every year.

6844. *Mr. Jones*: That is a run down of approximately £300 million; is not that £300 million equal to about 5 per cent. of the total National Savings?——Yes.

6845. And the commodity value of £1,982 million then would be about one and a half times what it would be today, so that actually there are substantially less resources in the Post Office Savings Bank than there were in 1946?——Yes.

* Memoranda of Evidence Part IV No. 9.

6846. You have to go fast to remain static in your total holdings; if you pay out £500 million, you have got to secure £500 million in deposits?——Yes.

6847. *Professor Sayers*: But when you have said all that about the switch of money from the Savings Bank to other uses, there does appear to be quite a large block of Post Office Savings Bank deposits that are more or less insensitive to interest rate changes, that people hold for the convenience and various advantages that the Post Office can give?——That is true.

6848. *Professor Cairncross*: Between 1950 and 1953 there was a fall of about £200 million; but after 1953 the fall was no more than about £60 million over an equivalent period of time. That seems to me to indicate not a more rapid rate of run down but a much less rapid rate of run down in the last three years?——Yes, £380 million of deposits were in respect of release benefit monies of people coming out of the Services, in 1946, 1947 and a little in 1948. Those release benefit monies were quickly withdrawn.

6849. But my question related only to the period since 1950. The bulk of the reduction in balances occurred in the period 1950 to 1953; since then it has been really remarkably low, I should have thought?——Yes. We were taking heart from the fact that the rate of disparity between withdrawals and deposits was decreasing, and we were hoping that this was a good sign, but in the last year I am afraid that the trend has become bad again.

6850. *Chairman*: Have you got figures for last year?——Yes, Sir. The figures of deposits and withdrawals for the year 1957 were:—deposits, £457 million; withdrawals, £507 million; interest, £41 million; balance, £1,678 million.

6851. *Professor Cairncross*: That represents a reduction of only £10 million?——Yes. When I said that we had a bad year, I had in mind the financial year: we have had three rather bad months since the beginning of January, when normally we should have good months. For the calendar year net withdrawals were £50 million; for the financial year as a whole the net withdrawal was £64 million.

6852. What it all adds up to, surely, is that the bulk of the deposits in the Post Office Savings Bank are comparatively constant, and do not respond to any great extent to changes of interest rates? If you compare the 8 per cent. paid by the hire purchase companies with the 2½ per cent. which you pay, is it not a little surprising how little is withdrawn from the Post Office Savings Bank?——Yes; it is true, as Professor Sayers said, that there is a large bulk of our money which is impervious to the attractions of a higher rate of interest.

6853. *Professor Sayers*: And even the last three months would seem to bear that out?——Yes.

6854. *Chairman*: I thought the tenor of your evidence was that the Savings Bank deposit was very largely impervious to the current rate of interest, whereas the Defence Bond is the one which is more directly up against it?——The Defence Bond is up against it; but we have to take into account that it is only the injection of this £41 million a year of interest which prevents the Savings Bank figures going down much more. Net withdrawals are much more than the reduction in the net balance shewn in the last column of the table in Appendix A.

6855. *Professor Sayers*: Why should people be expected automatically not merely to save their interest but to add it to this treasure chest they have put aside?——In many cases what we call the good savers, those who keep their money in, are often blissfully unaware, or do not express any very great desire to know, how much interest they have got, until their book comes up, maybe after three or four years; then we put in three lots of interest. They are our best types of savers: they give us the least trouble by way of work in the number of transactions, and they contribute to the balance most by way of deposits and a minimum of withdrawals.

6856. *Lord Harcourt*: The more casual the customer, the better the saver?——I do not think he is casual; I think in many cases he is very systematic, because he makes a large deposit at the beginning of the year and then forgets about the Savings Bank. The casual depositor is one who tends to treat his Savings Bank account as a current account. There is a great increase in the kind of depositor who uses his Savings Bank account largely as a current account.

6857. *Professor Sayers*: Is that an increase which has taken place largely since the war?——Yes.

6858. That ought to be put alongside the facts you have given us, which tended to suggest the imperviousness of the bulk of deposits to interest differences. If in fact you have had a big increase in current account business in these years, should not that have meant that your balances had been going up by that much?——Not necessarily. There has been of course a great amount of withdrawal, not by people who use the Savings Bank as a current account bank but by people who have had their money in there and take it out in order to make, say, a fairly substantial deposit on a house.

6859. Has that been continuing, or is it something that was confined largely to the early post-war years?——We do not know why our depositors withdraw their money, and much of the evidence that I give to the Committee arises from what we believe. We are not like a commercial bank which has personal knowledge of its customers. We have about 20,000 withdrawals every day by notice to the Post Office, and about 120,000 every day up to £10 on Post Offices on demand. We have no means whatever of telling you for what purpose that money on demand is required, and only a very ephemeral knowledge for what purpose the money that is drawn by notice is required for. But we can sometimes tell from the payee of a crossed warrant. If it is a building society, we can make a very good guess that this is required for deposit on a house or for the purpose of investing in a building society. It is only from that standpoint that I can give you information. I do not pretend that it is at all detailed, and I would not like the Committee to think that we have specific knowledge of exactly what happens to the money withdrawn from the Post Office Savings Bank.

6860. But what would seem to be more interesting, and something which would have to be looked into in a rather different way, is this growth of current account business. That does seem to me to threaten some invalidation of the conclusion that the Post Office Savings Bank balances are impervious to changes of interest rates. Could you take a sample check, not on withdrawals at any time but on the behaviour of accounts?——Yes.

6861. You have a definite impression yourself that the current account business has increased considerably, and that is an impression which I do not find at all surprising. But if that has been responsible for substantial holdings of balances, and that has been increasing, then would it not appear that the more resting type of deposit has been going down more than we had supposed?——The percentage of people who definitely use their accounts as current accounts is small: only 2 per cent.; but it is 2 per cent. of 23 million, which means about 460,000 depositors, who will have anything up to, and over, 80 transactions a year.

6862. Does the average balance of the current account depositors work out at anything substantial?——I cannot give you that figure precisely. The average balance overall is about £88. But we do know that quite a large number of our current account depositors use their accounts, by way of deposits for putting in their salary cheques, and by way of withdrawals for withdrawing most of it throughout the course of the current month, and that they leave virtually nothing in the account at the end of the month.

6863. To the extent that it is those people, as I suppose it mainly is, the total of their outstanding balances would not be a very big proportion of your total deposit liabilities, would it?——*Mr. Frazer*: No.—*Chairman*: You say you do not encourage current account banking business in paragraph 5 of Appendix A.

6864. *Professor Cairncross*: May we ask about your interest rate policy? The interest rate has never been changed since the Post Office Savings Bank started?——No.

6865. As you show in your Appendix, half the depositors have balances under £10. Do they not create work disproportionate to any return which you have on that money?——Yes.

6866. But you do not penalise them by depriving them of interest?——No.

6867. In that way you are very different from the commercial banks, who pay more on one kind of account than on the other kind of account. Has it ever been considered whether you might introduce a distinction between deposits larger than some minimum figure?——Yes, but its has been rejected; we feel it is impracticable.

6868. Your expenses of management have risen more than sixfold since before the war; at the same time the deposits have risen roughly threefold. Why have the costs gone up in nearly twice the proportion of the deposits?——Deposits have gone up, as you say, three times; and the average wages of staff have gone up quite three times. If we had had, as would have been not unreasonable to increase our staff *pari passu* with the increase in the total number of deposits and the increase in the number of depositors, *and* we bad had to increase the average wage paid to that increased staff, the costs of the Savings Bank would have increased even more than they have.

6869. Do you know any commercial bank whose expenses of management have gone up sixfold?——I have no knowledge of commercial banks. I should hesitate to say that their experience has been on a par with ours.

6870. You do not want to put it to us that some part of the reason for this lies in additional services provided for your depositors?——No. By and large no additional services have been provided to depositors. We have a few additional services such as the periodic payment service; we had that before the war. We have discarded certain services, such as cruising credits and things of that discription, because they were hopelessly uneconomic.

6871. *Sir Reginald Verdon Smith*: How do you arrive at this item "expenses of management"? Does it include an allocation of costs from Post Office activities all over the country?——Yes, it includes everything. It includes the staff of roughly 9,000 at the Savings Bank; it includes the unit credits which are allowed to sub-postmasters for the work they do for the Savings Bank

6872. It is a unit credit per transaction?——Yes, based upon transactions.

6873. However large or small the transaction?——Yes. It includes an allowance for the cost of established staff at post offices in respect of the work they do for the Savings Bank, and it includes all services, such as printing and so on, ancillary to the running of the Savings Bank.

6874. *Professor Sayers*: Looking at it over a period, one would expect that amount to rise, in relation to two factors: first, the increase in the number of transactions, and second, the increase in rates of wages; the balances of depositors and the size of the transactions would have very little bearing on this. Do those two factors fully account for this rise?——Yes.

6875. Then there must have been quite substantial increases in the number of transactions?——There has been a substantial increase.

6876. Why has there been that increase in the number of transactions?——To some extent the increasing current account work means that the total number of transactions per depositor tends to rise.

6877. *Professor Cairncross*: If this is so, are you not performing services which are akin to those of the Trustee Savings Banks in many ways?——There are many things that we do not do that the Trustee Savings Banks do.

6878. The Trustee Savings Banks have increased their business since the war. They have a larger volume of deposits. For one thing, they run Special Investment Departments. Have you contemplated doing anything of that kind?——We have contemplated it, but we have not thought it was a good thing.

6879. They do introduce a distinction between the rates paid to depositors of different kinds; you would prefer not to do that in the Post Office Savings Bank?——We feel certain that, if we introduced a Special Investment Department, much of the "good" money, if I may use that term, would be transferred to it. The Savings Bank Fund could not possibly stand the increase in interest charges which would arise. We are not like the Trustee Savings Banks, who can invest their Special Investment Department money, in certain things, such as local loans, at 6 or 6½ per cent. All the money in the Post Office Savings Bank, according to the Post Office Savings Bank Act, must be invested in gilt-edged securities. It costs, as you will be able to see, roughly £8 million to service ¼ per cent. of interest.

6880. Suppose that people continue to make use of the Post Office Savings Bank to hold current accounts, but on a scale that rises from 2 per cent. to 5 per cent. or 10 per cent. Would this, judging from the figures that you have given here, make very serious inroads into the interest you can then offer?——We are to some extent able to control the current account aspect of the Savings Bank. The limit on deposits is £500 in any one year. We have held on to that maximum annual investment, and we would not like to see it rise, because if it were higher it would encourage the deposit of salary cheques. There are not many people receiving salary cheques who could invest twelve monthly salary cheques totalling under £500 in the course of the year; so by restraining the investment potential to £500 a year, we feel that we are keeping out the deposit of salary cheques to a very large extent.

6881. *Chairman*: But your general attitude is that you do not want the current account system to be operated in the Savings Bank; you do not think it is your function?——Yes.

6882. And you can always introduce rules which will discourage the use of it for that purpose?——There is a very difficult point: to what extent is an account a current account? Different people may have different ideas. We might say that we would restrict the number of transactions to so many, and after that we would regard it as a current account; but that would be extremely difficult to administer. In certain cases one comes across an account which is operated as a current account, which, nevertheless, has a very large business. Take a business man, for example, who uses his account for his business: He pays in cheques, and he draws on the money for domestic purposes. We could offend depositors by saying: "You have had so many withdrawals, and that is all you are entitled to for this year". Restrictions and rules of that description are impracticable in a large organisation such as this, where we have to deal with roughly 350,000 transactions a day. If we had to be weighing up what these people were doing, whether they were using their accounts as current accounts, or genuinely as Savings Bank accounts, we would get nowhere.

6883. *Professor Sayers*: May I suggest an entirely different approach? Could you offer a current account service (which, obviously, from your experience of people using this, is a thing much in demand), on which you would pay no interest at all, or very little interest, and simply insist that people must keep a positive credit balance? Have you considered that hiving-off of the current account business?——No, we have not. We have thought that it would not be practicable to distinguish between types of accounts within the one organisation.

6884. Would not this be another department? One would not call it the Post Office Savings Bank; one would say the Post Office offers these two services (as is done in a number of countries): a Savings Bank, and a current account service.——We have always operated as the Post Office Savings Bank, and we have always frowned upon the use of the Savings Bank for current account purposes.

6885. Nevertheless, the current account use has developed, is developing, and may one day threaten your income and expenditure account quite seriously, quite apart from the administrative complications?——Yes, I quite agree that it might. But on a "bad" current account (in the sense of the kind of accounts I have described, where the depositor pays in money at the beginning of the month, and withdraws the lot throughout the month) the amount of interest payable would be very little indeed. One would not be withholding much from the current account depositor. The saving would be that we would not have to calculate how little they were earning.

6886. Exactly, and you would not have to service them at the counter on the account of the Post Office Savings Bank; this increasing work that is burdening your budget would be avoided?——I wonder whether it would. The next development from that would be to do as the commercial banks do, and pay interest on deposit accounts but charge for current account work.

6887. But in other countries this work is done by the Post Office, either at no charge or at a very trivial charge;

nothing like the charge that the commercial banks have to impose. After all, the commercial banks are not perfectly organised for this type of business. The Post Office has tremendous advantages over them for this type of business. Why would it be more expensive in this country than elsewhere?——*Mr. Frazer*: Are you referring to the postal cheques system?—*Professor Sayers*: Yes.—*Mr. Frazer*: The postal cheque system in those countries has made the headway that it has largely because the commercial banks are not developed to the extent that they are here. If the commercial banks had been developed as well in the Continental countries as they are in this country, they probably would not have had a postal cheque system. The Post Offices have stepped in where the commercial banks have not been able to fill the bill.

6888. Is not this a travesty of the facts, if I may say so? Have not the commercial banks developed their small customer business in this country, at considerable expense to the customers, because there has not been a Post Office facility of this kind in this country? I put that to you as a fairer view of history than the one you gave?——If you are putting to me not that we should have a different kind of Savings Bank but that we should have a postal cheque system, the ramifications of that are rather outside my own responsibility as Director of Savings. This brings into question the money order service, the postal order service, and every remittance service that the Post Office arranges. I do not feel that I am capable of giving a closer opinion than that the Post Office Savings Bank could not take on a postal cheque system without very grave consideration, not only by my own department but by all other departments of the Post Office, and probably by other authorities outside the Post Office.

6889. *Chairman*: Your funds are invested for you by the National Debt Commissioners?——Yes, Sir.

6890. Was 1910 the last year when your annual account produced any deficit?——That is so.

6891. The income consists of the interest accruing from the securities; the expenditure is interest paid to depositors, expenses of management, and properly allocated depreciation provision, and the surplus goes in every year to the Treasury?——That is so.

6892. How does it come about that every year there is a charge for depreciation of securities?——That is not my responsibility; I am not brought into this question of how much shall be hived-off for the depreciation of securities. It is the responsibility of the National Debt Commissioners and the Treasury.

6893. You have no power to query it?——I have no power to query it, neither have I any power to query how our deposits shall be invested.

6894. *Professor Cairncross*: Is it equally true that, when repayments have to be made and funds have to be realised, you have no say in the decision about which funds will be realised, and that that is entirely a matter for the National Debt Commissioners?——Yes.

6895. *Professor Sayers*: At the end of paragraph 6 you refer to the maximum holding of 600 units of National Savings Certificates; that limit is just being raised to 1,000 units. You suggest, on the basis of how these Certificates are held, that the advantage to savings of such an increase would be marginal. There is, of course, the important point of the development of the savings habit; considering the fall in the value of money, the limit may well have operated to check the habits of sections of the community which one would like to see saving more. The fact that the additional amount invested is only marginal, is not really a serious argument against it?——No.

6896. *Sir Reginald Verdon Smith*: In paragraph 6 you say: "What would be of decided advantage would be for more savings to come from the wage packet and for such savings to be kept invested for a reasonable time". I think we should all agree with that in general; have you any particular thought how this advantage might be gained?——No. The National Savings Committee do a great deal of work in encouraging cycle schemes in industry and in offices, whereby so much is collected week by week, and when 15s. has been collected a Certificate is handed by the Group Secretary to the saver; if that habit could be extended considerably, and if the money could remain in, which is another important proviso, then I think that one could say that the savings habit was becoming a realised objective in this country; but I do not think that is so yet.

6897. You were thinking more in terms of Certificates than salary cheques or weekly wage packets going straight into the Saving Bank?——Yes. I would prefer it for Savings Certificates; there is also a direct transfer scheme for saving through the Savings Bank, and that scheme is excellent so far as it goes, but we find it expensive. It involves at least twelve deposits in the course of the year, and too much of the money comes out too quickly after it is put in. The average number of transactions in such a scheme is of the order of 17 a year, whereas the average overall is about 4½. With Savings Certificates, the same thing does not apply. The work is done by the Group Secretary to a greater extent than it is when the money is saved through the Savings Bank. The Certificate is sold at the Post Office, the counterparts come to the headquarters of the Certificate Division, they are filed away under the holder's number, and then we can forget about them. So long as that money stays in a reasonable length of time, we are quite happy with that kind of savings. I regard my function as Director of Savings as being to deal with the maximum amount of savings at the minimum amount of cost to the Government.

6898. *Professor Sayers*: When we are thinking of the use of these schemes, we have to consider who these Group Secretaries are. Are they voluntary?——Purely voluntary.

6899. Do they do this job in their own time, or are they people in factories who are, by arrangement with the management, doing work in the firm's time?——I think much of it is of that order, and I think that many enlightened managements reckon that it is a justified and useful expense for them to undertake to promote savings amongst their workers.

6900. *Mr. Jones*: In the National Savings movement are not the trade unions associated with local management in industry for these periodical drives? The man signs a form, either in the factory or in the colliery yard; that is put up to the management, and the management from then on make systematic transfers from wages either to the Post Office Savings Bank or the Trustee Savings Bank?——Yes.

6901. And there is no cost at all to the banking bodies?——No, not in a collection like that.

6902. The management pay in the amount deducted, and it is paid in en bloc in relation to the number of persons concerned, with their names and addresses, so that there is no administrative cost on that basis?——Not until the cheque gets to us, with the schedule showing the list of the people to whom the various portions of the money have to be credited.

6903. It is labour saving and expense saving from the point of view of getting the deposits; I am not talking about what happens after the deposits have been secured?——Yes. So long as the money stays in a reasonable time, they are savings well worth encouraging; but when, as is sometimes the case, a man asks for £1 a week to be taken off his money and put into savings, and then, almost before the money can be credited to his account, he is round at the Savings Bank trying to get the money out again, that is excessive work for the Post Office or Trustee Savings Bank, and has virtually no savings value at all to the Government.

6904. But the Savings Movement has attached great importance to this aspect of savings, and there has been a good deal done, particularly within the last six years. There is no advantage to a man to have £1 deducted per week from his wages for the purpose of saving, and then going across to the Post Office and drawing it back. To what extent would you consider this savings by transfer of amounts from wages has helped the savings movement, and has provided deposits to the Post Office Savings Bank?——Not a very large amount. These schemes account for about £7 million out of nearly £1,700 million in the Post Office Savings Bank, and about £28 million in the Trustee Savings Banks. Obviously that kind of scheme is better managed locally than by central accounting. The men prefer it that way, because they can go round to the local Trustee Savings Bank knowing that the money has been sent to them by cheque, say,

the day before, and if they want it quickly they can have it quickly. With the Post Office, they have to send the book to us just to have the money entered in their book. We are not as popular for direct transfer work with industrial workers as are the Trustee Savings Banks.

6905. *Chairman*: When you raise the limit on the holding of Savings Certificates, as you have done on a number of occasions since the war, I suppose the immediate impact is that you get a great deal of applications coming in?——Yes; there will be large sales at Post Offices from the 1st May, after this latest increase.

6906. Would you regard those as being new savings, or are they primarily a shift of money from other investments?——We do not know, but obviously a large number of the people who will buy up to 1,000 units will be people who will write a cheque on their local bank account for £300 to buy Savings Certificates. It has this virtue, that perhaps the money is then fixed to savings for a longer period than it would be if it remained in their bank account, because they have to keep the money in seven years in order to reap the full advantage of the interest arrangements. Though the average rate is $4\frac{1}{4}$ per cent., it is much less in the earlier years, and then rises to over 8 per cent. in the last two years.

6907. Is it not more likely to come out of another investment which has been realised for the purpose, rather than loose money in a bank account?——We do not know. I would think that much of it would come out of commercial banking accounts, but much of it, of course, will come from encashments of old Certificates to reinvest in the extended issue.

6908. *Mr. Jones*: You say that 48 per cent. of the amount invested in the Tenth Issue is in maximum holdings, but that these maximum holdings are held by comparatively few people. Is that an indication that they are the sort of people who would have money to save and invest in any case, as they have other savings, and that there might merely be a transfer of savings when the limit is raised from 600 to 1,000 units?——Yes.

6909. *Professor Cairncross*: Do you know the number of people who hold Certificates?——Yes. The numbers are subject to very considerable fluctuation.

6910. You give us no figures comparable to those provided for deposits in the Savings Bank, showing the proportion of large holdings to small holdings. Is it possible to give any indication how far Certificates are concentrated in a limited number of hands, or how far they are spread?——One has to take a sample over millions of holdings. That takes a very long time. The trouble is that the situation tends to change very quickly, depending upon the different conditions at the different times, and the different services offered. For example, I mentioned the way the Savings Certificates are purchased by cycles; there is a deduction from wages of, say, half-a-crown a week, and then the saver is given a Certificate when the total so deducted reaches 15s. In all too large a number of cases, as soon as a man gets a Certificate he writes out an application to have the money refunded to him. The counterpart of that Certificate gets to the headquarters of the Savings Certificate Division and is put in his holding, under his registered number. Often that is the only counterpart in that holding, because he makes a habit of saving his money by half-a-crown a week and taking it out again when he gets a Certificate. He gives himself trouble, and he gives us trouble. At one period of time that holding is a live holding, but as soon as the application to repay that Certificate comes along, and the counterpart is taken out of that holding, within a day or two that holding is a dead holding, in the sense that there are no counterparts there. That change in the ratio of live holdings to dead holdings is all too frequent to enable us to give a very exact picture of the number of live holdings, but at any particular moment of time we think there are about $10\frac{1}{2}$ million live holdings of Savings Certificates.

6911. This is only relevant to the people who are at the lower end. I was asking you about the numbers who hold substantial totals of Savings Certificates in the same way as in the case of the Post Office Savings Bank, where there seems to be a large number of dormant accounts. Can you say something about the people who hold £300 or more?——Yes. I have given certain figures to show the extent to which the amount of money held in the various issues of Savings Certificates is held in maximum holdings.

6912. *Professor Sayers*: You must have some way of enforcing this maximum. How do you know that a holder has gone beyond the limit?——We count the number of counterparts in the file, and if they are at any time in excess of the permitted holding of Savings Certificates, then we tell the holder that he has exceeded the limit, and require him to encash the excess.

6913. You have individual files?——Yes. There are many millions of files.

6914. *Chairman*: Somebody is regularly checking to see that no individual holder is getting beyond his maximum?——That is so. If the limit is 1,000, as it will be from the 1st May, when the holder has as many as 950 units a red seal is stuck on the holder's card, and that warns the assistant who is doing the work that that holding is very close to the limit. When she puts in another counterpart, shall we say of 100 units, she counts the lot and sees that there are 1,050, and we immediately write to the holder and ask him to encash the excess

6915. *Professor Sayers*: This check must give you some guide on the amount of the big holdings. A great many files must be looked at, to see if they have reached the 950 figure?——Yes, but that is rather different from taking a detailed sample.

6916. *Lord Harcourt*: They are not tabulated?——There is no tabulation.

6917. *Professor Cairncross*: Is it possible to give us some idea of the distribution of holdings? The figures you give here relate to a series of different issues; that is the numbers held to the maximum for each issue, separately. This does not really convey to us any very distinct impression.——I admit that figures more on the lines of the figures given for the Savings Bank would be of more value to the Committee. But one cannot take a small sample, if it is to be of any use to the Committee. The statisticians would have to go over the whole run of the files; and there are about 25 million different holdings, of which we estimate that about 15 million are dead holdings, and $10\frac{1}{2}$ million or so are live ones. I will ask the statisticians whether they could take some kind of sample which would enable me to give you some information of the kind you want. I will let you have the figures as quickly as I can.*

6918. In paragraph 9 you say that, although you have no official information, you are convinced that Premium Savings Bonds are being bought by people who have never hitherto cultivated the savings habit. Is this based on evidence, or why do you come to this conclusion?——It is the pattern of purchases which is leading me to the opinion that Premium Savings Bonds are being purchased by people who have not been savers before. At the outset, in November, 1956, 48 million bond units were sold in the first month, of which 28 per cent. were in denominations of 500 (the maximum holding) only about 2·5 per cent. in single units. By December, 1957, the pattern had changed; in that month only 9·6 per cent. of the bond units were sold in the 500 denomination, and 7·5 per cent. were sold in the one unit bonds—that is three times as many for the single unit, and only one-third as many for the £500 bond. By now 15·9 per cent. is being purchased in denominations of ten units.

6919. *Professor Sayers*: Why do you think those small amounts are coming from people who would not otherwise have saved?——To a large extent, it is a hunch. I imagine that it spreads from the football pools.

6920. But the pools have not suffered?——Not yet, no. I do not think that people who invest in the pools regularly are necessarily people who invest in small savings regularly. I may be wrong, but one has to have hunches, and the fact that 7·5 per cent. is being purchased monthly in single units does encourage me to believe that this is being purchased with money which would not have come into savings, if Premium Savings Bonds had not been there. I think it might either have gone in some other form of expenditure; or conceivably into the pools. You say that the pools have not been hit; one would have thought that, with the huge prizes they were giving, their investment ought to be going up. I do not think that is the case. We have a continuing fund of investment in Premium Savings Bonds. It now stands at £153 million. We feel that regularity of investment in Premium Savings

* See Appendix to Minutes of Evidence.

Bonds may very well mean that, one of these days, Premium Savings Bonds will reach a level of investment comparable with Savings Certificates. The larger the fund gets, the larger will be the prize fund month by month. It jumped from £260,000 in December, 1957, to £460,000 in January, 1958. It will be over £500,000 by June of this year. If investments keep on as they are going, it ought to be of the order of £1 million per month in about two years' time, and we shall then be really competitive, as regards the amount of the prize money, with the pools. We shall be able to talk of £1 million to be distributed in respect of an investment where the investor is not losing his money. I think that will be of itself a very considerable encouragement to people to get in on this investment more and more; it will advertise itself. I speak very much as an optimist with regard to Premium Savings Bonds!

6921. *Lord Harcourt*: In paragraph 9 you say: "If heavy encashments do not take place in December, it is likely that the amount of prize money will increase." I take it that those heavy encashments did not take place?——They did not.

6922. *Professor Cairncross*: Have you noticed any reaction on Savings Certificates sales?——It is difficult to say. Premium Savings Bonds started three months after the 10th issue of Savings Certificates, when the new issue at 4½th per cent. was bringing in abnormal amounts of investment. That investment went on up to June, 1957. Since June, 1957, Savings Certificates have failed to hold their own, new purchases as against repayments. Quite a number of things have contributed to that, I believe. The summer months are never very good months for investment in savings, because they are the holiday months; and on 19th September, with the Bank Rate going up to 7 per cent., I think that not only did the Defence Bond suffer a bad reaction, but also Savings Certificates, because I think the small investor compares them with building society investment. The building societies were able to offer considerable inducements in the way of non-taxable interest, and the money is paid half-yearly; whereas, the holder only gets the benefit of his 4½th per cent. in Savings Certificates, provided he keeps his money in for 7 years. So I think that the failure of Savings Certificates to hold their own since June, and particularly since September, has not been so much due to the competition of Premium Savings Bonds (although it is quite possible that regular savers, who might have invested in Savings Certificates, have turned over to Premium Savings Bonds), as to the non-competitive aspects of small savings generally at a time of high interest rates.

6923. Was there an increase in the rate of encashment of Certificates after September?——Yes. From June of last year up to the present time, with the exception of three weeks in January of this year, encashments of Savings Certificates have been consistently in excess of new purchases.

6924. Were encashments higher than they had been running at previously?——I have not those particular figures here; but I do not think there has been any great change in a bad picture.

6925. *Chairman*: In paragraph 11, you come to the important point that you are making, that you are "convinced that the solution to the problem of National Savings does not lie in the direction of more savings services". Would you enlarge on that?——I have thought very closely from time to time of what new savings services the Government could offer, but I feel that, having introduced Premium Savings Bonds, there is nothing else left.

6926. It is rather noticeable that the one which is rising at the moment is the one that has been introduced only in the last two years?——Yes; we touched upon an aspect of human psychology which the Government had always fought shy of before, and which appears to be paying dividends now. But I do not believe that there is any other scope for that kind of thing.

6927. *Professor Sayers*: Is it possible that there was something in the newness of the thing which was attractive, and that if you brought out a new savings method every five years you would encourage saving?——In the sense that there are new issues of Savings Certificates and new issues of Defence Bonds with different interest rates, for a time they become novelties and encourage new savings, and I should have thought that one could refer to them almost as new types of savings. But I have gone very closely in my own mind into other possible aspects of saving, such as encouraging people to save for retirement, for example, and I feel that the field is already a pretty wide one to anybody who has the ability to save and the will to save, for whatever purpose he may want to save.

6928. That does not meet the point that the novelty of a device may have effects in encouraging people to save?——I do not think that had very much to do with it; I am looking forward to Premium Savings Bonds being a success ten years from now.

6929. *Sir Reginald Verdon Smith*: Do you consider, in that same sort of connection, that questions of nomenclature are important? For example, the use of the word Defence Bond at the present time might be something of an anachronism, and some other description might be more appealing?——"A rose by any other name may smell as sweet", perhaps, although I have always thought that Defence Bond was a very good word. It was a good word during the war, and I think that it is applicable now, because it is the defence of the economy that the National Savings Committee would wish people to have in mind when they are considering Defence Bonds.

6930. Supposing you brought out a retirement bond. Would that fetch the money?——Not necessarily. If we brought out a bond such as a retirement bond, there would obviously have to be restrictions on it: that it must remain there until such time as the person wanted it for the purpose for which he originally invested his money, that is for when he retired. I think that people who have the pre-vision to make provision for their retirement are already doing so, as far as practicable to them individually, and that it does not follow that bringing into the savings field a particular bond called a retirement bond would serve any purpose that the existing services could not serve.

6931. *Chairman*: In paragraph 12 you say that we must not consider National Savings in isolation, and that they must be considered in relation to other avenues for savings. You also say: "Competition in interest rates between the National Savings Services and these institutions is hardly desirable and can work to the prejudice of the interests of the community as a whole". But if you do not regard the interest rate as competitive, I do not quite see where one gets to. Is there very much left, except a comparison of the services which one or other renders?——The building societies, particularly, are very touchy upon an increase in the interest rates in the small savings services. They regard any larger opportunities in small savings as something which, to some extent, takes money which might go to them. They are already in considerable difficulties in attracting enough funds to lend on mortgages, and if they cannot get enough they have to put up their rates on their borrowing and therefore on their lending, rather undesirably from the point of view of those people who already have mortgages with them.

6932. I appreciate that point of view, but if you found that your services were running down steadily, and that what you offered was not competitive with other avenues of the same kind, would you not have to give effective competition? Is not that what you are doing with the new Defence Bond?——That is true. It is a matter of compromise. We must not forget that this country is about the best savings country in the world. 11 per cent. of personal incomes last year was saved; that is something which is not approached by any country, even by the United States, where savings in insurance and through the banks are regarded almost as a necessity of life.

6933. I do not see how you can avoid to some extent being competitive with interest rates?——I quite agree; my argument is that it is a matter of compromise all the time.

6934. *Professor Sayers*: Is it not because there is this competition for savings in so many channels that our savings position is as strong as it is?——That is true.

6935. Might you not say that competition on interest rates was desirable?——As I see it the Government can always get as much money as it wants if it is prepared to pay a high enough rate of interest. If it introduced a Savings Certificate tomorrow paying 8 per cent. free of income tax, and put up the Savings Bank rate to 5 per cent., and other rates *pari passu*, there would be no trouble

about small savings. But who is going to provide the money to pay the interest on investments of that nature? Obviously the function of Government must be to borrow money at all times as cheaply as possible. I agree that, if it finds that it cannot borrow money because it is trying to borrow too cheaply, it has to step up its interest rates; but I feel that interest rate competition between the various very estimable social savings services which are run in this country is rather bad for the community as a whole, because if there is going to be an upward surge of interest rates because of competition, then the general taxpayer, who often is a man who is not in a position to save, has got to find the interest.

6936. That is an argument against raising interest rates, not against competition.—*Professor Cairncross*: If there is no competition, you are presumably thinking in terms of rates that are fixed, or do not change very much, and then the rate at which you operate becomes a little arbitrary?——Not necessarily. Obviously there must be some change in the level of interest rates depending upon outside conditions. It is no good the Government offering 2½ per cent. Defence Bonds when the level of interest rates in outside investment is of the order of 5½ to 6 per cent. It is not my function to fix interest rates, but it does seem to me that the line of policy should be to offer as low an interest rate as will attract as much money as possible, and to keep out of the picture any sense of competition in interest rates with other avenues of savings, building societies, etc., so as to have all of them encouraging the public generally to indulge in the function of saving to the maximum potential of each individual person.

6937. *Chairman*: I follow your general idea, but I was wondering how it could ever be applied in practice. If you want to have National Savings at all and not let it all go into other avenues, it seems to me you have to keep your eye on the terms offered?——That is what happens in practice.

6938. *Sir Reginald Verdon Smith*: At the end of paragraph 13 it seems to me very much in your mind that there is a large area of potential savings amongst weekly paid employees who are not paid by salary cheque. Do you feel that this is a very important area of large potential savings?——I am inclined to think that much more could be saved by industrial workers than is being saved. As I have said, the level of investment in direct transfer schemes is very low. I would exclude the very considerable body of people who are regularly saving money as individuals by going to the Post Office or the Trustee Savings Banks and depositing their money from time to time, and I would even exclude the large number of people for whom hire purchase is so important, who put so much money from the weekly wage packet to pay for hire purchase that there is no possibility of saving. But, excluding those factors, I still believe that there is something more which could be done if these people had the will to save. I think the ability is there.

6939. Is this impression supported by any analysis, by sample survey work or anything else, of savings habits amongst particular groups?——An Oxford group made an investigation into savings three or four years ago, and wrote a book about it. Their view was that a large proportion of the public did not save. They were of the impression that what one might term middle class people and salaried individuals were more prone to save than those who were paid weekly and who were in fact industrial workers.

6940. In a time when much attention is focused on the consequences of redistribution of income, to try to arrive at some sort of order of magnitude on this does seem to me very interesting. In terms of what you are saying, and thinking in terms of an insured population of 20 million people, I would have thought that the amounts involved in the existing direct transfer schemes are not in fact very large. They may be large in terms of the personal effort or thrift of the people involved, but in terms of potential savings, as a means of increasing the total volume of the Savings Bank per annum, would a figure of £25 million be a very large figure in your mind?——No. On the other hand there are 19 million industrial workers in this country, and I feel that if the savings habit was regularly practised by them to the extent of, say, £10 net savings a year, that would bring in £190 million. Some of that money is already coming in, because some of these people are already savers, but I do not feel that a large portion of them are, and I think that much more can be done. I do not mean this in any way as criticism of the National Savings Committee, whose workers are doing a magnificent job of work; I simply mean that it is an average type that one meets fairly regularly who just does not save. His commitments are not such that he cannot save, but he prefers to spend his money. I think this does apply very much to the young adolescents, and the National Savings Committee are thinking very closely how to inculcate the habit of saving amongst the youth of this country.

6941. *Chairman*: We now come to these points, which are a summary of the various folders attached to the paper. We have covered a good number of them in a more general way already.—*Mr. Jones*: On Point 4, are we right in drawing the conclusion that a good deal of the holdings of Savings Certificates is really gilt edged investment on the part of people who are using money rather than savings, having regard to the fact that 48 per cent. of the Tenth Issue is held by people who hold the maximum amount of certificates?——Yes.

6942. So the additional 400 units that can now be purchased might not give rise to a greater degree of savings, but might result in people seeking a greater and more rewarding rate of interest on that investment, and transferring from other investments?——Yes; and it is also possible that older certificates which are not now paying such a high rate of interest as the Tenth Issue will be encashed and the proceeds used for purchasing more of the Tenth Issue certificates.

6943. What happens to the holder of Savings Certificates who has not taken sufficient interest to encash and re-invest at the maturity of the earlier issues, having regard to the fact that the present rate of interest in the seven year certificates of the Tenth Issue is higher? Is there a disposition on the part of a lot of people to lose money, or does the Savings Department make provision for paying interest on uncashed certificates that have reached maturity? Is any provision made for rewarding any loss that has been sustained by failing to encash and transfer?——No. The holder of Savings Certificates continues to earn interest at varying rates however long he chooses to keep them in. If eventually he comes to encash the certificates we do not say: "If you had only re-invested those certificates in the Tenth Issue you would have been paid 4½ per cent. instead of the 2 per cent. which these old certificates are paying you." We must leave that entirely to the wish of the holder.

6944. *Chairman*: He remains fixed on the terms of his issue as long as he holds it?——Yes. Even if he forgets, for however long his certificates are held, he gets a rate of interest every year applicable to the particular issue. For example, First Issue certificates purchased at 15s. 6d. in 1916 are now worth 58s. 0d. They were paid a rate of interest of about 5 per cent. for the first ten years; then for a further ten years they were paid a rate of interest which was rather less than 5 per cent.; and after they had been held for twenty-two years there was a fixed rate of interest, which was not so much a rate of interest as an increment on capital of a fixed amount year by year; it was one shilling a year.

6945. Is it a common feature of all your issues, once they reach maturity, that from that time onwards one gets an annual increment which is fixed and is irrespective of the capital to which it is added?——Yes; and the greater the capital the lower that increment represents in terms of interest.

6946. *Mr. Jones*: Let us assume that someone who has not gone into this thing very deeply has got fifty Savings Certificates, of the Seventh Issue, which were not encashed and the proceeds reinvested when those certificates reached maturity. Would the rate of increment applicable to the Seventh Issue continue on the capital value of those matured certificates?——Yes.

6947. Then would not someone in that position lose money? He would not be making the most of his investment?——It all depends on what the holder wants to do with his money. Suppose that he has Ninth Issue Certificates, and he holds them for ten years, and then reinvests in the Tenth Issue. If he found at the end of another three years he wanted his money out, he would be far worse off having re-invested in the Tenth Issue than if he kept the money for that extra three years in the Ninth Issue; the rate of interest at the beginning of the Tenth

Issue is very low, and it is only by keeping the Tenth Issue for the full seven years that he would reap the benefit of the full 4½ per cent. We are very careful to avoid giving any advice to holders of Savings Certificates, because if they find that their circumstances are such that the advice we give them results in their earning less interest than they might otherwise have done if they had not taken the advice, the tendency would be to blame us. We give them all the literature that a reasonable man ought to have; I quite agree much of it is unintelligible to many people, but we cannot do much more than that.

6948. *Chairman*: You criticise the Defence Bond because it is a one way option in favour of the holder: he can always take his money out, if the current rate of interest is higher than he is getting on his bond, and re-invest it somewhere else, and he is not exposed to the market in so doing. Is it an instrument to which you attach value among the series of National Savings securities?——The Defence Bond has regrettably ceased to attract the very great amount of attention that it got during the war years. I would like to see this new 5 per cent. issue help to bring back the Defence Bond to what I think is a position of deserved popularity. I do not look upon the Defence Bond as being necessarily a security which is only attractive to the investment-minded man; I think that people who have relatively very little can often get the best advantage from investment in Defence Bonds. For example, take the man who is retiring on a pension of £350 to £400 a year with £1,000 lump sum on retirement. £1,000 invested in 5 per cent. Defence Bonds brings him in an extra £1 a week on which he does not have to pay tax provided his total income is below £440 a year. It strikes me that that is quite a useful avenue of investment on that £1,000, and in a sense it is better than Savings Certificates, because we pay £25 interest every six months. That would be a very useful investment for that particular kind of case, though one cannot call it a Retirement Bond, because it often serves purposes other than that of retirement. That is merely one instance in which the Defence Bond could in my view be very usefully employed by persons whom we look upon as being on a very low scale of income.

6949. *Sir Reginald Verdon Smith*: What sort of policy apparatus, apart from the advice of the National Savings Committee on such matters as you spoke of, exists as between yourself as Director of Savings and the Chancellor, or Treasury officials, in relation to the sort of policy issues which you have been talking about this morning?——I have very close relations with the Home Finance Division of the Treasury; they usually ask my advice, or I ask theirs, on policy generally with regard to small savings. The implementation of policy through regulations is done very closely in collaboration with the Treasury, and where necessary with the National Debt Commissioners and the National Savings Committee. We also maintain friendly and quite close relations with the Trustee Savings Banks, although we are to a very considerable extent competitors with them in the Savings Bank field. In recent years the Trustee Savings Banks Act of 1949 resulted in their number of offices increasing from 850 to the present figure of 1,350, and that is largely responsible for the improvement in their development since the war. That, broadly speaking, is the range of the co-operation and collaboration in savings policy generally as it affects my department.

6950. *Professor Sayers*: Do you ever meet the National Debt Commissioners to discuss with them what they do with your money?——No. The responsibility for the investment of the Post Office Savings Bank Fund is that of the National Debt Commissioners.

Chairman: Thank you. We are very much obliged to you.

(*The witness withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

H. WILMOT, Esq., C.B.E., Chairman and Managing Director Beyer, Peacock & Co. Ltd., G. COLLINGWOOD, Esq., T.D., Managing Director, The Vulcan Foundry Ltd., and G. R. CURRY, Esq., Past President, Member of Council and Director respectively of and representing the Locomotive and Allied Manufacturers' Association of Great Britain, called and examined.

6951. *Chairman*: Mr. Wilmot, we have all read your memorandum* carefully, and have it in mind. It starts off with an introduction to give us the place of the locomotive industry; then you go on in section 2 to the case for a British Export/Import Bank, and you compare the possibilities of such an organisation in this country with what is done in the U.S.A., in Japan, in Western Germany, in France, and in the Netherlands. Then you go into the details of how the Export Credits Guarantee Department is worked, and reach the conclusion that the facilities for the capital equipment exporter as provided in London are inadequate. Then you go on to the attitude of H.M. Government, about which we have heard something more in the last two days in the Budget debate. Then you have a third heading on ideas for a Commonwealth development finance organisation. Perhaps we might run through it with that break-up in our minds?——*Mr. Wilmot*: We are here to answer your questions, but this memorandum has a number of pages, and a lot of things are ancillary to the main proposition. May I just for one moment outline what is our main proposition?

6952. May I just tell you what is the chief point in our minds? The terms upon which E.C.G.D. guarantees are given do not seem to be absolutely fixed, because there have been alterations made in the last day or two; we are even more interested in the actual difficulties that you experience in getting the finance from the City of London, whether based upon the E.C.G.D. guarantees or not. What goes wrong in the provision of the money that you want? Where are the gaps?——Yes. If I may take up, say, three or four minutes' time, I would like just to take three main headings. First, you are quite right in saying that we consider that in respect of our industry the facilities provided by the E.C.G.D., though good, are inadequate for modern conditions. The length of credit is not sufficient, the degree of flexibility allowed is not realistic, and that the Treasury view, so far as we understand it, that we must not involve ourselves under any circumstances in some kind of international credit race is unrealistic. We are already as a nation involving ourselves in international races in the education of technicians, and in armaments. If a race is involved in credit for exports, it would not be illogical to participate in such a credit race; it would only be the third race in the same programme. We believe, therefore, that some modification of E.C.G.D. is overdue. We think that the length of credit, which at present is limited to five years, should be limited to twenty years, with a degree of flexibility according to the nature of the product, and the credit-worthiness of the customer. At the moment five years is quite unrealistic in the international market.

Secondly, it so happens that the joint stock banks and E.C.G.D. both have a sort of common term of five years. We do not think that that was because they had some arrangement between themselves; it just so happened. Our competitors are talking in terms of eight to ten years. Ten years is too long for the joint stock banks and too short for those funds such as insurance funds which require an investment of greater length. We believe that the need for some kind of central export financing body (what it is called is immaterial) is urgent. It is vital to the export trade of this country, and when I say "our export trade" I do not mean the export of silk stockings or handkerchiefs, I mean the export of major capital items. E.C.G.D. is limited by its terms of reference; the banks are limited because they are not willing to lend, even supported by E.C.G.D. guarantees, longer than five years or thereabouts. Our competitors are, as I say, offering eight, nine, ten, twelve years credit, and we think that something needs to be done about it.

* Memoranda of Evidence Part VII No. 10.

The third point is this. The Treasury say that they cannot in law discriminate in favour of the exporter. We wish to say from our industry, amateurs though we may be in law, that that is illogical. The whole basis of law is the basis of discrimination not between citizen and citizen *qua* citizenship, but of the behaviour of citizens in the face of the law. The whole basis of British law is to penalise the man who does the things which the laws says are disadvantageous to the community. There is nothing illogical in a general proposition that the law should also help those citizens who are doing those things which the Government says, and the nation says, are vital in the interests of our national existence.

I think that this Committee would not go beyond its terms of reference if it were to decide whether exporting is desirable or necessary or vital to our existence and the standard of life. If you say it is desirable, that is a nice theoretical proposition that we can play with; if you say it is necessary, that is something we can think about; but if you say it is vital to the employment of our people, then it directly affects the standard of life of the nation. We maintain that our exports determine this, that the whole standard of life our nation and the maintenance of full employment depend upon our ability to export in the face of international competition.

This is a technical industry. It is not like selling, as I said before, silk stockings or handkerchiefs. If we are out of a traditional market once, we are probably out for years, because new standards and new specifications are set; the specifications and standards of other countries become the current practice. It is doubly hard to get back into a territory or into a market that has once been lost.

6953. We should like to get from you some measure of how far the handicaps to which you draw our attention, and from which you say you suffer in comparison with competitors from other countries, are a threat for the future, or are causing actual loss of business today. Can you provide figures as to the course of business over the last few years in export markets?——It is very difficult. We can tell you the orders we have lost, and what we think are the reasons why we lost them. We cannot be quite sure that, had those reasons been removed we would have got the contracts, though we believe we would.

6954. Some orders, as you say, have gone elsewhere, and the reason may well be what you say; but then other orders may have been obtained in their place, and the volume of your business may still be showing a satisfactory course. You have not given us any light on that.——I am not entitled to speak for the industry as a whole, but I am entitled to speak for my company. In my company we find the utmost difficulty today in meeting the very serious competition of Italy, of Germany, of Japan and of the United States. In the case of the United States there is a case on record of a contract in India, which went to the United States because the credit was tied to the United States, at a price which is roughly twice the price that the British quoted; in other words, India took advantage of credit, and in so doing paid twice the price they would have had to pay. We could not offer them the credit, because E.C.G.D. and the banks would not meet us. We are not asking for any favour from the British nation; we are asking that the British nation should decide whether exports are vital, and that, if exports are vital, the British nation should put us in a competitive position *vis-à-vis* our international competitors.

6955. I appreciate that there are great difficulties, and no doubt you to some extent are able to cope with them; but have they led to a decrease over the last few years in your export business?——*Mr. Curry*: In general terms we as an exporting industry view the future with considerable trepidation. I should like briefly to quote certain remarks of our President, Sir George Nelson:—

"... In a world which is hungry for the type of plant we manufacture, for the generation and application of electrical energy, the outstanding problem is how to bridge the gap between the sales of primary products from the newly-developing countries and the purchase of high quality machinery to aid in the development and improve the standard of living in these countries. It seems to me that we must do more than has been found possible in post-war years to spread the period over which capital equipment is financed.

We see from the operations of the American Export/Import Bank that where capital projects are undertaken, the term under which loans are repaid can be up to 20 years or even longer. It is clear that long-term financing is a competitive weapon as well as the quality and price of the product. It is also true that it will help the newly-developing country to make the best use of its resources if instalment payments can be spread over sufficient time to allow the newly-acquired plant a period of operation which will itself help to pay for it. This is not a new theory but it is one which requires urgent study with special reference to this country's export of capital goods." . . .

We view with alarm and trepidation the fact that, for example, the American locomotive industry created vast capacity to dieselise the American railways. It has now more or less completed that task, and it has got to fill that capacity; it is looking towards the export markets of the world, and it is using the medium of the U.S. Export/Import Bank. It has concentrated in its early years, as we have tried to show in Appendix B of our memorandum, on Latin America, but we have now considerable indications that it is turning towards the Commonwealth. Our prospects as an exporting industry are extremely alarming, because of the sort of problems that we have tried to outline in our evidence. It so happens that some of our members have had some of the gaps filled with what we have long sought, which is a home market from the British Transport Commission. We are participating in the modernisation programme. But in terms of exports we are extremely worried, because we cannot see beyond the next year or so. As Sir George Nelson says, long-term financing is a competitive weapon which our competitors seem to be using more effectively than we are able to do at the present time.

6956. How are order books going with regard to the export business?——*Mr. Wilmot*: They do not exist in the terms that we thought of three or four years ago. They have gone right down; there is no question about that. If you wanted a statistical note of this, we could easily produce it for you, but you can take it that the locomotive exports of this country are steeply on the downgrade. We are extremely worried.

6957. *Lord Harcourt*: Are we talking in terms of steam locomotives or diesels?——*Mr. Curry*: All types: steam, diesel, electric, shunters, underground.

6958. *Professor Cairncross*: Is it your view that not only in non-sterling markets but also in sterling markets we are losing ground to other countries?——*Mr. Wilmot*: Yes.

6959. Excluding India for the moment, in the whole of the sterling area?——Yes.

6960. Who is obtaining these markets?——Germany and the U.S.A.

6961. Is Germany as successful as the United States?——*Mr. Curry*: Sometimes one, sometimes the other.

6962. Have you any evidence that the Germans in selling these locomotives have access to capital on terms different from you?——*Mr. Curry*: We have. We have an announcement that an additional revolving fund for the long term financing of German export orders is to be set up by the Minister of Federal Property. But Germany has not been the leading source of loss of orders to us in this particular field. It is undoubtedly the Americans.—*Mr. Wilmot*: Except in the case of Henschels, who have been very unwise in their policies: they took orders at such low prices that they found themselves in extremely difficult financial conditions, and in fact the company has had to be reorganised.

6963. In that case it was a question of price and not of terms of credit?——*Mr. Curry*: Yes, but it seems to us material to draw the Committee's attention to Western Germany which we have always understood is a classic case: a problem largely of a creditor nation, with its export surplus conditions, which yet needs to set up a revolving fund whereby its credit terms can be lifted from the present four to five years maximum, under which we are operating under difficulty, up to eight to ten years, for projects in newly developed countries. Germany, with an export surplus, seems to recognise that, if one is to do business in capital exports, one has to move

into the orbit of eight to ten years, while we are firmly bedded down to the E.C.G.D.'s five years.

6964. *Chairman*: I do not want to get off the immediate point being put to you. The Export/Import Bank in the United States has had these long term credits for a number of years. Has there been some change in the terms it has offered within the last two or three years which accounts for your loss of markets to them?——*Mr. Wilmot*: In our business contracts are eventually signed in respect of business which originates five or six years earlier. There is a project; that project has to be developed, designs have to be considered, the traffic potentialities have to be reviewed and so on. It is not possible, as in the case of consumer goods, for example, to point to a list of offers from the world, and say: "This is what goes". Britain has in our industry a certain amount of inbuilt goodwill in these overseas markets. That goodwill is changing rapidly, partly because of the technical differences in locomotives as locomotives. Had the world still been tied to steam locomotives, this proposition would not have been as clear, but the world is turning from steam locomotives to diesel locomotives, and to straight electrification. In those conditions it is reasonable for a foreign power to instruct its railway officials to investigate the world, and commissions of all kinds of railways have been all round the world on this kind of thing. They usually have three principal questions to answer when they get back home: (1) What is the best (not "is the British the best") for the new type of technique? (2) What are the delivery terms? (3) What are the prices, and what sort of contract can you make? I am very proud to say for this industry that technologically, in spite of our big brothers over the ocean in America, nobody has yet proved that an American product is better than a British product, or that a German, Japanese, French or Italian product is better than a British product We do not ask for any protection for our technological resources. The only thing we ask is to be put on competitive terms in relation to the finance terms of credit. This nation is prepared at any moment to finance unemployment without question; we believe that it is a better proposition that this nation should finance employment. Either you finance unemployment, or you finance employment which brings full employment to your people with all the benefits.—*Mr. Curry*: You can conclude from Appendix B of our evidence that the British locomotive industry is in effect out of Latin America. That is a very serious state of affairs. We have long been suppliers to Argentine and Brazil; but, as we have tried to say, once you are out, in terms of locomotives, you are out for forty years, and probably for all time.

6965. Have the terms of credit lengthened in your experience in the last year or two?——*Mr. Wilmot*: In the last ten years they have lengthened very considerably. One never knows at the date of quotation what your competitor is going to quote. That is why we are asking that your Committee should recommend to Her Majesty's Government that there should be some flexibility in E.C.G.D., with an upper limit of twenty years, but according to well-informed opinion about the honesty of the buyer, his financial standing and the potentialities of the region which he proposes to develop by this means We think that to have a rigid frozen period of five years is unrealistic under modern conditions.

6966. As far as the financial position goes, is this your proposition: that unless you have an E.C.G.D. guarantee you cannot get finance to cover any of these medium term credit arrangements and——?——That is only half the proposition, if I may say so.

6967. I meant it to be half——.——Assuming that E.C.G.D. had its terms modified to meet the whole of our conditions, we still could not find the money.

6968. If you will let me just ask my question, I shall probably arrive at the end you want. Is it right so far, that unless you have an E.C.G.D. guarantee you cannot hope to get the finance that you want?——Yes, you cannot go to any financial institution and get what you want.

6969. Within the range of time covered by the E.C.G.D. guarantees, have you failed to get the finance you want for any contract you have been interested in up to date?——Not within that range. The point is that the range has been inadequate. It so happens that the City generally takes the same view about period as the E.C.G.D. As I have said, we think that that was coincidental.

6970. Have you any reason to fear that within the terms which E.C.G.D. guarantees make possible you will not be able to get the finance that you want in the future for medium term arrangements? Are funds running short?——I have not referred this to the industry; I have been its President on two occasions, and I think I am entitled to speak for it, but this is a personal opinion. In the absence of some action along the lines we have indicated, I consider that as an export industry we shall be dead ten years, or even five years, from now. It is declining so rapidly that many thousands of people are going to be unemployed unless the British Transport Commission fills the gap, which it is obvious they cannot. They have not the demand; no programmes that have been published could possibly fill the gap that is going to be created unless something is done, and done fairly quickly.

6971. My question was a very limited one. It was about the finance within terms the E.C.G.D. provide, or may provide; they may alter——.——Mr. Chairman, please! One does not know what conditions may alter. If the conditions as of today persist, I can only say that what the Chancellor said the day before yesterday in his Budget speech is begging the question. It does not even touch the problem. If those conditions are not materially altered this industry as an exporting industry is going to disappear.

6972. Do listen to my question. I am trying to find out what the situation is. I am asking about the availability of finance in the City of London for what is or may be covered by E.C.G.D. guarantees. That is quite a limited question.——What is the point? If the City will give credit for five years, and if the E.C.G.D. will cover you up to 85 or even, as the Chancellor now says, 90 per cent., what is the advantage of that, if our competitors can give eight or ten years?

6973. *Mr. Jones*: Which competitors would those be? A customer could get that credit from the Export/Import Bank of the United States of America; can you tell us where else in the world similar conditions would be available?——Germany, Italy.

6974. At the moment?——*Mr. Wilmot*: At the moment.—*Mr. Curry*: We can give you an example. An electrification project for the Chilean railways worth $21 million, including 56 electric locomotives, went to an Italian group. We know that it was between one of our own people or the Italians, and we know that the credit terms were the deciding factor. The Italians got the order; the terms were 5 per cent. payment on the placing of the order, 5 per cent. on delivery and the remaining 90 per cent. over eight years in six-monthly instalments.

6975. What organisation in Italy provided the credit?——The Italian Government.

6976. *Professor Cairncross*: Directly?——Yes.

6977. Not through any financial institution?——We understand through an Italian consortium, which is partially Government financed. We understand that the Italian Government made available finance to enable the Italian consortium to quote these credit terms.

6978. *Mr. Jones*: A consortium of banks in Italy made the credit available, and it was guaranteed by the Italian Government; is that what you are saying?——That is so.

6979. Can you tell us of any other evidence that you have of a similar character? That is one outstanding case; what other cases are there?——*Mr. Wilmot*: If you refer to Appendix B in our document, you will see specific examples of the intervention of the American Export/Import Bank over two years from April, 1955 to April, 1957.

6980. *Professor Cairncross*: Surely many of these contracts would never have been placed, if there had been no credit provided by the United States Export/Import Bank?——I would not accept that.

6981. Surely in many of those cases the loans are really to the Governments themselves, for a variety of purposes, at the instance of the American Government; the loan was not for the purpose of buying this or that, but was intended to be made to that country?——We do not

know what political conditions may determine the attitude of a Government through its financial organisations.

6982. Are you not pretending to too much ignorance? In 1956 a loan of $500 mn. was made to this country; you refer to it in your paper. Is not this the largest single loan made by the Export/Import Bank, and is it not clearly also a Government transaction?——*Mr. Curry*: We do not refer to the loan made to this country in our evidence.

6983. You do include it, but you do not say specifically where the $500 mn. went.——*Mr. Curry*: We are only trying to say that these loans in Appendix B are loans to railways which have reached the stage of urgent rehabilitation, where, other things being equal, we should have had a better chance of competing in the normal way if the Americans had not moved into these markets.—*Mr. Wilmot*: Or if, *per contra*, we had equivalent competitive financial facilities available

6984. *Chairman*: We want to make the best of your evidence if you will allow us to. We quite follow that in this appendix there is a list of contracts which have gone, it may well be specially because of the terms of credit offered, elsewhere than to British manufacturers; but I would like to get some idea of the contracts which you have obtained. On what credit terms have you obtained contracts?——*Mr. Curry*: We are still able to get by, largely in the Commonwealth, within the E.C.G.D. five-year umbrella, and from certain Commonwealth markets that are not requiring long term credit. That is at the moment working in what you might call the easier Commonwealth markets. For the future——

6985. I really want to get the present picture if you will help us to get it. In the published figures for external trade exports of railway vehicles were still showing a rising trend up to £45·3 mn. in 1956; and the figure was £41·9 mn. in 1951.——*Mr. Wilmot*: Official statistics relate to something which is normally twelve months earlier; in fact they relate to contracts which were in practice made two years earlier than that, and to negotiations which began one or two years earlier than that. So any statistic which is up to date relates to negotiations which took place four or five years ago, when things were not quite the same as they are today. We were in those days, as you well know, in a period of what has commonly been called the sellers' market, and we are now in what is known as a buyers' market. The chill east winds of world competition are blowing round our rather bare knees, and with devastating effect.

6986. *Professor Sayers*: Is it the chill east winds that you are complaining of, or the change in credit terms?——*Mr. Wilmot*: We are not complaining. We do not know whether in the over-all economy of this nation our industry is expendable or not. We are asking you to take into consideration the facts of the case before you write this industry off as an exporting industry. Traditionally it is an important export industry. We can deliver goods which are technically speaking equal to any in the world, but if we are not put into a position where we can be financially competitive with our overseas competitors, we are here to tell you that this industry, which employs many thousands of men, is not going to employ those men much longer in the export market. We ask the Government and the nation to consider whether it would prefer to finance the unemployment of our men, which it will do under the law, and without question, or whether it would prefer to spend a very small fraction of that amount in helping us to be financially competitive with our competitors overseas.—*Mr. Curry*: Could we ask you not to be guided here by the railway vehicle statistics? Wagons and rail cars are probably predominant in that figure. The locomotive industry is a special case, and the railway vehicle statistics are misleading. In the next two or three years, with these chill east winds surrounding our particular industry, the trend of the railway vehicles statistics might still be flat; but the locomotive industry looks with trepidation and alarm at the years 1959 and 1960. That may not necessarily apply in the carriage and wagon industry, but that is all wrapped up in that particular statistic.

6987. *Professor Cairncross*: You mention in your paper a loan of £5m. to the Argentine Government for the purchase of steam locomotive spares, arranged by a City organisation, which was conditional upon the money being spent in the United Kingdom. Did the loan go through? Are the steam locomotive spares now on order?——*Mr. Collingwood*: Yes, to a limited extent they are. We could not take the full amount because the finance was limited to a term which allowed insufficient time for the manufacture of these items.

6988. If the period of the loan had been longer, then——?——*Mr. Wilmot*: Then the amount of the orders would have been quadrupled.—*Mr. Curry*: Instead of getting orders for steam locomotive spares for £5m, by the time it had been circumscribed by these conditions, we probably did very well to finish up with orders adding up to £2m.

6989. *Sir Reginald Verdon Smith*: I wonder if we could go back to that part of the discussion when the Chairman put a question dealing with the E.C.G.D. I was not clear, from what Mr. Wilmot said, whether, apart from E.C.G.D. policies, his Association had any evidence of difficulty in obtaining adequate funds for credit for this type of contract?——*Mr. Wilmot*: If Sir Reginald would read the City column in *The Times* of this morning, he would read how the City Editor of *The Times* reacts on that very point.

6990. I am asking you the question. I know the City Editor's view; I want to know whether the locomotive manufacturers have any evidence on this point?——We entirely concur in the views of the City Editor as printed in *The Times* this morning.

6991. Have you had particular cases where you have had negotiations which have failed because the bankers in the City of London have been unable to provide funds?——They are hesitant about the five years, but that is not the point; the point is that the five years is totally inadequate in the competitive international market. In practice a firm has to negotiate with the customer first of all in relation to a possible demand; then it has to have an official enquiry from that potential customer: then it goes to the E.C.G.D.

6992. I appreciate the procedure, but one has to try to find where are the various points of difficulty. It is clear that many people think there is a point of difficulty about the terms which the E.C.G.D. are in a position to offer. It is also alleged that if the E.C.G.D. were able to offer insurance policies for a longer period of years the City of London would not be able or would be unwilling to provide funds also over a longer period of years. I want to find out whether there is any substantial evidence for saying that about the availability of funds in the City?——The availability of the funds in the City is something we know nothing of; we are not City people. What we do know is that our banks look over their shoulders very carefully up to the five years to which the E.C.G.D. is prepared to go. The belief of our industry is that, even if it should be provided that E.C.G.D. could go up to a flexible twenty years, there would still be a need for some central financing export organisation in the City of London, other than the joint stock banks. We do not believe that the joint stock banks would go beyond the five years, from conversations we have had confidentially with them on this; they believe that that is too long for them. On the other hand the insurance companies regard it as too short. We believe that this is a problem which ought properly to be put at the dining table as it were of the Chancellor of the Exchequer; it should be right on his plate before the soup. We think that the Chancellor has every right, being the custodian of the finances of our nation to say that it is better to expend a fraction of the money in order to maintain our vital export trade rather than pay five, six, ten or twenty times as much in order to finance unemployment. You cannot move technicians from the locomotive industry to making anti-biotics, or anything else which the Government may say is easily exportable; you have either to find those men employment in the trades they know or you have to finance their unemployment. Financing their employment is only a fraction of the cost to this nation of financing their unemployment.

6993. *Mr. Jones*: We understand quite well that you are putting before us proposals for extending credit in order that this export development can take place. We are anxious to find out whether, when you have got

provision for the insurance of a particular piece of exporting business, you ever have any difficulty at all in getting credit for five years from the bank? Have you any cases where the bank has refused to give you credit up to five years?——Not up to five years; but five years is totally inadequate.

6994. We understand that, but there is not a case on record where credit has been withheld?——*Mr. Wilmot*: No.—*Mr. Curry*: The Chancellor has said that, if our competitors were to press for terms for a particular type of export beyond those normally insurable in this country, and our exporters found themselves excluded from business, we should be bound to consider extending our cover. We are saying to the Committee that we are there now.—*Mr. Wilmot*: The Chancellor is saying in effect that, if the horse has already bolted from the stable he will now consider the question of painting the door. It is not a practical proposition to paint the door of the stable after the horse has gone; it does not get you anywhere.

6995. *Professor Sayers*: I thought you said if the horse went he would be gone for 40 years?——*Mr. Curry*: All the horses have not gone; we are trying to keep the ones we have got.

Chairman: We fully appreciate the points you are making: we should come to a close now, before we get too involved in these metaphors, as we have other people coming. Thank you very much for your help, gentlemen. ——*Mr. Wilmot*: Thank you very much, Mr. Chairman.

(*The witnesses withdrew*)

The following witnesses, representing The Export Group for the Constructional Industries, called and examined.

J. M. LAING, Esq., Chairman of the Council of the Export Group for the Constructional Industries, and Managing Director, John Laing & Son Ltd., E. C. BECK, Esq., Director, John Mowlem & Co., Ltd., R. D. CHALCRAFT, Esq., Director, George Wimpey & Co., Ltd., SIR RICHARD COSTAIN, C.B.E., Chairman and Joint Managing Director, Richard Costain Ltd., W. H. MCFADZEAN, Esq., Chairman and Managing Director, British Insulated Callendar's Cables Ltd., HECTOR MCNEIL, Esq., Managing Director, Babcock & Wilcox Ltd., FRANK TAYLOR, Esq., Chairman and Managing Director of Taylor Woodrow Ltd., W. A. DE VIGIER, Esq., Chairman and Managing Director, Acrow Engineers Ltd., and R. W. TODD, Esq., Director, The Export Group for the Constructional Industries.

6996. *Chairman*: Mr. Laing, we have all read your memorandum* through very carefully, and you can take it that the points which you make are fairly familiar to the Committee by now because we have had them from various sources. To get the best out of what you can offer us today with your wide range of experience, we should want not to dwell too much upon details of the E.C.G.D. forms of guarantee but to get your general picture of the world situation with which you have to cope in your overseas business, and what is amiss in a large way with the arrangements of finding finance for your long-term contracts. I think you can take it as a general assumption that we would think it amiss if the contractor had to find out of his own resources the finance for these five, six, seven or ten year contracts. May we run through the memorandum you have given us on that basis and see what questions arise? First of all there is an analysis of the constructional industry. Then you give us figures of overseas contracts obtained for the twelve month periods ended March, 1955, March, 1956, and March, 1957. Have you anything which would indicate the order of events up to March, 1958?——*Mr. Laing*: Nothing definite. We think it is going to be around the same figure as for March, 1957.

6997. *Professor Cairncross*: Are most of these contracts in the sterling area?——No; quite a large proportion of these are in Canada, and there are signs that there may be an increasing amount in South America shortly, although there has hardly been any so far.

6998. But well over half the total would be in the sterling area?——*Mr. Laing*: That is right, and about one-third of the total in Canada.—*Mr. Taylor*: We have suggested to the Government that it would be desirable that they should build up a figure of the potential overseas contracting, building and civil engineering work available, but so far they have not done so. If I were to give an estimate, I would say probably the total potential work overseas is between £2,000m. and £3,000m. per annum.

6999. Your suggestion is that the information provided by the Government should be similar to the Latin-American project information published by *Construcción*, which you have circulated to us with your paper; not just a total, but a complete list of potential projects, with some details about them?——Quite so

7000. *Chairman*: Historically was not Latin America very much a field for British civil engineering?——*Mr. Laing*: Yes, it was; today it is almost totally neglected. One of our members here will be awarded a contract very shortly in Latin America, but other than that, on the purely civil engineering side as opposed to the mechanical, almost nothing has been done since the war. Latin America is the place where the American Export/Import Bank is probably busiest; I think that has a lot to do with it.

7001. *Professor Cairncross*: Have the British firms represented here tendered in Latin America in the past with success?——*Mr. Laing*: Yes they have. May I ask individual firms to talk?—*Mr. McNeil*: My company have put in substantial tenders in South America. We have had a certain amount of business, but in the last few years the competition from America, which is very largely sustained by the Export/Import Bank and to a degree by the World Bank, has been something we have been unable to meet, particularly on the length of credit which they are able to give.

7002. You are putting it to us that this is one of the main reasons why contracts have not come to this country?——*Mr. McNeil*: Definitely.—*Mr. Chalcraft*: From the civil engineering point of view, my company first went to Peru in 1955 for some harbour work, on a contract worth about £2½m. on six years' credit. We were invited to take on further works in other parts, but we were not able to make the necessary arrangements through E.C.G.D. Now we understand that one of those projects is shelved altogether; as regards the other one, I think a firm of British consulting engineers are proceeding with plans and investigations on a much larger scale than was originally contemplated with, we believe, the object of a World Bank loan. We shall tender for that in competition in due course. In Peru a number of other projects have cropped up from time to time, but we have not been able to arrange finance for them; and since then the Government has changed and they have cut down rather on work, and the only thing there now is the possibility of an extension to our existing contract.

7003. *Chairman*: You say you have not been able to arrange finance for that; what went amiss? Was it that you could not get an E.C.G.D. guarantee because of the length of time?——In this particular case it was the period of time. The E.C.G.D. originally offered seven years; on our original scheme it was finally arranged at six. When the Peruvian Government came along with the extension, they had been advised by the World Bank people that their commitments on medium term credit were rather too much, taken together, and they could not take anything less than eight years. We could not get anything more than six years at that time, and the Peruvian Government were not prepared to do it on that basis.

7004. So it fell through because of the E.C.G.D. rule?——Yes.

7005. *Sir John Woods*: It is not clear to me whether the limitation of time on the E.C.G.D. credits leads to British manufacturers or civil engineers losing a job to competitors, or whether it is more that the project simply does not come to fruition at all?——In this case it was not a question of losing to competitors; it just did not

* Memoranda of Evidence Part VII No. 4.

come to fruition at all, though one job may come out by a World Bank loan instead.

7006. Has the civil engineering industry lost much business to competitors because of this limitation of the length of credit? In electrical and mechanical engineering it is not easy to find particular cases where you know you have lost the job to a competitor because of this limitation, and I wondered whether your experience was the same or different?——*Mr. Taylor*: We have a case at the present time where we were tendering for a dam and a hydro-electric power station in Iran, valued at approximately £28m. The longest terms we were able to arrange for E.C.G.D. cover plus extras were ten years. The contract, we are now advised, has been awarded to a Swiss-German consortium who have advanced the credit over fifteen years at rather less interest than we were having to pay.

7007. *Chairman*: Do you know where the Swiss/German finance came from?——I understand that the majority has come from the Swiss banks. There are also a number of bonds which will be discounted in America.

7008. *Sir John Woods*: Has the consortium got the benefit of any credit insurance?——*Mr. Taylor*: I believe not.—*Mr. Laing*: I think we miss a lot of things which we do not go for because we cannot go for them. The case of Latin America is a typical example. We are competing with the U.S. Export/Import Bank who are going to give a twenty year loan in the first place. It is no good talking to a potential client who is interested in a twenty-year loan if we cannot match that.

7009. That is as against the Export/Import Bank; what about other countries which have credit insurance arrangements and which are members of the Berne Union?——We have instances of the Germans; a particular case is the Maracaibo bridge, about which Mr. de Vigier would perhaps like to say something; and a steelworks in Portugal has been done on terms much longer than the normal Berne Union's length of time.—*Mr. McFadzean*: I believe that is a combination of export credit from Germany for a period of seven years, plus a loan through a consortium of bankers over a further period.

7010. If I have understood other evidence we have heard correctly, a split of that kind, in which the credit insurance organisation takes say seven years and there is a balance of liability left over to be taken by the manufacturer or someone else, is supposed to be contrary to the terms of the Berne Union?——Yes, I would say so.

7011. *Chairman*: But in the Portuguese case you are speaking of, where seven years is covered, who finds the money on the basis of the credit insurance?——*Mr. Laing*: I do not know how the Germans are arranging to do that.—*Mr. de Vigier*: I was last week in Venezuela, where there is a £60m. contract for the Maracaibo bridge. A German firm has the contract. I was speaking to the director in charge of the contract, and he told me the financing came mainly from the Ruhr steel industry, coupled with the Dresdner Bank. The reason why the Ruhr steel industry is interested in such a contract is fairly obvious: the German firm of civil engineers would buy all the steel from the Ruhr; even all the cars around the contract would all be German cars, and all the plant comes from Germany. The German steel industry is interested in German plant going to Venezuela because they can produce the steel for that plant.—*Mr. Todd*: There was an announcement in the "Financial Times" of 27th March of a combination for development work arranged by the German Minister of Federal Property, whereby the Frankfurt Export Credit Bank was to be the operator of a revolving fund of DM. 250m., by which credit would be extended from the normal four to five years to eight to ten. I would expect that "Hermes" would be insuring the first part and this Frankfurt Export Credit Bank would be insuring the second part. I should think that was contrary to the Berne Union.—*Mr. McFadzean*: We have had quite a success with Venezuela, but in other parts of South America it has been the same as for Mr. McNeil. One of the problems is the amount of time that is necessary for getting out a technical specification for these estimates. Unless you can ascertain fairly quickly that you can get E.C.G.D. cover and also that you can get finance, it is frankly not worth the commercial risk to make all the preparations.

7012. Is it your general experience that it is difficult to get ahead with E.C.G.D. and bring your proposals to a point where you can take action?——I pay very high tribute to E.C.G.D. personally; the trouble is that it is not flexible enough. One has to get a tailor-made job, and then go round the city and find the finance.

7013. Would you just explain a little more what you mean by "not flexible enough" in regard to E.C.G.D.?——It is this question of period more than anything.

7014. *Sir John Woods*: You are saying that it is much easier to negotiate an arrangement with your foreign customer, quite apart from the question of period, if before you start you know for that project you can have E.C.G.D. cover; but that E.C.G.D. are perhaps a little liable to say: "We will certainly consider that very sympathetically once you have brought us a considered worked out and negotiated scheme"?——That is a very real point, I believe, because one only gets a limited amount of time to determine whether one is going to tender or not. For a contract on which large credit and therefore large insurance is wanted, one hesitates before putting in a tender unless one is satisfied that one can, in the event of getting the tender, cover oneself and finance oneself. We consider ourselves manufacturers and not financiers.

7015. *Chairman*: Have you found it difficult to tap the resources in the City that you want?——*Mr. McFadzean*: For certain countries, yes.—*Mr. Laing*: The figures revealed today are rather illuminating: E.C.G.D. did £29m. worth of work last year on the basis of bankers' guarantees. That is indicative of the difficulties that industry faces; £29m. is a very small sum compared with the kind of work we could do.—*Mr. McFadzean*: Our experience has been that immediately after the war the thing got out of control (we certainly lost a very big job in Venezuela to the Germans on much longer credit); then things seemed to improve, and people were playing more together; but recently it has been going the other way, and credit competition certainly exists again.—*Mr. Beck*: I think on this Mr. McFadzean is talking of manufactured goods rather than civil engineering; it is a very different picture where we go to try and sell a civil engineering contract, because where E.C.G.D. are concerned we have not got a satisfactory form of contract that allows us to go and borrow money at all; so I do not think anybody has ever done it on an E.C.G.D. policy as far as civil engineering is concerned.

7016. Because of the difficulties about acceptance which you mention in your paper?——*Mr. Beck*: Yes.—*Mr. Laing*: Even in the case of the steel works in India, I believe the civil engineering side is outside the agreement. —*Sir Richard Costain*: Just after the war my company spent quite a lot of money trying to get into South America, and all the time we found that the credit offered by the American banking people beat us every time. We pulled out of there altogether about six years ago, because the U.S. Export/Import Bank had a complete grip on the situation. There is of course an E.C.G.D. problem; but the main problem is much more that of tied loans, not only in South America but in the whole world.—*Mr. Laing*: From the point of view of manufacturers, once the Americans get in on the electrical side it means that the pattern has been set for future years.—*Mr. McFadzean*: Yes. One particular job in Venezuela was for a large telephone installation, and in a developing country like that, where they are starting from scratch, it involves construction; and, as I am sure the Committee fully appreciates, once they adopt American techniques and American standards, it is awfully difficult, when they come to an extension, to get them to change over to some other standard. It is something of growing importance, doing complete jobs not just the manufacture of the equipment, in these developing countries, where they are short of technical people, they always want the job not only manufactured but also installed and handed over to operate; you cannot divorce the manufacturing side from the constructional side because one is as important as another. It is frightfully important, on the electrical side, to try to get the British technique and standard in at the outset, so that when they come to extend or replace they hesitate a very long time before swinging over to American or German standards.—*Mr. de Vigier*: It is not only the

17 *April*, 1958] MR. J. M. LAING, MR. E. C. BECK, MR. R. D. CHALCRAFT, SIR RICHARD COSTAIN, C.B.E., MR. W. H. MCFADZEAN, MR. HECTOR MCNEIL, MR. FRANK TAYLOR, MR. W. A. DE VIGIER and MR. R. W. TODD [*Continued*

contract itself which is of importance from the export point of view; it is the whole way of life which is brought to the contract. If one goes to a contract like the Kariba scheme in Rhodesia, one finds Italian goods of all kinds on that contract, as a result of which the local natives are getting used to Italian products and ask for them. That means that the other industries benefit through that. Again in Baghdad the big national bank has been built by a German firm; even the windows were imported from Germany, as a result of which those people will get used to that kind of window and ask for that on other contracts. The constructional industry can be a tremendous spear-head for the export industries over all the other fields of activities connected with the contract.

7017. Then we come to section 7, on the U.S. Export/Import Bank and its activities; you say that development loans are made for periods falling within the 15 to 20 year bracket.—*Professor Cairncross*: Are not many of these loans made to the country concerned in advance of specific projects? Would not such loans have only a very general clause indicating the type of thing on which the money would be spent?——*Mr. Todd*: I would say that is rather the exceptional case. The general case is the specific project, but in three or four of the South American countries they have made very large authorisations of the order of \$100m. to be spent on the general economy of the country and projects of the public utility type. They may advance, say, \$100m. to the Argentine Government, but that \$100m. has to be spent on American goods and services, even though they may not define all the projects in advance.

7018. Is not this becoming the more common form of loan? Take the figures you give here, for instance: if you take out the \$500m. to the United Kingdom, the two largest loans left are the Argentinian and Brazilian ones which are of this character, and when these two are taken out there is only rather less than \$200m. left?——I agree that this seems to be something that has come up more often in recent years; but I do not think there is much, if any, difference in the end result. They are still tied to American goods and services.

7019. There is a certain difference between a project which might never be carried out at all unless the Export/Import Bank intervened with money and a project which is going to be carried through anyway, and which the country concerned is prepared to finance. If you are taking the Argentinian and Brazilian cases here, are not many of the projects rather of the first category than the second; they would not be carried out unless the Americans had lent the money to these countries?——*Mr. McNeil*: I have known two or three cases where certain plant was about to be ordered, not very extensive in character, where the British quotation was the most competitive; but at that point either the American agent or some other enthusiast brought in the Export/Import Bank and that immediately diverted the order to America. It was right on the point of being ordered when this last device has been employed.

7020. Would this be in Latin America?——*Mr. McNeil*: Latin America, from Mexico right down.—*Mr. Todd*: My interpretation of the loan to the Government of Brazil of \$100m. tied to railroads would be this: those Brazilian railroads were constructed by the British; they have lasted 40 or 50 years, and this is the Americans getting in for the reconstruction and re-equipping. So far as Latin America is concerned a representative of the World Bank who addressed an F.B.I. meeting recently told us that the World Bank were trying to put the economy of one of the Latin American countries in a better shape, and that they were succeeding, until the Export/Import Bank came along and offered a substantial loan. He made that comment: that they not only came in but they pushed the World Bank out.

7021. *Sir John Woods*: So far as a contractor is concerned in any case does he normally get from the Export/Import Bank a loan of 60 per cent., 70 per cent., 80 per cent. or 100 per cent. of the value of the contract?——I think that, so far as the contractor is concerned, he can get 80 per cent. from the Export/Import Bank and has to find 20 per cent. from his own resources or otherwise.

7022. Presumably he will try to get the 20 per cent. from the customer?——*Mr. Todd*: Yes.—*Mr. McFadzean*: The difficult point of recourse comes in here. There is quite a distinction on the constructional side between a job being carried out with an Export/Import loan and a job being carried out with the help of an E.C.G.D. guarantee. Where there is an item of dispute, if the contractor has a loan from the Export/Import Bank and a single item is in dispute, it is only that amount that is kept outstanding, whereas here you will know the trouble one has with recourse on the constructional side.—*Sir Richard Costain*: Outside the World Bank and British finance, any loan made from any country has strings tied to it, and very strong strings. In practice people are unlikely to borrow money from France, but I tried on one occasion; I could have borrowed money there for the Middle East if I had spent 90 per cent. of the money in France. We could not do it; it was not a physical possibility. Every country has something similar to the Export/Import Bank except Britain.

7023. *Professor Cairncross*: Would you not except the Swiss here? We have had a reference to the use of Belgian, Swiss and other funds by a consortium of banks. British banks do not appear to resort to any consortium of that kind to finance contracts?——The Swiss have been known on two occasions to lend money, but there are not very many Swiss contractors, and the banks have a lot of money.

7024. *Professor Sayers*: You mention the Norwegian organisation; is that a Government undertaking?——*Mr. Todd*: No, I do not think so. It probably represents mostly Norwegian industry; shipping and other interests.

7025. *Chairman*: I see the insurance companies come into the Norwegian consortium for supporting engineering exports?——This statement was included to be comprehensive. We do not put Norway down as a serious contender in this field, but we wanted to put in as much information as we could on this subject.

7026. It leads me to ask you if you have had contact with insurance companies in this country from the point of view of obtaining finance for these contracts?——*Sir Richard Costain*: Insurance companies by and large like a longer term of loan; something more like a 20 year loan. One of the post war problems has been this period of five to fifteen years; insurance companies do not really play in this.

7027. You have found that this gap is a reality?——*Sir Richard Costain*: Yes.—*Mr. McFadzean*: Seven to 12 years particularly.

7028. *Professor Sayers*: From your point of view would something on the Norwegian pattern fill the bill?——*Mr. Todd*: We should welcome anything that would find the money under conditions in which our industry could use it. We are not tied to anything. We should like to see an ample supply of money without the technical difficulties of acceptance such as we experience with E.C.G.D.

7029. *Lord Harcourt*: Something after the Norwegian pattern would enable both the banks who are interested with the shorter term money and the insurance companies to lend to industry *via* the organisation; it would be a medium whereby both long-term and short-term lenders could provide funds irrespective of the actual loans against which the money is going to be re-lent.—*Professor Sayers*: Have you tried to get such an organisation started up in this country?——There is no risk money available unless it is backed by an E.C.G.D. guarantee. No one is prepared to lend money in these risky markets unless it has a bankers' guarantee behind it. That is what makes E.C.G.D. so important in this.

7030. *Professor Cairncross*: Quite large sums of money are provided through the Commonwealth Development Finance Corporation to finance things like the Kariba Dam?——*Sir Richard Costain*: Their loans do not have strings on them like other country's loans do. They have money in an Italian firm in Nigeria, which is a rather odd situation.—*Mr. Todd*: The Commonwealth Development Finance Corporation has not been a large operator. It has been in existence for about four years and has lent about £14m., most of which goes to the investment type of project rather than to the constructional type of project. £3m. of that went to the Kariba Dam.

7031. *Professor Sayers*: What is there about this business which makes it so difficult for the City of London to cope with? The size of the risk does not seem so enormous as compared with the size of a catastrophic fire in one of the world's leading cities or even the loss of a Britannia aircraft. What makes it so difficult?——*Mr. Laing*: I think the difficulty is that one is asking the City to take risk capital for a period of years at ordinary debenture rates. The borrowers overseas naturally want this money at cheap rates.—*Mr. McFadzean*: There is another point, too; I think it is a question of the gap between the recognised terms of lending money. The joint stock banks lend on a day-to-day overdraft for a few years at most, and the insurance companies prefer, as we understand it, long-term loans. I am sure that it is this gap between six or seven years and fifteen years that does not make it very attractive to the City.

7032. Have you not tried to persuade the City to do differently and follow the example of Norway?——*Sir Richard Costain*: I spent practically the whole of my two years as Chairman of our Council trying to persuade the City to do it. All the time they said: "If you get the guarantees right, we will play", but we have never succeeded in getting the export guarantee situation right. They say that the money is available, but I am not absolutely sure that it is. You talked about a Britannia: if there is an order for 20 Britannias, and 10 are delivered but not paid for, you can keep 10 back; but you cannot fly a dam out. It is there, on the spot.—*Mr. Todd*: Sir Richard Costain asked the Accepting Houses Committee when we met them why they did not find money on the scale they did at the beginning of the century, and the answer was that income tax was then 2s. 6d. in the pound; there is not now the return on the money that takes account of present economic circumstances and the credit-worthiness of the borrower. That is why we are always forced back on the E.C.G.D. guarantee When large sums were found by the City for development overseas, largely in Latin American countries, it was on the basis that the City owned the equity in the project, or that they had a concession. They sometimes made several hundreds per cent., they sometimes lost the lot; but they could still make a business of it. Today all they can get is a debenture return of 5 or 6 per cent., with the present rates of taxation; and they still run the risk, if they have not got an E.C.G.D. guarantee, of losing the lot. It just is not a business proposition; they can employ the money better at home.

7033. Norway is a country which has rather higher taxation than the U.K., but they have managed to think up how to do it?——*Mr. Laing*: I think it was unfortunate we quoted Norway. We do not know how much Norway does and what kind of work it does. I have a suspicion that it does it in shipbuilding and things like that more than in construction.

7034. *Lord Harcourt*: Against long-term charters?——Yes.

7035. *Chairman*: You say that you spent a long time trying to find available sources of finance in the City for your purposes, and the answer came: "Get your E.C.G.D. guarantee right, and then we shall be able to play". Does getting the E.C.G.D. guarantee right mean finding a Government guarantee that has no qualifications or snags about it at all?——*Sir Richard Costain*: No, it simply means that as soon as the contractor is entitled to a part payment the E.C.G.D. will pay up on guarantee if the country defaults; in other words, if a dam is half built and £2m. has been paid, that should be considered to free the contractor and to free the private banker, and E.C.G.D. should pay if a country defaults in payment. The whole problem has always been that it takes five years to build a dam; at the end of five years payments are then starting to be due, and the buyer finds every excuse why he should not pay. So the contractor has not got his acceptance, and up till now the E.C.G.D. say that they will not pay until the client has given complete acceptance.

7036. It all comes back to that point again?——*Mr. Laing*: It comes to two points: acceptance, and secondly length of loan, even if we get the acceptance right.

7037. On an ordinary large-scale contract in this country a contractor has a smoothly organised scheme for certificates signed by the architects, and those are you warrants for getting payment against what he certifies. Is there nothing comparable once you are launched on a large-scale contract overseas?——*Sir Richard Costain*: It is not comparable in this sense of the word, that people abroad are, putting it quite bluntly and frankly, not quite so honest. With a payment like that in this country there is no guarantee that the employer is accepting the work; it is just a payment on account.

7038. I know that, but it does provide money?——It provides money.

7039. Is not that the relevant point?——*Mr. Beck*. They will normally pay the money abroad.—*Mr. Laing*: But E.C.G.D. will not accept that as acceptance of that portion of the contract; therefore we cannot make terms through them at all.—*Mr. McFadzean*: Another difficulty in certain overseas countries is getting them to accept arbitration. If one goes to litigation that can hold one up for about five years before it has gone through.

7040. If you can work a system under which you get the release of moneys periodically as you work your contract even under these overseas contracts, you are bringing your finance back again according to the release of the money; you are not out of the whole of your money on the whole period of the contract?——*Mr. Laing*: On a normal contract no, but on a contract that has to be financed under the E.C.G.D. they will not accept that as acceptance.—*Sir Richard Costain*: You are at risk all the time. I was not satisfied, though this is only my own personal opinion, that if we had got the E.C.G.D. problems cleared up the City would really have found the moneys, for the reasons Mr. Laing has been explaining earlier.—*Mr. Laing*: I should like to revert to this question of tied loans, if I may. We have already said earlier that ours is a very risky industry; all of it is risky, but particularly the civil engineering side. In paragraph 6 we say: "Much mort important, however, it [*sc* the tied loan] ensures that the goods and services are sold at remunerative prices." That is one of the things that we would like to see achieved in this country in our overseas work. If a loan is tied, one is reasonably certain that the price one gets has a fair margin of profit. One will probably be competing with several of one's own nationals, but one will not be competing with the world.—*Mr. Beck*: I heard of a case the other day: the British Government lent Malta some money to do construction work in Valletta harbour, and Mr. Mintoff had said in no uncertain terms that he wanted British money but was not having a British contractor at any price.—*Sir Richard Costain*: My firm have protested to the Government about a case in which the British are finding the money but a Dutch firm will get the contract.

7041. *Professor Sayers*: It does not sound in either of those cases as if credit is the trouble?——*Mr. Lang*: In that particular case it is a Government loan to another country which is in no way tied.—*Mr. Taylor*: The Export Group has suggested to the Minister of State's Overseas Advisory Council that, if the Government do not want to see tied loans, that a hint might be given to British manufacturers or contractors that certain loans might be made available if the contractors went to those countries, tried to negotiate orders for the goods required, or contracts for the work they want, and made a promise that they would endeavour to obtain the money in Britain. We think there would be no adverse effect.

7042. *Professor Cairncross*: When Sir Richard Costain says that the sources of finance, with certain exceptions, have conditions attached is he suggesting that there are not substantial moneys from elsewhere without conditions? Do you think that for almost all the projects now carried out by one country or another the money is advanced by the country carrying out the projects and with the conditions attached?——*Sir Richard Costain*: With a lot of strings attached; I do not say in every case, but in almost all.

7043. My reason for querying this is that, when you take the example of the German corporation AKA, the moneys that you mention here are so small. Take Fund A, where credits are granted for 12 or 48 months, the total amount mentioned here is DM 270,000,000?—*Mr. de Vigier*: In the case of Germany the vast majority of the competition comes, as in the case of the Maracaibo bridge, from the steel industry as a whole.

7044. In that case it is not the fact that there is a consortium, but rather that some way round is found each time for the provision of the money on condition that the orders are placed in the country supplying the capital?——*Mr. Todd*: There are these vast industrial structures in Germany; they do not always pull off the grandiose schemes that get into the papers, but very often they do. Recent reports were that Krupps were entering into contracts with Poland for £40,000,000 covering hydro-electric schemes, etc. There is that, plus the fact that German industry of that nature very largely owns the German banks, and it goes forward as a solid phalanx. That does not exist in this country; I am not saying it should, but that is the nature of the competition. One is not comparing like with like; what we have put in the paper for Germany does not add up to very much, but that is the small part that we experience of German industry.—*Sir Richard Costain*: In Italy Fiat are enormous. In France it works very differently. I do not know where they get the money from, but the French banks allow credit, though they put conditions to it. French firms have, to my knowledge, put some £50,000,000 into Kenya in the last three or four years.

7045. *Professor Sayers*: That is without an export-import bank?——*Sir Richard Costain*: Yes.—*Mr. de Vigier*: French contractors are mainly financed by Schneider. We are supplying a French company now, which is being financed by Schneider. We had small dealings with a scheme in the Port of Colombo, also financed with Schneider. About Kariba, it was rather interesting that we had to send to Fiat copies of the drawings we sent to the Italian contractors.—*Sir Richard Costain*: I created a fuss about Kariba two or three years ago, and they told me two years ago that they were nearly going to throw me out of the country; but they now agree that everything I said was right. The Italians are sweeping through the country, putting the European labour out of jobs, and getting nearly all the jobs there are. Four Ministers I saw out there within the last month said what a great mistake it was to allow the Italians into Rhodesia from a British point of view.—*Mr. McFadzean*: We are faced with great competition. We are anxious to meet and beat it. But the trouble is that, when credit is wanted beyond a certain stage, there is no place here that one can go to; there is no centre, no pipeline between the constructional and manufacturing industry and the City. It is a question of individual negotiation with E.C.G.D. The time taken in these negotiations is very important. The pleas I would make on behalf of this industry are these two main points: can we have a pipeline to the City, a centre to which one can go to talk to experts and get a quick decision, which might be financed by the banks; and secondly, can E.C.G.D. be made more flexible in covering some of these real difficulties, such as the questions of acceptance and recourse, so that we can compete on level terms with people overseas.—*Mr. McNeil*: At the present time the gap between what can be offered with the backing of E.C.G.D. and the competition that defeats us is usually only a matter of two or three years, but that is all that they require in order to defeat us at the present time. The Export-Import Bank have the facility of giving up to 20 years; so that we need somewhere the possibility of facilities for a far greater length of term than has so far been envisaged. I am quite sure that the competition will just extend their facilities to meet whatever we put forward up to a certain point.—*Mr. de Vigier*: I would also like to make a further point; the psychological advantage of the United States Export-Import Bank. If a contractor is backed by the United States Export-Import Bank and the question of dishonesty arises, the contractor has far more chance to get his claim settled if it is backed by the United States Export-Import Bank, because that country would be frightened to do something which would prevent them from getting another loan in the future from the Bank; whereas if a British contractor goes in as a lone wolf, he is not so protected.

7046. *Professor Cairncross*: This implies that you are not optimistic about getting private capital in any shape without converting it into a gilt edged loan? You are contemplating that the Government either provides the money directly, or erects the transaction into a gilt-edged loan?——*Mr. McFadzean*: Or that all the people will get together and form this corporation; as long as they stand by it is good enough for us.

7047. That is a different proposition; there you are talking not in terms of E.C.G.D. but in terms of finance which would run the risk, and you told us that you do not think from your own experience and effort, that the circumstances now are conducive to the formation of a consortium for which capital is provided privately and bears a risk?——*Mr. Laing*: Unless the people who are going to provide the capital also have a slice of the equity I do not think there is. Take the Middle East as an example: I cannot see any group giving a loan to, say, Syria, at 6 per cent. with no capital gain at the end of it.

7048. *Sir Reginald Verdon Smith*: Is your problem entirely different from the one in the aviation field? Is not Air Finance Ltd. a specimen of the sort of thing that you are talking about? Is not that the sort of banking machinery that you want to see?——*Mr. Todd*: I think so, subject to the fact that different industries have different characteristics. Air Finance Ltd. is the finance corporation designed for the aircraft industry, and from what we have seen it is doing a good job for the aircraft industry. If we had a similar corporation which took account of our own characteristics we would be quite happy.

7049. But this was formed as an arrangement between bankers and the industry, and the industry had a hand in the initiation. Would you not wish to do the same sort of thing rather than suggest necessarily a Government concern?——Again we must bring Hamlet back into the play, in the shape of the E.C.G.D. bankers' guarantees. I do not think, as I understand the position, that Air Finance Ltd. would have, as it has at the moment, overdrafts to the tune of £15,000,000 unless there were E.C.G.D. bankers' guarantees in the background.

7050. *Professor Sayers*: There are two quite different points: there is the point about modifications of E.C.G.D.; and there is the point about finance. Assuming that the modifications of E.C.G.D. are achieved, then from the point of view of the provision of credit is not this sort of consortium between the City and industrial concerns interested in the manufacture of the goods or their supply the sort of private enterprise project providing credit which you are in fact advocating? Is this not an example of it working, and is it not something that the bankers can achieve without necessarily asking the Government to do it?——*Mr. McFadzean*: I agree that this falls into two parts. If a consortium of bankers provided the finance we would be perfectly happy. But surely the consortium of bankers is going to want some guarantee, because we as manufacturers and constructional people would not be interested in getting the finance on the understanding that if things went wrong it came back to us in total; therefore the credit guarantee must remain, either to the consortium or the manufacturers.—*Mr. Taylor*: When a contractor takes a contract overseas he goes to the country and starts building and fixing his expenditure in that country; whereas with an aircraft it is built in this country and at the time of delivery the manufacturer knows pretty well whether the country can pay or otherwise. I think that is a fundamental difference.

7051. *Chairman*: Are you saying that it is difficult to get away from the E.C.G.D. part in these two things, because in the case of a constructional contractor's work it is inherently difficult to give a satisfactory E.C.G.D. guarantee with regard to it?——*Mr. Laing*: We think it could be done very easily. We have regularly put up recommendations to E.C.G.D. which we think are fair and reasonable, but which they apparently do not.

7052. I may be a little ignorant about this, but I was not very satisfied about the proposals that you put in the second part of your paper. But suppose that you could easily get a satisfactory guarantee; would there then be any difficulty in getting satisfactory finance from non-Government sources?——According to what Sir Richard Costain was told in the City, there would be no difficulty. But we then come to the second point: the length of time of the loan.

7053. *Professor Sayers*: And is it because of that second point that you want to have a consortium to deal with and do not wish to take advantage of competition between the banks?——*Mr. McFadzean*: It is because of that, and also because of the cost of the effort. It is a very expensive matter making these tenders, and having to go round

and do so much private individual negotiation instead of having a recognised address to which one could go where there would be a concentration of experts on finance.

7054. *Lord Harcourt*: Air Finance fulfils that need for the aircraft industry?——*Mr. Laing*: If we had something like Air Finance, tailored for our particular requirements as far as time was concerned, and if we could cover this question of E.C.G.D. guarantee, we should be very satisfied with the results.—*Mr. McFadzean*: I agree entirely about that. It comes back to the point that Constructional Finance Ltd. would have to be prepared to lend the money without recourse on the manufacturer, or the E.C.G.D. policy, which does not meet the requirements of the construction industry, would have to be so adjusted that Constructional Finance Ltd. would have recourse to E.C.G.D. and not to the manufacturer. And it is important, I suggest, to bear in mind that construction leads on to the sale of goods; if we can solve the construction problems, by and large we are bound to help the sale of goods and professional services from this country.—*Mr. Laing*: This is going to come to a head with atomic power stations overseas. A large portion of those are manufactured goods, and it costs a matter of £100,000 to prepare a tender for a large atomic power station. Nobody is going to spend that much money if he does not know where his source of finance is at the end. The contractor must have that all lined up, and must have a vehicle through which to work. And, of course, with an atomic power station five or seven years' credit is no use at all.

7055. *Sir John Woods*: We have been talking about this on the basis that if money is to be got from the City E.C.G.D. cover is required for any contract overseas. That is not really true, is it? If one is thinking of a contract in Australia or New Zealand or South Africa, there is no reason why finance should not be arranged, provided the Government will agree, without E.C.G.D. cover?——*Mr. Taylor*: Yes; of approximately £100 million of work done now, maybe not more than £10 million is insured under E.C.G.D.

7056. *Mr. Jones*: Who are the guarantors for the remaining £90 million? Suppose that there was a default in respect of part of that £90 million not covered by insurance in this country, who would be responsible overseas for meeting the losses?——In Ghana we are doing work, and if the Government did not pay for that it would be our loss.

7057. Are all these Government contracts, then, that you are talking about?——No, there are contracts for private individuals.

7058. *Chairman*: But they carry no guarantee except with the person with whom you have made the contract?——*Mr. Beck*: Those are not on long-term loans, or even medium-term loans; they are mainly being paid monthly as we go along, as in this country.

7059. *Mr. Jones*: Is there a special degree of credit worthiness in this particular field?——*Mr. Beck*: Yes. That is more important than anything else; the contractor works on the site and must be sure of the integrity and honesty of his customer.—*Mr. Taylor*: At the moment Turkey has no sterling; so E.C.G.D. have stopped giving any cover for Turkey for the time being.

7060. What proportion of the business that you have to do abroad needs to be covered by insurance, as against the part of the business you can rely upon in terms of credit worthiness? Is it 50/50 or is it 75/25, or what is it?——*Mr. McFadzean*: This is a very difficult question. If we are going to attempt to broaden our markets, we must attempt to increase exports in undeveloped countries; those are essentially the countries that require export credit. Where there is a risky political situation we as commercial people feel we should be insured.

7061. Is it substantially the undeveloped areas of the world which are worrying you?——Where credit guarantee is concerned, yes.

7062. *Professor Cairncross*: You say you could treble the work overseas; is that intended to refer exclusively to those countries or to the total contracts you carry out?——*Mr. Laing*: We believe we could treble it in various territories, but the majority of the increase would be more work in the undeveloped countries or the developing countries. That would include places like Latin-American countries, which you might say are half-developed.

7063. In practice perhaps no more than 10 per cent. of the work done at present is subject to E.C.G.D. guarantee?——*Mr. Taylor*: We are doing the maximum work overseas without E.C.G.D. cover that we can do. If we are to increase the volume, we must have E.C.G.D. cover.—*Mr. Laing*: The risky areas are in the Middle East and, to a lesser extent, India; and then there is very considerable potential in Latin America.

7064. *Professor Sayers*: It is for the development of this new business you are making these proposals rather than for the present?——*Mr. Beck*: It is new to us, but the other countries are all going there. We see German, French and Italian competitors going to these places.

7065. *Professor Cairncross*: Can we pursue this one stage further? Of the money going into this at the moment a very substantial proportion, probably half, comes from the International Bank for Reconstruction and Development?——*Mr. Laing*: The U.S. Export-Import Bank is lending three or four times as much as the World Bank.

7066. If you take out the $500 million that we got from the Export-Import Bank last year, the position looks rather different. World Bank lending is of the order of $500 million, and it has risen quite steeply during the last three years. Last year I think we may take it that the World Bank did lend more?——*Mr. Todd*: In the six months ending 31st December, 1957, the Export-Import Bank lent $468 million. World Bank lending for 1955 was $274 million, for 1956 $283 million, and for 1957 $332 million.

7067. I think you will find that those Export-Import Bank figures are total commitments, while the World Bank figures are actual disbursements. At any rate, without arguing about precise magnitudes, it is quite a steeply rising total for the World Bank. They concentrate both on the under-developed countries and on loans of the order of fifteen years, and they do not make tied loans; but you appear to have some reservations about the World Bank?——*Mr. Laing*: Three quarters of the amount they are lending is lent in dollars, which means that the people who are borrowing have expressed a desire to have the loan in dollars because they want to spend it on dollar goods for some reason or another.——*Sir Richard Costain*: Although it is called the World Bank, because of its physical situation the American contractors of all shapes and sizes get a material advantage, as Mr. Eugene Black himself has said. And these under-developed countries, like Brazil, consider it to be an American Bank and consider it preferable to give work to the American people rather than to anybody else.—*Mr. McNeil*: The World Bank recruit their engineering staff and their assessors almost entirely in America and they are United States citizens, and they naturally know American equipment and are very strongly biased towards it.

7068. *Lord Harcourt*: The chief consulting engineer for the last three years has been an Englishman?——He is in a terrific minority.

7069. *Professor Cairncross*: Let us make a number of favourable assumptions: first of all that World Bank lending in the next few years achieves a much greater volume; secondly, that there is no particular American flavour about the consequence of the loan. We then get free from the tied loan system in these countries in which you want to do a large amount of business. Would you still, because of political risks, want E.C.G.D. cover, on a scale which under its existing terms you could not get?——*Sir Richard Costain*: If we had a World Bank guarantee we should not want one. But if the contract is taken on with the country, and the country could divert that money for some other use, we should want E.C.G.D. cover because of that risk.

7070. But there is no possibility of World Bank money being diverted. Assuming the World Bank continues to increase, would you still wish to have other facilities in this country?——*Mr. Taylor*: Yes.—*Mr. Laing*: There are many instances where our members have got contracts which have been financed by World Bank loans. But

those are competed for by every country under the sun, and the competition is open competition and one is not necessarily comparing like with like as far as performance or ability of firms is concerned. In certain cases Britain and the United States are working under great disadvantages, as our labour costs are very much higher than, say, the Italians'. In the case of Kariba we put in a tender, which took us a lot of time to do, and we reckoned the difference between the rates we had to pay the British craftsman and the rates the Italians are in fact paying amounted to something between £3 and £4 million on a £30 million contract. That is one of the reasons why we should not necessarily benefit so much as other countries, particularly Italy, if World Bank loans increased.

7071. *Chairman*: Given a World Bank loan to a country that wants to achieve some development project, then that project is open to competition, as you say. But if it is an area where you need insurance against the political risk will you not still find, if they can offer better credit terms for carrying out the contract than you can, that you will have the same E.C.G.D. impediment as before?——*Mr. McFadzean*: Yes, but in an assessment of credit worthiness one is influenced by the fact that the World Bank is giving a loan.

7072. *Sir John Woods*: I am not clear about this wanting E.C.G.D. cover where there is a World Bank loan. I would have expected that the World Bank itself would police its own loan so that the funds could not be diverted to some other purpose.——*Mr. McFadzean*: We have taken jobs financed by the World Bank without an E.C.G.D. guarantee.—*Mr. Beck*: The World Bank loaned so much to Abyssinia for a development programme The money is paid to the Abyssinian Government for that, and how much they pay is purely in the hands of the Abyssinian Government.

7073. *Lord Harcourt*: That is not so. Every single contract is under the direct control of the Technical Operations Department of the Bank, and the Bank disburse the money.—*Chairman*: Then the difficulty I was trying to clear up would not arise.—*Mr. Laing*: There are cases, such as Kariba, where the World Bank is putting in a portion of the finance and the rest is raised by all sorts of other means. In that kind of case we might want to have cover from E.C.G.D.

7074. I think that completes our questions, Mr. Laing; is there anything you would like to add arising out of our discussion?——*Mr. Laing*: I should like to make one point. We believe that our industry is, as Mr. de Vigier has said, the spearhead of industry generally from Britain, and we know that we can expand our overseas activities very considerably indeed. I mentioned earlier the question of atomic energy; that is just one item. With atomic energy and hydroelectric power and so on, if we can get into the position where Britain is able to finance complete schemes right through from the design and construction to the complete sale of them, I am quite sure that we can expand our industry very considerably. I will go back a few years to the origins of the Kariba scheme. My own firm was interested with a group that was trying to raise the finance for the whole of Kariba. The Rhodesian Government was quite satisfied that, if we could raise the finance under reasonable terms (and they told us what broadly were reasonable terms), they could negotiate the contract with our group for the Kariba. That fell through, as you know. That is the kind of thing that can happen more and more in the underdeveloped countries of the world.—*Mr. McFadzean*: I do not think we should get the World Bank out of proportion, because, valuable as that concern is, it still is not doing everything. One is up against competition from other countries, like Germany, and we have simply got to compete against that.—*Sir Richard Costain*: I should like to stress this question of sterling as a trading commodity; we should not let contractors in other parts of the world have the use of it at 5 per cent.—*Mr. de Vigier*: I should like to stress that in the United States there are insurance companies and banks, as in this country; yet they found it sufficiently important to found the Export-Import Bank. They must have had a good reason for doing so, and the good reason surely was that where American money is being used, American contractors and American goods are being used, thus backing the home industry.

Chairman: Thank you very much, gentlemen. This has been a very helpful afternoon.

(*Adjourned until Thursday, 24th April, 1958, at 11 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-EIGHTH DAY

Friday, 18th April, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E. (Questions 7075 to 7288 only)
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The following witnesses, representing the British Insurance Association, called and examined: C. F. TRUSTAM, ESQ. Chairman, B.I.A., General Manager, Royal Insurance Co. Ltd. and Liverpool and London and Globe Insurance Co. Ltd.; H. A. WALTERS, ESQ., Deputy Chairman, B.I.A., General Manager, Royal Exchange Assurance; R. K. LOCHHEAD, ESQ., Secretary, Commercial Union Assurance Co. Ltd.; A. F. MURRAY, ESQ., Chairman, Investment Protection Committee, B.I.A., Investment Manager, Prudential Assurance Co. Ltd.; and R. T. D. WILMOT, ESQ., Secretary, B.I.A.

7075. *Chairman*: Will you have your memorandum* in front of you, gentlemen? It is very informative, and we should like to go through the main points with you.——*Mr. Trustam*: May I suggest, Sir, as a preliminary—Mr. Walters and I are here as Chairman and Deputy Chairman and not as investment experts. We are concerned with the overall investment but not with day-to-day market operations. That is the province of my colleagues Mr. Lochhead and Mr. Murray. I should be glad to answer any general questions, but anything on the technical side might be sensibly addressed to them.

7076. It is quite convenient to us if you settle among yourselves who is to deal with the various questions. You distinguish in the role of insurance companies as investors, between the functions and characteristics of your life business and the functions and characteristics of the general business. Then you give us a note in paragraphs 12 and 13 about overseas life and general business. In effect that means that overseas business generates its own fund of investments in the country in which the business is conducted?——Very largely.

7077. What qualifications of "very largely" are there? Is it not becoming more and more habitual for countries to require the retention of at any rate a proportion of the funds representing business done in their own country?——That is correct. There is the enforced retention of funds overseas; there is the voluntary retention of funds overseas, where we must demonstrate that we are participating in the activities of the country and not merely bleeding it and bringing out everything we can; and of course there are sometimes exchange restrictions in these other countries which prevent our remitting funds. On the other hand we aim at bringing home the maximum possible subject to those considerations, and, as a minimum, bringing home enough to pay in this country the expenses that arise in this country with relation to the overseas business. For example, if we pay British tax on that overseas business, we must bring back at least sufficient money from that country to pay our British tax on that business transacted in that country. Those are roughly the guiding principles.

7078. The general picture is one in which you conduct operations from the head office here, but each country generates and retains its own funds and investments according to the business done. Is that right?——I would think that slightly over-stated. That implies having nothing accruing to this country in the way of remittances.

7079. How far should we qualify it? Naturally you have a claim, which most countries would recognise, to return to the head office the expenses of conducting the business from head office. There is also the profit element. Is there difficulty about that?——No, that does not matter.

7080. *Professor Cairncross*: Do you have any latitude in the moving of funds for investment between one country and another? Do you in fact move any substantial sums between one country and another, if you are obliged to retain the funds arising in the country in which the insurance is transacted?——You mean as between one country and another country abroad? I would say no; the traffic is almost entirely as between this country and the various countries overseas where we trade.

7081. In that case, are you free to bring here for investment any substantial proportion of the funds arising abroad?——Subject to the three considerations that I mentioned: statutory retention of reserves in that country overseas, voluntary retention of funds there, and exchange restrictions in that country, which may preclude you, either for a shorter or a longer time, from bringing home what you want to bring home.

7082. How far is there any capital transfer between insurance business transacted abroad and this country?——I find it difficult to give any precise answer to that, beyond the fact that it does work out that we are as a minimum able to bring home sufficient to pay our expenses here on that foreign business.

7083. That is your costs; it is not capital. Are we to think in effect that there is no capital movement?——Yes, I think that is correct. The capital which we have invested in those countries overseas is the result of accumulated earnings over the years, which have been built up.

7084. You give us in paragraph 12 the proportion of your general business overseas to the total general business. Can you also tell us how much of your life business is transacted abroad?——*Mr. Murray*: I would hesitate to give a figure without asking the offices for information which we have not got.

7085. Is the proportion 10 per cent. or 20 per cent., say?——*Mr. Murray*: I would say it might be of the order of 20 per cent.—*Mr. Trustam*: Certainly not of the order of 60 per cent.

7086. *Chairman*: Is there an increasing tendency for the funds representing overseas business to be retained for one reason or another in the territory in which the business is done?——Yes, with varying degrees of emphasis in different countries. There may be legislation, as for instance in some South American countries, which puts increasing pressure to that end; on the other hand in a country like Australia there has been no change in the factors governing our movements of money at all.

7087. No technical change; but is there an increasing feeling in the countries concerned that business there must be repaid by investments made there?——Yes. The provision of capital to Australia (there is a good deal of talk about Britain not providing enough capital for Australia's development) in a sense includes not taking out of Australia what one can reasonably leave there. I do not by that mean to suggest that there is any special problem in relation to Australia; it is just part of the general picture.

* Memoranda of Evidence Part VI No. 10.

7088. *Professor Cairncross*: Do you not find, in some of the less developed countries at any rate, difficulty as regards putting your money into suitably liquid investments? Are you able to find short-term investments comparable to short-term Government Bills?——*Mr. Lochhead*: We have not in the ordinary way put it in short-term, even on the general side. Generally speaking we can put money on deposit at a bank, and there are indigenous Government securities of varying maturities which meet the needs of most of the companies doing business in those countries.

7089. Are we to understand that your general funds are only to a very limited extent tied up in this way?——The whole of our holdings in Treasury Bills are trifling; therefore there cannot be very much of our general funds in Treasury Bills. We did not divide the holdings between life funds and general funds in our table, since we imagined that this Committee would be more interested in knowing the volume rather than the source from which the investments sprang.

7090. Do the figures in paragraph 34 cover life funds only or general funds as well?——*Mr. Lochhead*: All our funds.—*Mr. Murray*: One would expect the proportion of general branch funds in Treasury Bills to be more than the proportion of life branch funds in Treasury Bills; but as the total of life funds so far outweighs the total of general funds it is impossible to say what the actual figures related to general and life funds separately would come out at.

7091. In some of the earlier paragraphs of the paper you emphasise the need to be able to realise your capital quickly on the general business. What forms of investment do you consider suitable for that purpose, if you say that Treasury Bills are not particularly important here? ——*Mr. Lochhead*: Short-dated Government stocks or cash.

7092 *Professor Sayers*: You mean by short-dated under five years?——Not as a rule. There is a practical problem here. The investments we hold overseas are generally speaking deposited by legislation or, if not, they are "bogged down" in the country for the reasons Mr. Trustam has mentioned. We do not want to have securities that turn over too rapidly or too frequently, such as bills or short-dated investments; we would rather have something which is going to be there for a reasonable period of time, for purely administrative reasons. To buy, for example, Treasury Bills would mean an awful business every three months to have to renew them.

7093. *Professor Cairncross*: Would what you say be equally applicable to the home business?——Not quite, because there are no deposit regulations here.

7094. But you would still show the same reluctance to rest in Treasury Bills?——Except as a very temporary d casual circumstance.

7095. *Professor Sayers*: And what about the Government bonds under five years?——There is very little investment in them at all. For one thing the banks are more interested in them, and that pushes the price up; they therefore become, to that extent, less attractive to us.

7096 *Mr. Jones*: What proportion of the British Government and Government guaranteed securities in the life funds and in the general funds shown at item 2 of Table I in your paper are short-term, under five years, what proportion are medium term, and what proportion are long-term?——I have not got the statistics broken down to that extent; but in general terms I should say that the bulk of the Government securities in the life funds would be towards the end of the range, practically nothing under five years, and very little between five and ten; whereas in the general funds you would find the centre of gravity, as one might call it, much nearer the beginning.

7097. You are saying that the £1,127 million of Government securities in the life funds are overwhelmingly in long-dated securities, anything up to 15 to 20 years?——Longer than that.

7098. Where would you put the average date of the £154 million invested in Government securities for the general funds? You might want the money at any time between one year and 15 years. Would the average there be medium-dated rather than long-dated?——Medium-dated; 10 to 20 years. We do not invest in short-dated stocks on the general funds with the idea of a particular investment falling in to meet a particular liability. The shortness is merely to ensure some degree of stability in the price.

7099. *Professor Sayers*: I thought that this £370 millions invested for the general funds was essentially a reserve against contingent liabilities, and that you had to keep it pretty liquid because of the risk of a catastrophic loss now and again; and that therefore you had a decided preference in your general funds for the rather short-dated securities. Are you saying that that is not so?——Only partially so. The preference for the short-dated is to ensure some measure of stability in value, but you can get the other desirable feature, namely marketability, in other than shorts.

7100. *Professor Cairncross*: Do you regard a ten-year investment as one calculated to give stability?——*Mr. Murray*: Relatively so.

7101. *Professor Sayers*: But there have been very big movements in the prices of ten-year bonds over the last ten years; yet you regard these as appropriate securities for your general funds?——Yes.

7102. You are quite happy to see these prices moving about as they do?——*Mr. Murray*: There are other liquid resources here quite apart from these; debentures form probably quite a substantial part. It would be impossible to say without getting the statistics, but there are probably in these holdings of debenture and loan stocks quite a lot of short-term loan stocks running out, or fairly short.—*Mr. Trustam*: We do not take the view that those £370 millions have to be immediately and literally liquid; otherwise we would just leave them in the bank as cash. As between a 15-year bond and a 30-year bond, the bias, if we are investing for the general funds, is generally towards the shorter term, but no more than that. You referred to the fluctuation of a ten-year bond; if one had very considerable need to realise quickly, and the price of one's ten-year bonds had moved against one, that would be too bad. They probably would not have moved so violently as the longer bonds. At any rate at the short end we finish with some volume of Treasury Bills, which would be our first line of defence.

7103. *Chairman*: We are not at all critical of the way in which you do your business; it is the reason why you do it which is the point to which we are directing you. I think we all felt a little surprised to find that in the investment of the general funds there was a readiness to go as long in the investments as you seem to. The reason for it, as I understand it, is that a better yield is obtainable in the medium-term, because there are a large number of other takers, such as the banks, for the short-term?——Yes.

7104. *Professor Cairncross*: Do cash holdings, both in general and life business come under item 9 in Table I, or is there a separate holding for cash which does not appear?——*Mr. Lockhead*: Table I only includes invested assets and not current assets. On Table II we have included current assets as well.

7105. *Chairman*: Could you define for us current assets, so that we may see what is excluded there, apart from cash itself?——*Mr. Trustam*: Agents' balances, outstanding premiums and miscellaneous items like that.

7106. *Lord Harcourt*: What proportion of your reserve for unexpired risk (we are talking about the general funds, where every contract is an annual contract) is held in cash?——I could not quote figures, but a very minute proportion. We do not aim, as a matter of general policy, to keep a reserve for unexpired risk in cash at all, but the money or assets that we hold against that liability should be in such a form as to be fairly readily realisable if we need it. Otherwise we invest, and our problem as regards cash is merely to ensure that we have, from week to week, sufficient to cope with our trading requirements.

7107. *Professor Cairncross*: If you meet with some unfortunate catastrophe and have to find funds quickly, where do you find them? Which of your investments do you realise? Is there some standard procedure, or does it vary?——No, it would vary. Obviously one would sell what is readily marketable and what one could sell with the least disadvantage to oneself.

7108. You have not a designated list of assets or types of assets which you hold against such eventualities?——Not in that specific way. We have cash; we may have money on deposit account with the banks (as distinct from money in current account); we may have Treasury Bills.

7109. *Chairman*: I suppose you find yourselves tapping a bit of all these assets so as not to load the market in any one particular way?——Naturally one would choose to use first the assets which were of the least advantage.

7110. *Mr. Jones*: To what extent is there switching of assets? According to Table II the total invested was £405 million in 1956. Could we be told how much of this £405 million was switched from other investments and how much was invested from surplus funds?——*Mr. Lochhead*: The third column, which is the difference between the first and second columns, probably answers the question adequately. The second column, total disinvestment, represents redemptions of holdings, the drawings of bonds, and voluntary sales on the part of the companies. The £405 million represents the actual investment made, which includes not only the new money collected but also what we call turnover money: so the net figure is really £259 million.

7111. *Lord Harcourt*: Would it not be fair to say that your first line of reserves is your premiums which are coming in the whole time, and which you can refrain from investing but use instead to meet a current claim?——Quite.

7112. *Professor Sayers*: The net amount accruing each week on the general funds surely cannot be so very big, because every week there are hosts of small claims which add up to quite a lot, and there is also the cost of running the offices. Surely there is not all that much profit in this business?——It may be pertinent to mention the figures given in the Board of Trade returns. They relate to life business and general business together, but the bulk of the cash figures mentioned will be general business only. Cash and stamps at the end of 1956 was £134 million. The bulk of that will be in the general funds and represents the working balances of general insurance business throughout the world. It is not all here, but then all catastrophes do not happen in this country, of course. The first line of defence is to run down the working balance. If you find you run it down too much, you do not invest any new accretions, small though they be from week to week. Then if you want more you would go to your shorter-dated investments, those showing the least loss; and so on.

7113. Do you ever change from cash into Treasury Bills in the general funds?——Only to a very limited extent.

7114. *Professor Cairncross*: You do not hold out the prospect to us that you will eventually become important purchasers of Treasury Bills?——It is most unlikely. There has been a suggestion of a tendency in recent months for the general departments and the life departments to go a little more into Treasury Bills than has been customary; the increase shown in paragraph 34, where the increase in the total is much faster than the increase in the total funds, hears that out.

7115. *Chairman*: Why should they be unattractive, considering you as organisations which, so far as the general funds go, have to keep large current balances? Is it the yield factor?——Today the return on Treasury Bills is a real point, but in normal times it is not.

7116. *Professor Cairncross*: But even at the current rates, you still do not expect to see any buying of Treasury Bills?——No.

7117. In what way do you hold your British government securities? Would these and the other stocks mentioned here be held in the name of the insurance company concerned, or is it a nominee holding, or is it held in some other way?——It is the practice of insurance companies almost unanimously to hold their securities in their own names. The use of nominees among insurance companies is very rare indeed.

7118. *Chairman*: On Table II, are we to regard the distribution which you give us for 1956 as being at all typical?——I would say that this is a fair representation of what has happened, and what would happen at the present time. One might find a little reduction in the amount of mortgages, if and when the building societies found themselves with a little more lendable money.

7119. *Professor Cairncross*: Does a substantial part of the sum in item 1 shown as mortgages represent advances to your own clients for the purchase of private houses?——Certainly; about half.

7120. You must be quite an important element in the house property market?——*Mr. Murray*: Very important at the moment.—*Mr. Lochhead*: But it is still small, relative to what the building societies do. If we are right that about half of this is mortgages on private houses, it means that there was net investment of about £40 million. Compared with what the building societies do, that is still pretty negligible.

7121. Would you perhaps be prepared to lend more freely on a property where building societies have at times shown a disinclination to make loans? Is there a distinction there?——The general run of mortgage investment in insurance companies as a whole is very much wider. The sort of investments that they like for mortgages are more the shop property type.

7122. Office buildings?——Office buildings particularly; and then perhaps flats and residential properties coming a very low third: whereas the building societies are much more confined.

7123. Do you draw a distinction in giving a mortgage between old property and new property?——We generally tend to follow the building societies very closely. We do not want to be, and in fact we are not, competitors with them in any real sense. The increase is due to a great extent to the shortage of funds in the building societies. I would say that the volume we have done in recent years since the shortage developed is exceptional.

7124. *Chairman*: Is the business that you do in this way mainly for people who are in other contractual arrangements with you as policy holders, or does it come as a general policy?——It is generally business with policy holders.

7125. *Professor Sayers*: Do you expect to increase it?——Not if the building societies come back with full funds to take their place.

7126. *Professor Cairncross*: Are we to understand that only a limited proportion of what you put here as mortgages represent advances to local authorities?——Advances to local authorities, including mortgages, would come under item 9.

7127. *Professor Sayers*: So this is all property mortgages for private purchase?——Yes.

7128. Would you say that about half of them is represented by moderately big business in shops and blocks of flats?——*Mr. Murray*: Probably.—*Mr. Lochhead*: We are not much interested in small mortgages, except houses.

7129. If one can compare the figures in Table II with those in Table I, your proportion of mortgages seems to be going up, even apart from the small house business?——*Mr. Murray*: This may not be typical. It might reflect loans to the smaller companies, who have had difficulty in getting bank advances, and so have come to the insurance companies and got mortgages from them. The amount we invested in this in 1956 is big in relation to the proportion of our total assets we have invested in this way in other years.

7130. *Professor Cairncross*: The proportion of your funds invested in mortgages has risen very steeply in the past six or seven years. In six years have you not just about doubled the amount?——Yes.

7131. *Professor Sayers*: Is the mortgage business, apart from the house business, going to continue to increase?——*Mr. Lochhead*: I should not expect it to go on increasing. The general long-term trend in regard to mortgages is downwards. In 1871 the proportion of mortgages was about 60 per cent. of the whole, and now it has come down, as you see, to about 14 per cent. That trend is matched by a corresponding increase in the holdings of debentures. It is really a reflection of the disappearance of the small unit, which would go for a mortgage, and the appearance of the big unit, which normally goes for debentures.

7132. *Chairman*: The debenture is almost entirely an industrial and commercial security; the mortgage covers a wider field, and takes you into the private field of course?——Yes.

7133. *Professor Cairncross*: Is there any organised market for these mortgages? Once you have taken them, do they stay with you?——*Mr. Lochhead*: Yes. There is a market in local authority mortgages, but the others come to us through the banks and chartered accountants, and mostly through our own clients.—*Mr. Trustam*: There are

two factors involved here: our desire or lack of desire for mortgages, and the availability or lack of availability of mortgages. A lot depends on the second factor. There are phases where in the course of several months there does not seem to be very much coming along on attractive terms in the mortgage world. That position can change, and that becomes quite active and on attractive terms. We would therefore find that our mortgage investments had increased, but it could very largely have arisen not from some policy decision we made two years ago but merely because opportunities have shown themselves.

7134. The business is brought to you; it is not that you go particularly in search of it?——*Mr. Lochhead*: That is true.

7135. *Mr. Jones*: Why are you not investing to a greater degree in gilt-edged than is shown in this table?——There are at least two reasons, and possibly a third reason for our action in this regard. The first is that gilt-edged reached a considerably higher proportion during the war than now holds good, and there is a tendency to allow that to run down to a more reasonable proportion. Before the 1914 war practically no gilt-edged were held by insurance companies, partly because there was not very much to hold. The two wars altered that completely and pushed them up to very high proportions indeed. Our tendency now is to invest elsewhere, so that the proportion shall fall, though not the absolute figure. That has not fallen despite the fact that there is eventually a point where one disinvests whether one likes it or not (e.g. Victory Bond Drawings). The second reason is the greater attraction of yield from other investments giving sufficient security for our purpose.

7136. From the last part of your reply it would seem that it is rather a question of profitability than proportion?——It is also a question of profitability.

7137. *Chairman*: Has this tendency to adjust the disproportion of the portfolio produced by the war years exhausted itself yet?——I should think it must be getting pretty near it. That is my personal opinion. But it is very difficult to answer that question; and I do not know that it would be safe to draw conclusions from what happened after the first war.

7138. Did it take a long time then?——It is difficult to get homogeneous statistics. I have statistics relating to ten life companies, which are not associated with any general business and do not have any material amount of business outside Great Britain, and therefore you could take them as being fairly homogeneous. The proportion in gilt-edged stocks which these ten companies held before the 1914 war was 0·3 per cent.; in 1920 it had risen to 35·2 per cent.; by 1925, some six years after the end of the war, it had risen to 39·5; it then fell quite rapidly to 15 per cent. in 1940. It shot up to 28 per cent. towards the end of the second war and reached a peak of 31·8 per cent. after nationalisation. The fall after the first war went on for nearly twenty years; we are only thirteen years at the moment from the end of the second war.

7139. *Lord Harcourt*: Was 15 per cent. the low point?——That was the low point in this quinquennial series. Possibly it was a little bit lower in 1939, because in 1940 there had been some war loans. These particular life offices would, from our own knowledge, be rather less in gilt-edged than the generality, so that these figures would be too low to be representative of the whole market, so far as the minimum is concerned.

7140. *Professor Sayers*: But the 15 per cent. of the late thirties is a long way below the 29·9 per cent. of 1956?——The comparable figure for these particular offices was 25·3 per cent.

7141. *Professor Cairncross*: You are not suggesting that after each war it is natural to go back to where you were before that? That did not happen after the first world war?——No; the question of availability rules there.

7142. But, looking to the future, if Government paper becomes, as it has become in the past, a rising fraction of the total on the market, ought this not to be reflected in your portfolio?——It has been.

7143. The proportion of the new money invested in ordinary stocks and shares in 1956 was rather under 20 per cent. The average man thinks that you have been pushing money into equities rather hard, but that proportion is not very different from the share of equities in the average book value of your total holdings in 1956 shown in Table I. Would it be a reasonable deduction that the proportion of your funds in stocks and shares has not been rising very rapidly in the last few years, or has there been any change in trends?——No, it would be incorrect to say that the funds in equities have not been increasing appreciably in the last few years. Very roughly, the equities in the last four years have increased by 60 per cent.

7144. *Professor Sayers*: Professor Cairncross was talking about ordinary stocks and shares, your item 7. Item 8 is real property and ground rents; would not a proportion of that in fact be invested; would it not be rack-rented property?——Yes.

7145. Could you give a guess as to how much of the £29 m. net investment under that item in 1956 would represent equity investment and how much would be fixed interest?——The bulk of it would be equity, but it would be equity which has a very fixed interest element about it; if it was let for 99 years at a fixed rent there would be no equity about it.

7146. I was thinking of equity as rack-rented property on 7, 14, 21-year leases?——We reckon that £6 million is for our own new property development. That leaves £26 million of the total investment. I am afraid I could not divide it up, or even guess at it with any safety.

7147. *Sir Reginald Verdon Smith*: Are these figures broadly similar in the offices, or would there be very wide differences in practice in different offices?——Considerable differences. Some offices specialise particularly in mortgages, and others have hardly any. Some offices have a much higher proportion than 16 per cent. in equities, and others have a considerably smaller proportion. Some offices will not touch preference shares; other offices specialise in real property investments; and others will not touch them at all. The pattern is kaleidoscopic.

7148. *Professor Sayers*: How big are the switching operations in gilt-edged, referred to in Note 3 to Table II, in total value every year?——Hundreds of millions of pounds.

7149. In which part of the market are those switches?——Mostly in the medium and long-dated stocks, 10, 20 and over 20 years.

7150. These are going on all the time?——All the time.

7151. What are your relations with the Stock Exchange? Are these switches going through particular big brokers in the gilt-edged market, or are they very widely spread?——I would say not very widely, because there are only a small number of broking firms who specialise about that, and unless they can give the service they are not much good to the client; but there are quite a number, about six really big ones, which give the service.

7152. Are you in and out of the short market at all?——No, not really.

7153. What would you say is your shortest active bond? Do you go down as low as five years?——One has to bear in mind that a bond starts off as being a medium-dated bond and in ten years' time it is a short bond.

7154. Yes, but I am talking about the short bonds.——Do we get out of them? Oh yes, we do a bit of leap-frogging.

7155. *Chairman*: What is the cause of the switching? Is it that each office carries out adjustments to its liabilities, which leads it to have a different distribution, or is it the yield which is regarded in itself?——It is not the yield; it is really distortions in the market.

7156. *Professor Sayers*: You are just active market operators, getting an advantage where you can?——The main thing is to keep the spread level with our own policies. We may find ourselves for a short time in an investment which is quite unsuitable, but we expect to go back and close that deal within a matter of six months.

7157. *Professor Cairncross*: Your intervention is never in the character of jobber?——No.

7158. Do you ever lend stock or bonds to the brokers?——Yes.

7159. Is this done by many companies?——No, I would not think so. My own company does.

7160. Do you leave money on deposit with the brokers?——Not as a rule.

7161. *Lord Harcourt*: You might occasionally put money with a broker for seven days, I suppose?——*Mr. Murray*: It is done, but I should not think it is done very generally.

7162. *Professor Cairncross*: Would any of the stocks and shares here in items 5, 6 and 7 of the Table II be unquoted?——*Mr. Lochhead*: Definitely.

7163. A substantial proportion?——I would not like to say substantial, but quite a proportion of the debentures and loan stocks would be unquoted.

7164. What kind of stocks would they be? Would they be blocks you took up where a company was trying to raise more capital?——They would probably be placings.

7165. In fairly small quantities?——Small quantities per investment.

7166. How far down would you go in size?——That would entirely depend on the company. Big companies would not be bothered with small amounts because of the administrative difficulty, but a small company would take smaller amounts; so the market is extremely catholic.

7167. What do you mean by small; about £10,000?——My company would take £10,000, but not too often.

7168. It is not very easy for us to judge from the table how far any of the items may represent investment abroad or loans to foreign companies?——You get an indication in items 3 and 4; items 5, 6 and 7 will cover quite a bit, but it is very difficult to say how much.

7169. It would be probably fairly small, apart from such investment as is made by British companies in their own operation?——I should say they would be small, but I could not possibly quantify it.

7170. Is this a table which you have produced especially for the Committee or an analysis which you do regularly?——It is a special table.

7171. It would not be possible for you to give us this for some earlier year?——It would be possible, but not very easy.

7172. *Lord Harcourt*: On Table III (amounts subscribed to new issues), does that include underwritings left with the underwriters?——Yes.

7173. *Professor Cairncross*: Are the figures shown in column 3 of Table III comparable with the figures in the first column of Table II?——Yes.

7174. On Table III there is no heading for Government securities?——There were no Government issues that year.

7175. *Mr. Jones*: In the final sentence of paragraph 21 you say: "It is very unusual for insurance offices in the aggregate to own more than 20 per cent. of the equity capital of any public company." To what extent would a 20 per cent. holding enable the insurance company to have control of the undertaking? Would not a 20 per cent. holding be fairly substantial, say, in a shareholders' meeting in modern days?——That is true; 20 per cent. would be a potent proportion; but whether one could say it would be potent to the extent of being able to control the undertaking is another matter. One might be able to exercise a very strong effect on a particular resolution, but one would only do that once, if it was wrongly done. Twenty per cent. would not be enough if the others ganged up against one.

7176. Nevertheless the influence of the investment would be very strong?——Yes.

7177. *Professor Sayers*: Would not that sentence be almost equally true if you had written 15 per cent. and not 20 per cent.?——The number of companies involved in the Actuaries Investment Index was 215. The number of companies holding in the aggregate more than 20 per cent. was 8 out of 215; if we had said 15 per cent., that would have added another 12.

7178. *Chairman*: What is the insurance companies' general approach to this question of holdings in public companies? Do you not want to regard yourselves as investors only, so that you have no policy which leads you to try to exercise managerial control?——*Mr. Trustam*: Our policy is very much the reverse of trying to exercise managerial control of companies whose shares we hold. If we cannot put it on a higher moral plane than this, we have all our time very well occupied in trying to run our own businesses, without any of the complications that would arise from an inclination to run other businesses as well as insurance.

7179. When from time to time some crisis in policy does arise, then you are forced into expressing an attitude, just because you are substantial holders? I think we can all recall a recent case?——That is the only case I ever heard of.

7180. *Sir John Woods*: The control Mr. Jones was talking about would only come into play if something happened in the company which led you to feel that your investment was perhaps not as safe as it might be?——Yes.

7181. *Mr. Jones*: I think that that is generally appreciated; but is it not quite clear from what is said in these four paragraphs that in relation to the general economy the insurance companies are in a very vital position, so that the authority and standing of the insurance companies in the monetary field is probably greater today than it has ever been in the history of insurance business?——*Mr. Lochhead*: Yes, that is so.——*Mr. Trustam*: And that involves a high degree of responsibility.

7182. To what extent do your investments take you beyond the three aspects: the responsibility of safeguarding the interests of your policy holders, the proportions in the portfolio of your investments, and the question of profit-making? Do you go beyond those three aspects?——No.

7183. So that the interests of the general economy, in terms of planning what is best for the nation as a whole, would not be one of the major considerations of the British Insurance Association and individual insurance companies?——Not directly.

7184. *Chairman*: How far are we to take what you say in section 4 about co-operation with the authorities? Are you prompted from time to time as to what kind of investment you should or should not favour for your funds? If you are, that is surely not quite the same thing as you were saying?——It is not quite that. From time to time, when a certain pattern of policy is necessary in the country's interests, we may be told of that policy.

7185. *Professor Sayers*: By whom are you told?——It comes down from the Treasury through the Bank of England.

7186. You have a letter from the Chancellor of the Exchequer to the Governor sent on to you?——Yes.

7187. How often has that happened in the last five years?——Three or four times.

7188. Has any such letter said: "My previous letter is now withdrawn"?——I cannot recollect such a case.

7189. Is each request just added to all those that have gone before?——*Mr. Trustam*: Each request stands on its own feet. I am sorry that I have not any wording in my mind.——*Mr. Lochhead*: Each request stands, and then a new one is added to it; an old request eventually becomes a kind of vestigial remnant.

7190. *Chairman*: I shall not understand this unless you make it more concrete. What kind of things have you been asked to do and what kind of things have you been asked to avoid doing?——*Mr. Trustam*: Normally we should get a copy of anything the Chancellor had written to the Bank, and possibly a copy of anything the Bank had written to the clearing banks; and then we are asked to ensure that our investment policy and our lending policy should conform to the current national policy, and not conflict with it: for instance, we may be asked to put the emphasis on the export trade, to go slow on matters such as hire purchase finance, property development of a speculative nature, and so forth. There is nothing specific, but it is a guide to the kind of thing that should be avoided at the time in the country's interest.

7191. Is that comparable to the directions given to the Capital Issues Committee, which are ultimately made public?——They should be parallel.

7192. *Professor Cairncross*: How do you inform the members of your Association?——We send a copy of what we get to every member of our Association.

7193. These letters reach the chairman of every insurance company in the country, but they are not made public?——Yes.

7194. *Professor Sayers*: Are any steps taken to ascertain whether the companies are conforming to these requests?——No, I do not think so. We get written acknowledgements from our members, confirming in writing that they will conform to the policy in accordance with the request. But, that promise having been given, there is no question of checking up in detail that they keep their word.

7195. *Chairman*: Is there any system by which the various companies discuss with each other their understanding and interpretation of the general requests?——No.

7196. I do not want to stress the word "system"; is there a practice under which discussions do take place?——I would have thought not. My thought would be that one would probably find two extremes, one where it is quite clear that the light is green, and the other where it is quite clear that the light is red, and in between there is an area less well defined. In that case, if it is going to help, one may quite informally discuss with one's colleagues if they are meeting this kind of problem, and find out what view they take of it; but I would hesitate to describe that either as a practice or a system in any formal way.

7197. *Professor Sayers*: You have said in your memorandum: "there is a very wide field in which differences of opinion could exist". That is obviously true with this sort of request. Do you in fact have much discussion about the interpretation of these requests?——*Mr. Trustam*: Not a great deal.—*Mr. Lochhead*: Very little.

7198. *Lord Harcourt*: Do members ever refer specific difficulties to the B.I.A.?——*Mr. Trustam*: Yes.

7199. Would those be discussed in the B.I.A.?——They normally would not be discussed in the B.I.A., but if a member had a problem where his own board did not see a clear indication how they should be handling an inquiry, he might come to the Chairman of the B.I.A. and ask him whether he had any information about how other people were dealing with this kind of problem.

7200. *Professor Sayers*: Have any of the requests hitherto made been clearly in conflict with what the companies would have done had there not been such a request?——*Mr. Lochhead*: Yes. Not always; sometimes the restriction has been a let-out for us, but frequently it has been a real restraint. That is where the difficulty arises: the problem is not defined very clearly, it cannot be; and many companies may have to interpret it, some one way and some the other. On the marginal case you get differences of opinion.

7201. *Professor Cairncross*: When you say that a greater readiness to explain the wishes of the authorities would help offices in their efforts to co-operate, what exactly have you in mind?——One of our principal difficulties is the instruction to apply to the small advances of under £10,000 the same rules as the C.I.C. would apply to larger ones. We are left in very much doubt as to what the rules are or how they would apply; the C.I.C. is entirely silent, and we are guessing. That was one of the points we had in mind. We can co-operate better if we are brought into confidence a little more.

7202. *Chairman*: The Treasury, I gather, originate these requests. Do you have any opportunities of discussing your difficulties with them?——*Mr. Trustam*: No. Any discussion would be between ourselves and the Bank of England.

7203. The Bank of England no doubt speaking with the mind of the Treasury. Do those discussions take place?——From time to time.

7204. *Professor Sayers*: Have you gone back to the Governor of the Bank of England at any time and said that such and such a request was being very difficult to interpret or to apply in particular cases, and asked what it meant, and how you should behave to meet the request?——Yes, but not quite in the way you ask it; not in a formal way appertaining to a particular category of restriction. But if there is a problem on which we do not seem to be able to get a reliable clearance of our minds, we do not hesitate to go to the Bank and talk it over with them to get their views. They obviously will not want to give us a specific ruling on an individual problem, but they can talk to us and give us their own interpretation of how that type of problem should be met.

7205. These requests refer to matters in which you are competing with each other to a large extent; do you find that in the course of time the competition between operators who are under these vague injunctions tends to undermine a request; that the man who takes one view of a proposition finds that his competitor is taking another view more favourable to his own interests, and therefore that gradually the force of a request gives way under the compulsion of that competition?——I cannot recollect a single instance of that kind in all my experience. I cannot think of any competition arising from what I would regard as an immoral suggestion.

7206. I was not thinking of it as an immoral suggestion; I was thinking of the honest difference of opinion?——If you mean a proposition which a competitor appears to be willing to do, and which I think runs counter to the national interest, I cannot recollect a single instance in my own case.

7207. The local bank manager has his problems, and is very much aware of what his competitor might be doing; and experience has shown that the force of a request to the banks has come to be undermined in course of time. Why should the experience of the insurance offices be different?——*Mr. Lochhead*: No doubt there is an element of influence in the way in which you look at a proposition according to what your business interests may be; but Mr. Trustam's point was that it does not arise very often. When it does, there is a good deal of excitement about it, and a certain amount of pressure and moral suasion is applied, because we all want to play ball with the authorities as far as we possibly can. When we get these "honest differences of opinion", it is only a question of one or two people getting together and saying: "This just won't do." The one who yells is the company that is going to lose insurance business.

7208. *Lord Harcourt*: The difference in experience between the insurance companies and the banks perhaps is explicable in that the local bank manager has considerable discretion for loans, whereas loan policy in the insurance companies is all centralised at head offices?——That is true; that would account for some of the difference.

7209. *Mr. Jones*: On this question of co-operation with the authorities, could you tell us anything that the Government have asked the insurance companies to do as a specific request?——*Professor Sayers*: May I ask a supplementary before the answer is given? We have been talking so far about the requests that are more or less in line with C.I.C. requests. Have there, since the end of the war, been other requests, of a different kind, from the authorities; to give you an example (although I do not want this to be the only kind of request) requests to participate in the taking up of particular issues of Government securities?——No, Sir, none; nothing since the pressure put on us to subscribe for the Finance Corporation for Industry.

7210. *Mr. Jones*: What sort of pressure was that?——*Mr. Trustram*: We were told that this was a necessary piece of machinery, to nurse back to health some of our different problems, and that it had to have the capital backing of people prepared to take a responsible view; that certain categories of people were being approached, the Bank of England, investment trusts, insurance companies; would the insurance companies play their part? There could be only one answer to such a question. It was not an investment question; it was a question concerning something proposed for the well-being of the country's industrial affairs. The answer was yes.

7211. *Chairman*: The pressure was an appeal communicated to you by the Bank of England to do this in the national interest?——Yes.

7212. But the kind of requests you have had specifically from the Bank on behalf of the Treasury through the years have been roughly parallel to the directions given to the C.I.C.?——Yes. Apart from the request to support Government securities during the war, I cannot think of anything else arising until we got into the credit squeeze and its related problems.

7213. *Mr. Jones*: Has the credit squeeze made very much difference in the way you allocate your investments? You point out in paragraphs 41 and 42 the gap that exists in the restriction of credit, and the outlets available through the finance companies charging a higher rate of interest. Are the insurance companies doing anything in the provision of capital to those finance houses which make this

money available?——That is one of the things we are asked not to do under the correspondence sent to us by the bank.

7214. Is that the sort of co-operation you are giving to the authorities?——Yes.

7215. *Professor Sayers*: In paragraphs 22 to 24 you deal with the effects of inflation on the insurance companies. How has inflation affected the development of the general life business of the companies for private individuals? The growth of life funds during the last few years has apparently been due largely to the group schemes; is that right?——*Mr. Lochhead*: Yes.

7216. Is the impression right, that individual life policies outstanding have not been increasing *pari passu* with the fall in the value of money?——The sum assured on each policy probably has been, but the volume and number of policies have been slowing down, or not increasing so rapidly.

7217. On the whole, if you take any thousand people, the amount they have insured on their life policies has not been keeping up with the rise in prices?——I should agree with that.

7218. Do you expect that trend to disappear, or is it simply that people have not caught up with inflation in their life business?——I would say they have not caught up, and some of them are getting too old to do it.

7219. As the younger ones grow up you expect the body of individual business to grow?——I would think so.

7220. You do not think this decline is the other side of the medal to the growth in group business?——At the present moment there is a sufficient volume outside the field of group business to keep the pot boiling, but if group business extended still further beyond its hold at the moment, then I think you are quite right: as the obverse of the medal, the individual business would inevitably go down. I do not know of any sign as yet that group business is crowding out private business.

7221. On the whole you would regard the great increase in group business as additional business?——Yes.

7222. *Professor Cairncross*: Your funds are roughly three times what they were pre-war; but prices have risen nearly three times since before the war. So the rise in insurance funds is really remarkably small. You have lately been accumulating more quickly; there was a long pause in the war and you have been overtaking the ground. So today, counting in the group schemes, people are probably insured to the same extent as before the war in relation to incomes, or rather less?——I should say rather more.

7223. Incomes have risen more than three times, and prices a little less, so that in relation to incomes probably it is rather less and in relation to prices it is probably rather more?——Yes.

7224. What kind of picture have you in mind for the next ten years? Do you think the growth in your funds will continue at the sort of rate recorded in the last two or three years for a further ten or twenty years?——I should think almost certainly.

7225. You do not see any likelihood of people being over-insured?——No; in any case even if we do not take on any new business, the funds will increase, because it is a while before many claims arise in life business.

7226. I was thinking also in terms of annual additions to the funds, the amount available for net investment. Do you expect that, as an amount, to grow or to remain at the present level? Do you think the funds raised by insurance companies will make a bigger contribution to national savings as time goes on, or do you think they may begin to be a smaller proportion?——*Mr. Trustam*: There will be a tendency to go on growing, although possibly not at the rate we have seen in comparatively recent times.

7227. And do you look to the group schemes more perhaps than to individual insurance policies?——As a new factor, yes; but beyond that we look to the life companies' organisation for the improvement in the development of life insurance. I would be surprised to find it standing still; normally it would not stand still.

7228. *Professor Sayers*: Looking not at amounts, but at numbers of people, and leaving aside the very small business of what is really insurance against funeral costs, are more people now going in for life assurance individually?——*Mr. Lochhead*: Yes.

7229. Do you expect that number of people to grow?——Yes.

7230. What makes you expect that?——*Mr. Lochhead*: Because of the general improvement in education. I do not mean by education popular education; I mean the education of our salesmen and staff. They are all the time improving their methods. Of course it comes down to the education of the population as well; they become more insurance-minded.—*Mr. Trustam*: It is a concomitant of an improved standard of living.

7231. *Lord Harcourt*: Looking at ordinary life insurance, is the percentage of with-profits business growing in relation to the without-profits business?——*Mr. Lochhead*: Unfortunately the without-profits figures include a whole lot of miscellaneous classes. If you were to ask whether the percentage of with-profits business on pure life and endowment insurance is growing, I should say that it is growing, under the impact of inflation.

7232. *Professor Sayers*: Are the outstanding policies predominantly with-profits?——Yes; but the non-profit business as a whole includes a lot of short-term policies and so forth.

7233. I have a question on paragraph 27, headed "The necessity for matching assets and liabilities". I am talking about life business only. Taking into account the last two lines of the paragraph, you seem to be saying two rather inconsistent things: that this is a simple business of having liabilities maturing at such and such dates and investing the funds to match those dates; or alternatively that the emphasis may be influenced temporarily by current conditions and the anticipated trend of interest rates, and that the pace at which you invest your funds and the securities you choose may be influenced from week to week by your view of the market. Which is the predominant factor?——The second is the least predominant; that has merely been put in as a kind of *caveat*. Sometimes the companies hold up their investment for a short time, according to their view of current conditions and anticipated trends; that is not an unusual proceeding.

7234. Do you mean by that that whole months and years go by without your departing from your general principle of matching assets and liabilities?——I would say years, not months.

7235. Sometimes you go to sleep in your investment policy?——*Mr. Murray*: We never go to sleep.

7236. I am trying to understand which horse you are riding, and when?——*Mr. Lochhead*: We ride the matching horse as a general rule. Occasionally we may get off it temporarily, but very temporarily.

7237. Mr. Murray said you are never off the other horse?——*Mr. Murray*: I am sorry; I would say the answer to this depends on how strong a view a manager takes. He has his funds, and his general view would be that these funds as a whole should be roughly matched with his liabilities; the disposition of the assets as to time will be roughly matched. If he thinks very strongly, let us say, that there is going to be a fall in interest rates, he may be willing to go longer. The extent to which he will break this balancing between his assets and his liabilities depends entirely upon the strength of his view.

7238. Are you taking a view all the time?——We are not changing all the time.

7239. I am not asking that; I am asking whether you are in fact taking a market view this week and next week and the week after that, and so on?——*Mr. Murray*: We are constantly looking at it and watching it; we may for a long period think that it looks about right, and do nothing unusual; then we might think that interest rates were going to rise and then we might take action. But we are always watching it.—*Mr. Trustam*: That word "matching" should not be taken in any mathematical sense at all; it indicates a broad bias. In our life business we do not have to be short, because broadly speaking there will be no need to be. So, if it will suit me best from an investment point of view, I can afford to invest for as long as I like; but there is nothing to stop me from going shorter, if I think that market conditions are

such that it would pay me to buy medium securities now and re-invest in 10 years' time, and I am satisfied that the market result of that operation would be worthwhile. So there is a broad bias in favour of matching liabilities with securities, provided other things are equal, and provided it meets requirements on market and investment considerations.

7240. This behaviour would seem to point to periods, that might amount to some weeks, when you feel that interest rates are going to rise and you stay out of the market completely for weeks. Is that a fair description?——*Mr. Lochhead*: Yes; I might be in the short market *pro tem.*; I might leapfrog when the time becomes ripe, or I might keep it in cash, but not for long.

7241. You suggest earlier that you are not constantly in the short market; it is on the whole a question of timing of your long investments. You are predominantly buyers, and it is a question of when you buy; even with big amounts accruing for investment you may be holding off the long market for a matter of weeks?——Yes, or even months.

7242. When you do this, you do it because you think that long bonds are going to be cheaper next month, or possibly next week?——*Mr. Trustam*: That is right.—*Mr. Lochhead*: I do not think we would play on a week or two; it would not be worthwhile.

7243. If you felt that over the next year gilt-edged prices were more likely to go down than up, you would be rather slow in your buying?——Yes, or we would buy something temporarily.

7244. What sort of factors would make you inclined to speculate on a fall in the gilt-edged market?——I would not like you to think that what you describe as a speculation on a fall in gilt-edged is a practice we are indulging every day; it is a very rare occurrence.

7245. I was using the word "speculate" in a purely neutral way; you would be taking a view of the market. What sort of factors would lead you to expect that gilt-edged prices were going to fall, and to think that you bad better go slow in your buying?——*Mr. Trustam*: The usual market considerations. If we feel there is not sufficient interest in the market and it looks as though it would be a bit difficult, then we can say: "There is no hurry; we can afford to wait. Perhaps there is a local authority across the way asking for short-term money, so that we can invest this money in such a way until we feel less uncertainty in our minds, and we can say: "Let us make this permanent".

7246. We have been used in the last few years to market conditions in which gilt-edged prices moved fractionally, day by day and hour by hour. They have in fact moved down over a period of years 30 or 40 points, but it has been a very gradual business, day by day and week by week. How would you feel if, instead, the market sometimes moved by a step of five points or ten points——*Mr. Murray*: We would think that it would be completely wrong; it would be impossible for the market to move like that unless it was directly manipulated.

7247. I am thinking of manipulation?——If the Government were to come into the long-term market and move it in jumps of five or ten points, we would think that was quite uncalled for.

7248. I was not thinking of the reasons for it; I am asking what would be your reaction if it were done?——*Mr. Trustam*: We should thoroughly dislike it; this would introduce an element of gambling.

7249. You are gambling now in the sense that you have to deal in a market in which, over a period of years, these enormous price changes take place; and the Government take actions which help to promote these price changes: they change the Bank Rate at a particular time, and they can change it by quite a bit. Suppose that they were to change quite sharply the yield offered on the long bond, in the same way as they change the yield on Treasury Bills; how would you feel?——You will understand that the price changes we get now do not matter, since once we are invested we are covered.

7250. In that sense such a market would not upset you any more than a market in which these price falls or price rises are gradual; is that so?——Yes, that is true. It would introduce, to my mind, rather an element of gambling as regards the timing of investment; we could no longer afford to say: "Let us make up our minds in the next two weeks."

7251. Is there not an element of gambling now?——No, because, whether we are in luck or out of luck, it is by something which is quite low over our whole amount. It does not matter if we miss the advantage now for the few points' difference of which you were speaking. But if it meant missing a big advantage or getting a big advantage, then it would become a fetter, which I think would tend to be a bad influence.

7252. *Professor Cairncross*: You speak of matching assets and liabilities as if your liabilities were fixed, and in a sense no doubt that is true; but if you have with-profits policies surely ultimately they are not fixed?——*Mr. Lochhead*: Yes, they are, because the liability is not a liability until it is declared as a bonus. Once it is declared it is fixed in the same way as the sum assured is fixed.

7253. But to the extent you are competing with other people who are offering with-profits policies with a bigger return than yours, you are approaching the character of an investment trust?——To some extent.

7254. Have you not then got to think seriously about how to get the maximum return on your investments? It is not just a question of automatically matching the period of your investments to the period of your liabilities. Is there not a certain difference there, and do you not very soon get over to the other kind of policy, where you are offering the insured person a still more speculative policy, in which case you would put the whole of your investments in equities?——That would be a fatal policy. We feel the proposition that we offer in this with-profits policy will stand on its feet even with what one might call a normal bonus rate.

7255. Within the range of ordinary investment trust business?——Yes; that could be achieved with no investment in equities at all. But knowing that that money, when received years hence, is going to have a very much lower purchasing power than the premiums received in payment for it, we are driven to seek to increase the money value, not *pro tanto* with the fall in the value of money but somewhere in that direction. We therefore go into equities.

7256. May not your policy holders be in the frame of mind that they think a fall in the value of money is a possibility, and would prefer a policy that gave them a more adequate hedge on that?——I know what you are thinking of. I can only say that on the whole we find we can sell our policies, and they are wanted in the form that we offer them.

7257. *Professor Sayers*: Do people still behave as though there was always going to be inflation?——I would not say that; we get a higher proportion taking with-profits policies now, but it arises for other reasons too. Whenever bonus rates are good we find that the proportion of with-profits rises, and *vice versa*.

7258. *Professor Cairncross*: You do not offer the alternative? Are there any policies in this country of the character I was referring to?——I do not think any.

7259. They exist in other countries and they have not proved altogether unpopular there. What makes you think people would not want them here?——One can only judge by the demand. I may be wrong; next week the demand may arise, and if it does, it will be met. But I understand from those who handle life business that there are some very grave disadvantages, though I am afraid I am not competent to deal with them.

7260. *Chairman*: You say in paragraph 50:

"So long as borrowers can see a prospect of earning on borrowed money enough to cover the cost of borrowing and leave a margin for an adequate profit, they are not likely to be greatly concerned with the rate of interest charged on the accommodation. A rise in the borrowing rate will narrow the profit margin unless the borrower is able to increase his prices. If profit margins were to shrink or to become incapable of expansion without the risk of loss of trade through excessive prices, changes in rates of interest would, no doubt, begin to have direct effect on the amount of timing of borrowing. Recently we have seen signs of such a position developing."

How much can you enlarge on that?——I am afraid we cannot go any further than that. People come to us

and ask what the rate of interest would be; when we tell them, they generally pull long faces and the business disappears.

7261. Is this since September 1957 as distinct from before then?——No, I should say it was before September 1957 as well. Everybody recognised that the post-September 1957 phase was not likely to be of very long duration, and lenders like ourselves (I am not referring to the banks) did not put their rates up for new loans to anything like the extent that the Bank Rate had been raised; people like ourselves think that there is no connection between the Bank Rate and the long-term lending rate, or that, if there is, it is minimal and remote.

7262. When did you see signs of this?——Last summer, if not a little earlier.

7263. September 1957 in your experience really made very little difference?——Very little.

7264. *Professor Cairncross*: What rates do you charge?——At a certain rate of interest we reach a stage where we are not prepared to lend at all. It gets so high as to be almost unconscionable, and causes a lack of good relations between borrower and lender; and we prefer not to lend. It is easier for the banks, because they can alter the rate just like that, but we have to have some permanence about the rate of interest. If you start charging a rate justified in the conditions of September, 1957, in a year's time it may look shocking.

7265. On mortgages what kind of rates do you charge?——At the present moment, 6½ per cent. or 7 per cent., perhaps shaded a bit to old clients.

7266. *Professor Sayers*: Is that the sort of rate which makes people hesitate about whether to go ahead in that kind of business?——*Mr. Trustam*: Yes.

7267. At what level of rates did you begin to hesitate as rates went up in the fifties?——*Mr. Lochhead*: Some borrowers rather fancy themselves as borrowers, and anything over 5 per cent. is very high; with others it may be 6 per cent.; and others will not even begin to look askance until we charge them more than 7 per cent. I believe that to some extent their view on the interest rate is governed by the margin they have on what they are dealing with.

7268. You mention three rates, 5 per cent., 6 per cent. and 7 per cent. Was it quite deliberately that you said 5 per cent., 6 per cent. and 7 per cent., rather than 2 per cent., 3 per cent. and 4 per cent., or 8 per cent., 9 per cent. and 10 per cent? Is that the sort of range at which people begin to get interest-conscious?——Yes.

7269. *Chairman*: When you saw this developing in the summer of 1957, was it because recently you had raised your rates?——*Mr. Lochhead*: The rates were going up, yes.—*Mr. Murray*: I think the decreasing expectation of making profits had a lot to do with it. Before that, when an industrialist came and talked to us, wanting £50,000 or £100,000, he came very full of the idea that he could not really help making a profit. As time went on and things were getting difficult, it would get to the stage where he was not so sure. I think that had more to do with it than the fact that the rates were getting a bit higher.

7270. *Professor Sayers*: When did you notice that change; in the middle of 1957, or earlier?——*Mr. Lochhead*: I should have thought earlier.—*Mr. Trustam*: It is difficult to give a time with precision; it is not something which happens on a certain day. One gradually becomes aware that this inquiry has been withdrawn, and then that inquiry; but one has no precise date in one's mind at which that happens.

7271. But this subtle change in the attitude of borrowers was already occurring before September 1957?——Yes.

7272. *Chairman*: In paragraph 60 you say: "The growth of the practice of overseas buyers seeking facilities for deferred payments spread over long periods has created new problems." Is it the general fact that the term of finance which is involved in this is unattractive to you because of the term alone?——*Mr. Lochhead*: Yes.

7273. *Professor Sayers*: It is too short?——Far too short.

7274. *Mr. Jones*: What does it require to be; 10 years?——15 years for preference.

7275. *Chairman*: You are not rigid in looking to all your investments to give you that length?——No, we have a pattern, a spread. We do not want to have too much at the short end, because probably most life funds today are matched by investments which are too short, not too long.

7276. *Professor Sayers*: If you were able to obtain really good rates of interest in this business, would you be prepared to lend on a 5-to-15 year range?——One or two companies might, but most would not; they would not be attracted by a high rate for five years, not knowing what they would get on re-investment. They would much rather have investments at the high rate today going for a longer period.

7277. *Chairman*: If a Corporation such as you outline here was created, which could do the short-term and medium-term lending, would you have any reluctance to lend it your money if it gave you fifteen year investment?——I do not think so; we lend to the Agricultural Mortgage Corporation, which is rather similar. There we could have gone direct, except that the units are too small.

7278. *Sir John Woods*: When you talk here of the Corporation holding a revolving portfolio of short-term paper, are you interpreting short-term as anything up to ten years?——Not so long as ten years; I had about five years in mind.

7279. Some of the problems of overseas buyers seeking facilities relate to the fact that the term cannot be extended beyond, say, seven years. Suppose that this situation were changed, if possible with E.C.G.D. cover, where necessary, so as to extend the period to something like ten years; would the insurance companies then be directly interested in propositions of that kind?——I do not think so, because the ten years would be subject to annual repayments, so that the average term would be only five years. But I am talking in terms of the present climate of interest rates, which is such that we want to have investments as long as possible in the interests of our policy holders. If the rates of interest became much less, we should be only too delighted to invest in a few short securities, because our expectation would be that rates would go up.

7280. *Chairman*: It is not the nature or complication of this kind of finance that E.C.G.D. guarantees that is the deterrent; it is at the present time the unattractiveness of the length of investment offered?——That is so.

7281. *Professor Sayers*: If you were in a consortium with other people, would you take the long end of it?——We did that in the tanker finance arrangement; we took the long end and somebody else took the medium and short.

7282. You would be quite willing to do that?——Yes.

7283. *Professor Cairncross*: You act as trustees on behalf of your policy holders to a great extent?——We are not legally trustees, but we behave as if we were trustees.

7284. Do you have large holdings on behalf of your policy holders, other than acting as trustees in debenture issues?——Yes; many of our companies act as executors and trustees for policy holders, or even for strangers: generally speaking the stranger becomes a policy holder, if one is awake!

7285. Can you give any indication as to the magnitude of this business?——*Mr. Walters*: The Royal Exchange Assurance administer trusts through a Trustee Department; taking all kinds, private trusts, debenture issues and all that sort of thing, that Department administers something like £300 million.

7286. I have seen no estimate anywhere, however approximate, of the total trustee holdings of insurance companies. I should have thought this figure would have been of some considerable interest.——*Mr. Lochhead*: It would be quite easy to get out figures showing the total

nominal amount; those would be similar to those published by the Public Trustee.

7287. *Lord Harcourt*: Could it be broken down into two parts: trusts which you actually administer and debenture stock?——Yes, we could show a separate figure for debenture stocks covered by us as trustees.

7288. *Professor Cairncross*: Would these exclude superannuation funds?——Yes; they would cover purely trusts under wills, settlements, and so forth.

Chairman: Perhaps you would let the Secretary have the figures in due course.* I think that completes our questions; we are much obliged to you, gentlemen.

(*The witnesses withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

FRED BENTLEY, ESQ., a Director, the Halifax Building Society, ALEXANDER MEIKLE, ESQ., General Manager and a Director, Woolwich Equitable Building Society, and C. G. GARRATT-HOLDEN, ESQ., Chairman, Deputy Chairman and Secretary respectively of and representing The Building Societies Association, called and examined.

7289. *Chairman*: Would you have in front of you the excellent memorandum† with which you kindly supplied us? We will look through it with you to see if there are any questions. In your first section you are explaining the role and function of building societies in the monetary system; you have a long history?——*Mr. Bentley*: We certainly have.

7290. You say: "In the early years the societies were small and numerous, but their number has gradually declined as their total size has grown. . . . The twenty years between the two wars proved to be a time of exceptionally rapid expansion."—*Professor Cairncross*: You say that about two-thirds of the houses privately built between the wars are believed to have been bought by their occupants with the help of a building society. Would you think that you still meet that proportion?——*Mr. Bentley*: Probably since the war a little less than that. I have no firm statistics, but my impression is more like 50 per cent.—*Mr. Meikle*: I entirely agree.—*Mr. Bentley*: Local authorities have been more active in the field of assisting house purchase since 1948.

7291. *Chairman*: Historically I suppose the building society was an organisation for getting houses built, not for the transfer of houses from one person to another? The emphasis was upon building houses rather than acquiring them?——I would not say that. Usually the building industry built the houses knowing that building society funds were available for financing the occupier. Going back to the very beginning, I would say that societies did help to finance houses built by the building industry; but in more recent years building societies have developed what we call a building mortgage or instalment plan, whereby a man can get his mortgage; and similarly the building industry can build houses in quantity and get instalments, although that type of finance is left principally to the banks.

7292. *Professor Cairncross*: Do you draw any distinction between an application for a loan in respect of an old house and an application in respect of a house that is being built?——Generally I would say no, but in recent years under credit restriction, when societies have been having a much greater demand for home loans than they have had funds to satisfy, some societies have concentrated most of their resources upon financing the purchases of newer houses. Most societies are quite willing to look at the older house that gets a good valuation.

7293. My friends tell me it is difficult to get a loan if you want to buy an existing house, and much easier if you want to buy a big new house. Is that unusual?——It might apply in certain areas, but that is not the general experience. Something like 290,000 loans were made on houses built before 1918.—*Mr. Meikle*: The statistics for the year 1956 show that somewhat less than 50 per cent. of all our loans were made on the security of newly built houses. I have no reason to believe the proportion has altered vitally in 1957.

7294. If you have rather less funds, or rather more calls on your funds, how is your policy adjusted? How do you decide who is to obtain a loan and who is not?——*Mr. Bentley*: Each society's board of directors will have a different policy. I can only speak for the society where I have had most experience in that respect. The Board decide how much money they are likely to have available over the year for mortgage advances, and each branch, according to its size in the organisation, is given an allocation. We then leave it to the managers themselves to decide how best to use the money which is available. Generally it can be said that a manager prefers to help the small man rather than the large man; he would rather recommend three loans of £1,000 than one loan of £3,000. That is my experience.—*Mr. Meikle*: I support what Mr. Bentley has said, and would add that in general a very high degree of priority is given to the would-be borrower who has held an investment in the building society, who has been saving systematically with the society for the purpose of providing a deposit on a house one day. In general managers prefer the smaller loan, not so much necessarily in order to save money but in order to try to accommodate the genuinely small person buying a £2,000 house. He is usually preferred to the man who may be buying a £10,000 house, who will be told to make arrangements elsewhere.—*Mr. Bentley*: When credit restriction became somewhat severe two years ago, some societies, I think quite rightly, decided that if they were to restrict too severely loans on new houses they would embarrass the building industry; those boards of directors as a matter of policy would allocate a proportion of their available resources to new houses in order to keep the house building industry going.

7295. Is it not curious that, if rising interest rates were in part aimed at a restriction of investment, funds should be diverted towards maintaining current building rather than towards making the maximum use of existing houses?——I could not speak for Government policy; the overall effect has been that there has been a reduction in the volume of house building both by private builders and the local authorities, but we rather sensed that the Government did not want to have too severe an effect upon the production of new houses. The result of the raising of the Bank Rate and higher interest rates has not been to damp down the demand for home loans.

7296. *Professor Sayers*: How do you know precisely what the Government would like your movement to do? Do you receive any requests through the Government, the Bank of England or from the Treasury?——Usually we have to read between the lines of parliamentary debates and the published statements of Ministers.

7297. Have you never since the war as a movement received a request from the Government or from the Bank of England?——*Mr. Garratt-Holden*: We have had no official representation since the war from the Government, the Bank of England or the Capital Issues Committee as to the policy which should he followed on the matters which you have been asking about.

7298. Or on any other matter?——No; there have been no official representations on building societies' policies.

7299. *Professor Cairncross*: No one has ever laid down policy as to the capital payments made when the house is being purchased?——*Mr. Bentley*: We have complete freedom from any direction or suggestion to that effect.

7300. We have been told of pressure brought in various ways on various people. You are in the hire purchase business without having received any requests or pressure at all?——*Mr. Meikle*: No pressure, direct or indirect.

7301. *Professor Sayers*: Have you at any time made any approach, formal or informal, to any Government body to ask what they wanted you to do, or have you

* *Note by witness*: On 31st December, 1957, members of the British Insurance Association administered £80 million trust and other funds (excluding pension funds). This figure is based on book values. In addition, members acted as trustees for issues of debenture stock, loan stock and unit trusts amounting to £855 million on the same date.

† Memoranda of Evidence Part VI No. 4, which includes figures for 1957 (see Qn. 7329).

been entirely independent?——*Mr. Bentley*: I should say that, since the Bank Rate went up to 7 per cent., we have had informal talks at the Treasury each month.

7302. At your instigation, or at the Treasury's?——*Mr. Garratt-Holden*: At the Treasury's instigation.

7303. What sort of thing has been said to you there?——*Mr. Bentley*: We have usually opened the conference by giving information as to the trends of our business. We get returns monthly from a group of societies sufficient to enable us to judge the trends. We have been concerned to see the extent of withdrawals. We have kept the Treasury informed of the trends of business, and have been able to convey to them our thinking on the question of interest rates: whether we were going to be able to hold the line as we have done, or whether they could anticipate that societies would under competition be obliged to move the mortgage rate above 6 per cent. That is the sort of thing we have discussed monthly.

7304. It has been exchange of information, not questions of policy?——No questions of policy; just exchange of information. I ought to add that Lord Mackintosh, Chairman of the National Savings Committee, has attended these conferences.

7305. These conferences have happened entirely since September 19th last, never before?——*Mr. Bentley*: Never before.—*Mr. Garratt-Holden*: No. We do of course meet Treasury officials from time to time, but within the last twenty years we have never asked them what they thought about so and so, we have had no official representations, no hint from the Government that they intended to do this, that or the other in any matter of policy.—*Mr. Bentley*: We have not made any disclosure of these conferences to the press or outside. We thought it was important that there should be no publicity for the fact that we were conferring monthly with the head of the National Savings Movement.

7306. It is pure exchange of information; would it embarrass you if this were known?——*Mr. Bentley*: I do not think it would embarrass us; but there might have been press comments, because the building societies have been subject to a fair amount of prodding from the financial journals with suggestions that we were trying to live in a world of our own. We have felt that, if they were apprised of the fact that we were having exchanges of confidences each month at the Treasury, there might be some speculations which would not please us.—*Mr. Garratt-Holden*: On the question of publicity I ought to add that the Treasury was anxious that the fact that these exchanges were taking place should not be disclosed.

7307. *Chairman*: That will be recorded in the minutes of evidence; but you yourselves would see no embarrassment in general if it was known that from time to time you were in contact with the monetary authorities or the National Savings Movement?——No. It was at the request of the Treasury.*

7308. Do you regard the National Savings Movement as a competitor for the money that comes to you on deposit?——*Mr. Bentley*: Yes, for a proportion of it.

7309. What would you regard as the other less important competitors?——The hire purchase finance houses over the last two years; and of course local authority mortgages have been increasing in recent years. Then there is the Stock Exchange in a subsidiary position, and the gilt-edged market; all those are alternative sources for the deposit of savings.

7310. *Professor Sayers*: Do you have any other contact at any time?——The Governor of the Bank of England issued an open invitation to me on the afternoon of the day on which the Bank Rate was raised to 7 per cent. I went to see him, and he was kind enough to explain all the circumstances in which the abnormal Bank Rate had been imposed and expressed the hope that it would not embarrass the building societies. He hoped that the impact would not be too bad, and suggested that I should come and see him again if we got into difficulties. I have not had need to take advantage of the suggestion to see him again.

7311. Is that the only occasion when you have been to the Bank of England?——Yes.

7312. *Chairman*: Do you make any general returns to the Bank of England?——No.

7313. *Professor Sayers*: You make returns under the Building Societies Acts?——Yes. We render all our returns to the Chief Registrar of Friendly Societies.

7314. Do you render any other official return at all?——No.

7315. *Chairman*: I think you said that generally speaking building societies do not regard the financing of the building of houses as being within their ambit?——*Mr. Bentley*: Not within the prime ambits, shall I say, because the amounts involved are too considerable. The banking industry is the source for finance when a builder is putting up 100 or 200 houses on an estate.

7316. The point of the distinction is the scale of the finance that is involved?——Yes.

7317. *Sir Reginald Verdon Smith*: In paragraph 15 you say that the role of the building societies "is the dual one of encouraging thrift and home ownership. It involves giving assistance to the building industry while offsetting inflationary tendencies". Does it in fact involve giving assistance to the building industry as such?——The readiness of building societies to provide finance for the purchase of houses by owner-occupiers is giving assistance to the building industry.

7318. Only indirectly?——Yes. The building contractor knows that when he has finished his houses building societies are willing to make loans. He gets his finance from the bank first, and the building society replaces the bank lending at a little later stage.

7319. *Professor Cairncross*: May we ask you about your depositors? You speak in paragraph 16 about "a form of directional saving, which has a strong and widespread appeal." Do many of your depositors contemplate buying a house?——Yes, they do.

7320. Is this the prime reason they leave their money with you?——One of them. That is the sort of thing we encourage. We like the man who puts down a few pounds a month to be an investor, and wherever possible we will show that man a favour if he has an experience of several years of saving in the society and wants that little extra to buy his house. The society is likely to go all out to help him.

7321. Of the £400 million invested over the years what proportion would be of this type?——I could not tell you that. There is no distinction in the books of the society. We do not even necessarily know when a man who comes to make a withdrawal is using the withdrawal money to buy a house; it is not necessary to go to the same society to get assistance on mortgage. Those of us who deal with mortgage applications in quantity know a good proportion of cases where the applicant has a previous connection with the society as an investing member, because the papers reveal it.

7322. *Chairman*: Is the depositor a different person from the shareholder in all cases, or do the same people have shareholdings and deposit holdings, and does one merge into the other?——Some depositors will also have share accounts.

7323. Is it usual for a man to transfer his deposit from time to time into a shareholding?——Over the recent years that has been a trend which has been interesting to observe. The total deposit balances with building societies are gradually falling; the extra security of capital with the lower yield is not proving so attractive as it used to be. The indication is that the public now considers the share investment as safe enough. There is a drift from deposits to shares in most societies.

7324. *Mr. Jones*: There is not very much difference in rates?——Half per cent.; occasionally a quarter per cent.

7325. *Chairman*: What about the tax position of the deposit? Is it the same as for the shareholding?——The depositor gets his interest paid without liability on his part.

7326. *Professor Cairncross*: Why have shareholdings increased much more than deposits in the last few years?——Because of the half per cent. better yield.

7327. You are very sensitive to this difference to interest rates?——We are. The new money is generally

* *Note*: At the request of the witnesses the Treasury has confirmed that it has no objection to the publication of the answers to Questions 7301 to 7307.

flowing into shares, and there is this steady drain from deposits into shares by people who want the extra half per cent. rather than the extra security.

7328. *Mr. Jones*: To what extent is this saving from frugal aims? What proportion of your shareholders and of your depositors have got very small holdings with the societies?——I could not answer the question specifically; but we favour very much the small man's savings. Most societies are pushing a regular savings feature. If I can speak for my own society, we have something like £36 million at the present time, all of which has been saved through regular monthly instalments. The maximum we take is £10 a month in that department.

7329. *Chairman*: In Table I you give us in the fifth column liquid funds as a percentage of total assets over the years. Have you the 1957 figure available?——We have just had the 1957 figures from the Registrar of Friendly Societies, but I am afraid we have not worked that one out. It is not much different, I am sure; about 15 per cent. May I say that, if the Committee would like copies of the memorandum retyped with the 1957 figures added, we should be happy to supply them.

7330. Thank you; that would be very helpful. How far does this liquidity percentage represent a rule laid down by your Association or a working practice?——A condition of membership of the Association is that each society must show a $7\frac{1}{2}$ per cent. liquidity ratio in its accounts.

7331. In paragraph 19 you say:

" . . . it has been for some years a condition of membership of the Association that a society must show in each balance sheet funds in hand (cash and trustee securities) amounting to not less than $7\frac{1}{2}$ per cent. of its total assets."

Is that the same thing as your liquidity percentage in Table I column?——The liquidity percentage in the table is the actual: $7\frac{1}{2}$ per cent. is a minimum. If a society falls below that, it is invited to go out of membership.

7332. Is there any condition as to the length or nature of investments?——They must all be trustee securities.

7333. No emphasis on short-term securities?——Only by recommendation of the Council. We have a brochure we issue and strongly recommend restriction of trustee investments to short and medium date, and warn against investment of long date.

7334. *Professor Sayers*: Have you any idea how much of this £278 million referred to in paragraph 19 consists of short securities, say, up to five years, and how much is longer?——No; we have not any break down. Some societies show in their balance sheets the break down of the amount, but only a few. In most societies they are bulked together. The total will include corporation loans, mortgages of the rates, which form a popular part of building society investment.

7335. You do not as a society get any special figures on this?——No.

7336. *Chairman*: There would be a general policy, reflected in your brochure, to keep your liquid funds in reasonably short-term investments?——Yes.

7337. *Professor Sayers*: Would you object to providing the Committee with copies of the brochure?——Not at all.*

7338. *Professor Cairncross*: Would this show the value of your annual purchases of Government securities?——*Mr. Bentley*: We get returns from our members which we collect in a private and confidential quarterly document. They are available if required.—*Professor Cairncross*: We should be glad to see them, if we may.*

7339. *Chairman*: Then the table includes a column of the percentage of assets retained as reserves. Paragraph 26 deals with the reasons for reserves being retained.——Yes. The figure last year slipped to 4·4 per cent.

7340. The general theory is it should be 5 per cent.?——We continue to adhere to our recommendation that 5 per cent. is the ideal for a society to work to.

7341. *Professor Sayers*: That is for the shares as well as the deposits?——Yes, Sir.

7342. *Chairman*: In paragraph 16 you say: " More than 97 per cent. of the total amount invested in building societies belongs to private individuals ". Has there been a tendency over the last three years for larger sums to be

* See Appendix to Minutes of Evidence.

offered to you for deposit?——Not more so than in the previous period; in fact, I think, over the last three years larger sums have been accepted to a far less extent than they were. The effect of credit restriction caused these larger investments to flow out too rapidly for the building societies' liking, and lessons have been learned from that.

7343. The money might be on offer still but it is not consistent with your policy to want to take it?——That is right.

7344. *Professor Sayers*: In attracting the personal saver you mention regular saving as something you like very much: the commitment on the part of the saver to pay so much per month. I notice that some societies give better terms in interest on such savings, others do not. Why is there that difference?——*Mr. Bentley*: Very few do not give better terms for regular savings. All societies I have in mind give an extra quarter per cent. or half per cent., or pay a bonus after a period of, say, three years of consistent savings. Normally it is the practice to allow a more attractive rate, with a limitation of £10 or £20 per month as a maximum qualifying to attract the higher rate.—*Mr. Meikle*: There has been a very curious geographical difference for no good reason at all. The Northern societies, such as the Halifax, have been pushing subscription shares ever since they were founded. These shares have only come to the metropolitan area quite recently.

7345. *Chairman*: Do you find them popular?——*Mr. Meikle*: They are becoming increasingly popular.—*Mr. Bentley*: I would say that it is rather harder to get people in the North saving than it was twenty years ago. I think the Welfare State has something to do with that. The Halifax does not open so many regular savings accounts to-day as twenty years ago.

7346. *Professor Sayers*: The difference between societies has been becoming less?——Yes. This custom has spread to the metropolis in the last few years.

7347. *Chairman*: In Table III you give us in the third column the amounts withdrawn in 1954, 1955 and 1956. Those are mounting figures. Was there the same experience with withdrawals in 1957?——The figures for 1957 are £336 million withdrawn, and £432 million invested. The heavy impact of withdrawals has been a rather worrying feature of building society operations under credit restrictions.

7348. Can you enlarge on the main reasons?——I would say that difficulty in obtaining bank finance is one of the important reasons. If a small business man finds difficulty in getting finance from his banker, and if he has a credit balance with a building society, he will withdraw his balance. Again the rate of interest comes into it, if he finds he has to pay 8 per cent. to his bank on an overdraft. Then hire purchase restrictions are causing more people to pay cash. These have had influences on building society withdrawals, which have been running at a higher rate than we like.

7349. What importance would the third reason have in your mind?——*Mr. Bentley*: I would not place it in importance with the other two factors I have mentioned, but I think it is a factor.—*Mr. Meikle*: There is one other thing I would like to add: withdrawals in the event of death. Building society moneys are paid out at par; an executor who finds other securities in an estate depreciated naturally goes to the assets which are not.

7350. The first impact falls on you?——The first impact falls on the bank and the building society.

7351. *Mr. Jones*: To what extent are depositors and shareholders with the building societies changing their investments, having regard to the higher rates of interest obtaining these days? Would any substantial part of these withdrawals be attributable to those causes?——Yes, I think so. We have investors interested in the gilt-edged markets, and when prices are low and bargains available there are occasions when we suffer an outflow of our funds into the Stock Exchange.

7352. Has that been more marked since 1955 or from September 1957 than before?——*Mr. Bentley*: We have a general impression that, when Stock Exchange activity is very low and people are afraid of losses, they go to the building societies, and that in a rising market they go from the building societies into the equities or gilt-edged.

7353. Do not the figures seem to back up your impression?——They do. I would like, if I may, to give an explanation of one figure in Table V. We show in the

second column the net balance from Table III, that is the net inflow into the investors' accounts; then in the third column we show the principal repaid on mortgage accounts from Table IV; and then we add those two together to arrive at the total savings figure in the fourth column. The principal repaid on mortgage accounts is really built up of two factors, the amounts repaid in borrowers' monthly instalments, which we regard as money saved by the borrower, and principal repayments on sales of properties, which could not be described as money saved. If I were to be asked for an estimate, I would say that a half of the figure in column 3 of Table V is attributable to sales of houses and final repayments of mortgages, and the other half to personal savings; so that to get true personal savings one should deduct £100 million from the £363 million in the last column.

7354. *Professor Cairncross*. Why is there such a steep decline in the amount in 1956? Will it continue for 1957?——The 1957 figure is £370 million: 1956, I think, saw the first impact of really severe credit restriction upon the building societies. The first reaction of building societies to the onset of this in the middle of 1955 was to impose restrictions upon lending. We felt the impact of heavy withdrawals, and societies decided to build up their liquidity in order to be in a position to meet withdrawals if they occurred. That accounts for the fall. Lending has been increased, as I mentioned, to £370 millions in 1957.

7355. Would each branch manager be given a restricted slice of funds that he could use?——With the large society that is the way it operates.

7356. Is he given any directive, other than that he should try to give preference to the smaller borrower?——*Mr. Bentley*: The Association gives no lead to members on that. As for my own society conditions are so different in the many towns throughout the area in which it operates that was decided to leave it to the discretion of the managers.—*Mr. Meikle*: In our case the first priority was the one I mentioned a little while ago, of the existing investor; then the small borrower; then, going back to the question of loans on new houses, every effort was to be made to persuade the builders relying upon us to cut down their future building programme, so that we would not have to disappoint them. That produced a decline in the number of applications for loans for newly built houses. Apart from that it was a case of first come, first served. This was done partly by directive and partly by delegation of authority to the local branch manager.

7357. *Chairman*: You think of yourselves as highly decentralised societies in matters of policy?——*Mr. Bentley*: Yes, we do. Branch offices conduct their own accounts and considerable responsibility rests on their shoulders.

7358. *Professor Sayers*: Do you think the local branch manager in turn acts in a highly individualistic way, or is he very conscious of what other branch managers of other societies in the district are doing?——We encourage our branch managers do?——It is all subject to head office with the managers of other societies, to avoid cut-throat competition and guard each other against the odd rogue who goes from one society to another.

7359. *Professor Cairncross*: Where would you think intending borrowers went in 1956 when they found they could not get money from you?——I think they went round a few societies, and normally got what they wanted. Some would go to the local authority; and I think some would abandon for the time being buying a house.

7360. There was a drop in the total that would indicate that some people were disappointed?——Yes.

7361. *Professor Sayers*: I have detected a tendency for some societies to offer better terms for investments by shareholders which are fixed for a period of years. Not all the big societies do this, but some of them do. Why are some of them apparently standing out against that?——The general consensus of opinion is against the plan. Some of us feel that now, at a time of high interest rates, is certainly not the time to accept investments at still higher rates of interest and fix them for three years. If the Bank Rate were to fall once or twice over the next three years, and if the composite rate of tax which the building society is obligated to pay increases, this would be a very bad bargain before long.

7362. The difference is due to some of you taking more account of the possibilities of rates of interest dropping than others are doing? It is not that some of you are against this idea in general?——It is a variety of reasons. It has been for discussion what sort of a lead, if any, the Council of the Association should give. Up to date the matter has been settled by individual boards of directors, and with seven hundred building societies one gets a variety of views. My personal view is that under the stress of competition some societies are looking round for a method of giving something a little bit better than the next. They find this term share is a device for giving an extra quarter per cent. or half per cent., and so doing better than their neighbours.

7363. Your borrowers are borrowing for very long periods, and in general their preference will be for a fixed rate, so that they know where they stand from the beginning of the contract. If this fixed term for deposits and shares spread, would you hope to hold to fixed terms for your existing borrowers more, though the terms for new borrowers might well be varied?——That is the theory; but the man who borrows at 6 per cent. borrows in the hope of not paying 6 per cent. for the next twenty years. We say that, if there was ever a time for building societies going in for term shares, it was when rates were low; but then the investor would not be interested in fixing his rate at the low level.

7364. You take the view that rates are high now in relation to what they are going to be?——*Mr. Bentley*: Yes; we feel that rates are high and that there is more likelihood of a fall from the present level than a rise.—*Mr. Meikle*: This term share business has been a very recent development, since the memorandum was prepared. It is not at all widespread yet. None of the large societies offers these term shares, though it may well come. We bear in mind our borrowers; we have given concessions to borrowers by way of rebates when interest rates were falling and we felt that our charges were too high. One also has to bear in mind that every borrower has a legal right of redemption; if rates were to fall and we were unable to give a borrower a concession, he would borrow an equivalent amount of money elsewhere at a lower rate of interest, and we should be left with this long-term capital on which we could not get an economic yield.

7365. Is it your intention to move towards greater fixity of rates or greater flexibility of rates?——*Mr. Bentley*: Not to move in favour of fixed rates in the long term; tradition is against that.—*Mr. Meikle*: I agree. We much prefer the present flexibility of investor's interest rates, which have moved some half-a-dozen times in the last seven years.

7366. Although that implies flexibility for the rates you charge to the borrower?——Exactly.

7367. It does mean that, when rates in general go up, you have to put up your rates not only to new but to old borrowers too?——*Mr. Bentley*: They have taken it very well indeed, relying upon our being fair and reducing when circumstances permit.

7368. *Chairman*: In paragraph 24 you speak about your liability to profits tax. Have you not got a change in the Budget?——*Mr. Bentley*: We have; a little contribution towards our annual additions to reserves.—*Mr. Garratt-Holden*: We can thank Lord Radcliffe for that. —*Mr. Bentley*: Yes, my Lord, your report helped us very much.

7369. *Professor Cairncross*: In paragraph 28 you say that in an ordinary case a society will advance between 75 and 80 per cent. of the valuation. Is this true of all societies, or is there a wide variation in practice?——I would say that as a generality the normal lending limit is 75 or 80 per cent.

7370. When credit is being restricted is there a certain tendency to restrict that ratio?——That is one of the weapons which would be used by a branch manager with discretion. He might, in order to keep up the number of accepted loans, and to avoid having to say no to everyone applying, say that he would keep down his lendings to 66⅔ per cent.

7371. You have no detailed information about what the branch managers to keep in close and friendly contact supervision.

7372. It is your understanding that at present, if anyone were to approach a branch manager for a loan, he could expect 75 or 80 per cent. in almost any part of the country?——Yes.

7373. I am told that, if one tries in Glasgow to borrow money for an old house one will find only two building societies at most who will lend one the money. Is that statement in your view correct or incorrect?——I should want a definition of an old house in Glasgow.

7374. A house built some time ago?——*Mr. Bentley*: A house built between the wars? I should be very surprised to hear that. But my experience is limited to my own society; I cannot tell you what other societies are doing in Glasgow.—*Mr. Meikle*: I should be very surprised if that was true, if by an old house you mean a house built between the wars and a house in contrast to a flat. I have not the slightest reason to suppose there is any undue restriction placed on loans on that class of house.

7375. Does the statement apply to a house built before the first world war?——It might well, as far as the ratio of 75 or 80 per cent. was concerned, but I do not think that it would be true that no loan would be forthcoming on a lower basis. I would also think that the location of the property is important in Glasgow.

7376. The statement made to me referred to Glasgow itself, and implied not that one could get something less than 75 per cent., but that one would get nothing. You think this is an exaggeration?——*Mr. Meikle*: I think it is an exaggeration, though I do not think it is entirely untrue. I was born and brought up in Glasgow, and I know the city well; I take a special interest in my society's activities there, and it is contrary to my own experience.—*Mr. Bentley*: It depends on whether these old houses have been modernised or not. Many boards have resolved that unless they are modernised they will not advance on them. That is a direct encouragement for them to be modernised as much as they can be.

7377. In the other cases, where the advance may reach 90 or 95 per cent., you speak of one of the forms of additional security authorised by the Building Societies Act. Do you have in mind here chiefly guarantees by an insurance company?——That is one of the principal means by which an applicant could get a 90 per cent. loan. There is additionally since 1954 the implementing of section 5 of the Housing Act, 1949, which enables a local authority to give a guarantee; the extra risk is shared by the Exchequer, the local authority and the building society in equal parts. Some 40,000 loans of that character have been made. Unfortunately, due to credit restriction, it has not had the success the building societies hoped for at the time we negotiated it with the Ministry.

7378. Normally the premium will be added into the amount of the loan?——In the case of the insurance company's guarantee; there is no premium with the local authority guarantee.

7379. *Sir Reginald Verdon Smith*: Are your valuations carried out by your own valuers, or are they professional valuations in all cases?——It varies from society to society. Some employ their own qualified surveyors, some employ surveyors in private practice, and some societies have a combination of the two systems.

7380. *Chairman*: On paragraph 34, is it the normal form of a building society mortgage that the rate is not fixed for the period of the mortgage but is adjustable according to the rate current for new loans?——It has been general since about 1946 to have an interest variation clause contained in the mortgage deed.

7381. That altered the pre-war pattern?——It did.

7382. Was the pre-war pattern a fixed rate?——It was a fixed rate, but with the society having the power which enabled it to negotiate a higher rate.——*Mr. Meikle*: Or, in the case of southern societies, the device from 1935 to 1946 was a clause by which the rate of interest was related to the level of Bank Rate.

7383. *Professor Cairncross*: Would it be possible for you to give us particulars of the rates which have prevailed since the war?——Yes, certainly.*

7384. *Professor Sayers*: In general have you been moving in the direction of getting the rates flexible throughout the contract, not on the basis of Bank Rate or any outside rate, but on the basis of your own rate for deposits?——*Mr. Bentley*: Yes. The rate which we have to pay to get our money controls the rate at which we lend it out.—*Mr. Meikle*: There is no reference to the deposit rate in the mortgage deed. The rate on the mortgage is expressed as being entirely at the discretion of the board, subject to their not charging to existing borrowers a higher rate than the rate at that time being charged on new advances.—*Mr. Garratt-Holden*: That principle is being written into local authority mortgages; they have decided to adopt the building societies' technique of having a variable rate in the mortgage deed instead of a fixed rate.

7385. *Chairman*: Is it normally secured in the mortgage deed that the rate of interest should be reduced if and when the rates for new loans go down?——*Mr. Bentley*: The terms of the clause vary: sometimes it is secured, sometimes it is left to the discretion of the board. In that case it is usually secured by competition.

7386. In normal circumstances, when your interest rates change, this will not affect monthly payments made by borrowers, but the period over which repayment takes place?——Usually the society gives the borrower the option of paying the same subscription, or having the subscription recalculated and paying a little more each month for the original term. The majority of borrowers opt for the former.

7387. *Professor Sayers*: Much the greater part of them?——Yes.

7388. *Professor Cairncross*: In fact, many of them may hardly be aware that they are opting in that way, I suppose. If they take no action the option is automatically in favour of extending the period?——*Mr. Bentley*: Usually the letter from the society giving notice of the increase makes it that way for ease of correspondence. It probably says: "If you want to know the period to which it is extended, we will calculate it if you ask us."—*Mr. Meikle*: A high proportion of all mortgages give the borrower the inalienable right to maintain the agreed subscription; therefore he need not take action, though he is invited to do so.

7389. Would it be true that in recent years anybody borrowing from a building society may find at the end of a substantial period of time that he has paid remarkably little off his mortgage?——Yes.

7390. Is that brought home to him in any way?——*Mr. Bentley*: That is in the case when the building society advance is for an unduly long period. The Council of the Association is on record as recommending a maximum of 25 years. Some societies went longer than that, and it is in those cases that this difficulty arose.

7391. *Professor Sayers*: But even on a twenty-five year contract the effect of a rise in rates from, say, four to six per cent. can have devastating effects on the amount of the monthly payment that goes to repayment of capital?——*Mr. Bentley*: It can have quite a serious effect, I agree. Where the lengthening was undue, the building societies would exert their influence to get a man to pay a little bit more. He would do so if he was a sensible man, because a man's prime objective is to pay off his mortgage and get his deeds.—*Mr. Meikle*: This is at the heart of our problem. I think we have learned some lessons: one of them is that it is very unwise to lend as long as 25 years, and the second is the need for bringing home to the borrowers the consequences of any such increase. A 25-year term would extend to 37 years as a result of the range of increase you mention.

7392. And what happens if in the 37 years the rates go to 8 per cent.?——All we can hope for is that we succeed in persuading the borrower to face up to the facts of the position, or that there is a downturn instead of an increase in the rates; it has to be one or the other.

7393. *Sir John Woods*: What is the actual position as between the borrower increasing his payment or extending the term? Is it optional?——It is at the option of the borrower, but the society would encourage him to increase the payment.

7394. But in the case where there was a sharp increase of interest rates and the period went up to 37 years, if the borrower insisted on that that the building society would have to accept it?——There are exceptions, but in general it would be so.

* See Appendix to Minutes of Evidence.

7395. *Professor Cairncross*: Have you found in the past few years that many borrowers have accelerated the rate of repayment of their mortgages?——*Mr. Bentley*: That happens quite normally, irrespective of an increase in rates. Many borrowers pay more voluntarily.

7396. With the higher rates of interest now prevailing has there been any acceleration of movement in excess of what you have become accustomed to expect?——*Mr. Bentley*: I would say yes.—*Mr. Meikle*: My own society sent out eighty thousand circulars to borrowers advising them to increase their payments. The immediate response was from ten thousand to do so; and we gradually built up to a fifty per cent. response. The additions are very small, because it does not require much more money per month to cover a one per cent. increase on a debt of £1,000.

7397. *Professor Sayers*: Have these increases resulted in their not merely paying more in order to offset the higher interest charge, but also paying off the capital faster than before?——*Mr. Bentley*: I would say so. My experience is that many borrowers make part repayment of £10 or £20 just as the money comes handy, in order to get the deeds all the quicker.

7398. Have they been doing that on a greater scale since interest rates rose?——I would not think so. I think that is a normal trend, irrespective of the rates of interest.

7399. *Chairman*: When interest rates fall, what is the procedure?——The first step would be to reduce the investors' rate, usually by three months' notice, and then to follow that by a reduction in the mortgage rate. We should hope that the borrower would continue again to pay the same subscription.

7400. *Professor Sayers*: The object would be to maintain the same rate of instalment payments but to shorten the period of repayment?——That is so. The content of interest in each instalment payment would be less and the capital repayment content more.

7401. *Chairman*: In paragraph 40 you say: "Building society investments can be withdrawn on giving notice, without fee and without loss of capital". Is that a statutory obligation?——No. It is prescribed by the rules of each society. The society must state in the rules the terms under which shares of the society can be withdrawn.

7402. What length of notice do you require?——Usually six months for the larger amounts, in order to offset the power to call in a mortgage on six months' notice. Theoretically, if all investors wanted their money out, they would have to wait six months; it would take six months to get in the money.

7403. But you waive that requirement of notice?——*Mr. Bentley*: Yes. It is the objective to meet the investor wherever possible.—*Mr. Meikle*: There is a statutory requirement that deposit monies may only be accepted on the basis that the minimum period is one month. That stems from the Building Societies Act. Share monies are governed by the rules of the society concerned.

7404. Then we come to Section IV: the effect of changes in monetary policy. In paragraph 49 you say:

"Building society rates do not follow every movement of the Bank Rate and, *per contra*, they vary at times when there has been no recent change in the Bank Rate. Where, however, a change in the Bank Rate is a symptom or a forerunner of changes in the general level of rates, societies are bound to be affected, though the effect is often slow to come about and not always the same as the change in Bank Rate."

What is the determining cause of that kind of variation?——*Mr. Bentley*: The difficulty of the societies in getting the money in from the investing public.

7405. Is that a matter which your Council would deal with by recommendation?——*Mr. Bentley*: Yes, but only by recommendation. The individual societies have complete freedom to act on interest rates as they like.—*Mr. Meikle*: There have been times during the period we are considering when the Bank Rate has not moved at all, but the building society rates have risen.

7406. *Professor Sayers*: Between 1931 and 1939?——Yes.

7407. *Chairman*: Your competition for deposits with the other forms of savings led you to take this action?——Yes; the general level of rates rose or fell.

7408. *Professor Cairncross*: On paragraph 47, how great is the competition of other lenders on mortgage? You are by far the biggest?——*Mr. Bentley*: On mortgage, yes.

7409. Is the competition such that the rates you charge have to respond to the rates charged by other lenders, or do you set the pattern?——The rates we charge are influenced at times by the rates charged by other lenders. I am thinking particularly of local authorities, when the Public Works Loan Board rate is low, and the local authorities are lending at 4 per cent., or something like that, it tends to depress the building society rate; we have to come down in order to get the mortgage money out.

7410. *Chairman*: But the general thing is that the rates you charge on mortgages are determined by what you have to pay to get your money?——Yes.

7411. And what you pay to get your money on deposit or on shareholding is largely determined by what other people are offering for the use of money?——That is another influence and tends sometimes to narrow the margin.

7412. *Professor Sayers*: In general you seem to say that it is the competition for money with other channels of savings which forces your hand, rather than competition for mortgage business?——It ebbs and flows over the years. There are times when building societies are competing for mortgages and reducing the rate competitively; at other times they are looking for investments, as today, and some are finding means of offering a slightly higher rate to make their terms attractive.

7413. You say at the end of paragraph 49 that the effect of changes in the general level of rates is often slow to come about. Am I right in thinking that this is because the building societies are slow to make up their minds whether this is a lasting change, or is it simply that they wait for competition to force their hands?——I think there is an element of both. We are very reluctant to change at all, because it causes a lot of work. There is a reluctance on the part of the Council of the Association to make a recommendation, hoping that it may not be necessary to change. We are occasionally accused of dragging our feet on that very subject; but I think we are wise to do so.

7414. *Chairman*: Apart from the amount of work caused is there not a general policy to wish to maintain stable rates for social reasons?——*Mr. Bentley*: Yes; our investors and borrowers do not like to be disturbed.—*Mr. Meikle*: *The Times* once wrote: "Stability of interest rates is one of their greatest virtues". We accept that as a very fair statement of our policy.

7415. *Professor Cairncross*: In paragraph 53 you say that you are advised that there is no legal obligation upon a building society to ensure that C.I.C. consent has been obtained for loans over £10,000. Has this ever been tested in the courts?——*Mr. Bentley*: I think not. Building societies take the precaution, although they are advised that there is no legal obligation to do so. The practice of a society making an advance in excess of £10,000 is for the society's solicitors to see that the applicant has obtained the consent of the Capital Issues Committee. The recommendation of the Council is designed to secure that.

7416. *Chairman*: In paragraph 54 you say that the demand for houses is probably as high as, if not higher than, it has ever been. Would that be true as you stand today?——Yes.

7417. *Professor Cairncross*: The falling off in your advances does not represent falling off in demand?——No.

7418. Do you notice any shift in the demand towards smaller or cheaper houses? Do you find that, when the rate of interest goes up, the kind of house in respect of which you are asked to make a loan changes?——I think there is a slight effect in that direction. We relate lending to income; often a man with an unduly low income will seek to buy a house beyond his means, and he will be advised in his own interests to look for a cheaper house. That has the effect, I think, of concentrating the demand on a cheaper type of house when interest rates are pushing up the cost.

7419. *Sir Reginald Verdon Smith*: Do building societies take any account of caravans?——A caravan is not something on which we can take security.

7420. *Professor Sayers*: Is the kind of security you can take limited by the Building Societies Act?——It must be a first mortgage on freehold or leasehold estate in the U.K.

7421. *Chairman*: In the course of your answers to our questions you have stressed the independence of the societies from your Association. You have this central Council which makes fairly detailed recommendations for the conduct of business by the members of the Association; are we to take it that those recommendations are in fact effective? Is there, within the limits of its recommendations, central control?——I would not go so far as to say central control. But there is effective acceptance of the recommendations, most gratifyingly during the last few months. We have been extremely pleased that boards of directors have accepted the lead we have given.

7422. How is the Council elected and organised?——We have 24 members elected by the members of the Association, each for a term of three years, with one-third retiring each year. Additionally there are nine district Association representatives. They are elected by the regional Associations, which are affiliated to the parent body. So we have a Council of 33, with power to co-opt up to 6.

7423. How often do you meet?——Each month. Committees meet on a Wednesday afternoon, Thursday morning and Thursday afternoon, and the Council meet and receive the reports from the chairmen of committees on the Friday morning.

7424. You meet in London?——Yes.

7425. *Professor Cairncross*: Suppose that in time to come you had a lot of money and nobody wanted to borrow for house purchase; would you contemplate other activities?——*Mr. Bentley*: I think that we should not favour seeking any other fields than house property or trustee securities, preferably short dated.—*Mr. Meikle*: During the period of cheap money we met the situation by avoiding any increase in our assets; in one or two instances by putting a very low limit, at one time £100, on the amount any one person could invest in any one building society per year.

Chairman: I think that completes our questions. Thank you very much gentlemen. We are much obliged to you.

(*Adjourned until Thursday, 24th April, 1958, at 11.00 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

TWENTY-NINTH DAY

Thursday, 24th April, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

G. L. C. TOUCHE, ESQ., Member, General Committee, SIR EDWIN HERBERT, K.B.E., Deputy Chairman, and W. S. GAMMELL, ESQ., Secretary, representing The Association of Investment Trusts, called and examined.

7426. *Chairman*: We are much obliged to you for your memorandum,* Mr. Touche; we should like to run through it, to see what questions arise out of it. You say in paragraph 3:

"The Association includes among its members almost all the investment trusts whose stocks are quoted on Stock Exchanges in the United Kingdom."

There are 282 members of the Association. Have you any idea as to how many investment trusts there are in the country that do not belong to your Association?——*Mr. Touche*: To answer that question properly one would have to make "investment trusts" precise. There are investment holding companies, as we mention later in our evidence, which are not really investment trusts in the sense in which we are speaking of; that is, trusts formed for collective investment.

7427. Their capital in effect is held privately?——Yes. I believe that the number of investment trusts quoted on Stock Exchanges is not much greater than the number of members of our Association.

7428. *Professor Cairncross*: There are also many trusts with shares not quoted on the Stock Exchanges?——Yes; private companies formed for holding family moneys in a group which are not quoted. We do not know the number of those at all.

7429. You have no idea of the assets of these trusts, of the aggregate amount held in that way?——*Mr. Touche*: No.—*Sir Edwin Herbert*: There is no precise definition of an investment trust, but broadly speaking we regard as being an investment trust a company which raises money from the public with the specific object of making a collective investment. We would not regard a family fund as being what we call an investment trust.

7430. If there anything intermediate between the two, where the money is subscribed by different people not members of one family and the shares are not given Stock Exchange quotation?——*Mr. Touche*: We do not know. No doubt there will be some cases, but it is difficult to see why a company should be formed in that way. —*Sir Edwin Herbert*: I would hazard a guess that they must be very few indeed in relation to the privately-controlled company or the investment trust in the sense we use the term.

7431. *Mr. Woodcock*: You have no rule about membership?——No.

7432. Being joint stock companies, of course, they have to conform to the requirements of the Companies Act. Has your Association any additional requirements?——*Mr. Gammell*: The requirements are that the company shall have a capital which is quoted on the Stock Exchange; apart from that it is at the discretion of the general committee to decide whether an applicant is suitable to be a member.

7433. There is nothing that the Association lays down in addition to what is laid down by the Companies Act? ——The main requirement would be that capital profits arising from the realisation of assets should not be distributed as dividend.

7434. *Chairman*: Is that not a fiscal point?——*Mr. Touche*: It is not only a fiscal point: it is the point as between the company and its shareholders as to how the company shall be conducted.

7435. You would make that a firm requirement, whatever the taxation law was?——*Mr. Touche*: Yes.—*Sir Edwin Herbert*: For the purpose of drawing a clear distinction between the investment company and the finance company.

7436. Then you say in paragraph 4:

"256 of the members or 91 per cent. in number and probably a greater percentage in value of the total membership) had assets totalling over £1,142 million at their last balance sheet date."

Was there any particular reason for taking 256 members? ——*Mr. Touche*: Yes. We circularised our members for information. Naturally the answers we got were not all on the same basis, and we felt that we could only put together answers where the figures gave a true comparison. That 256 includes nearly all the members; there was only a small number whose answers could not properly be included in the total, for some purely statistical reason.

7437. Then you contrast that with the assets of the same companies in 1949. What are the main causes which have led to the increase of the assets that the investment companies hold? You speak later on in your memorandum as if the raising of new moneys by issues had not been a very large source of this.——We did not mean to imply that the raising of new money had not been considerable. We have figures for 255 of these trusts, which show that the net new money raised in cash from the public in the last nine years is £92 million. On top of that in the same period those 255 trusts retained revenue profits of £43½ million after taxation. That makes £135 million. I think it must follow that the remainder of the increase is due to a rise in the value of investments.

7438. *Mr. Woodcock*: That £92 million may be a switch in so far as you know?——We do not know where the shareholders got the money from: it may have been by sale of other investments.

7439. *Professor Cairncross*: Do you have these figures year by year?——These figures were provided in answer to a questionnaire sent out for the purpose of this evidence.

7440. The questionnaire did not call for annual figures? —*Mr. Touche*: No. We took 1948 as the new Companies Act came into force then. From that time onward we have a series of companies' accounts which are more or less uniform. We wanted to see what the changes had been between the first date when we had that uniform series of accounts and the latest balance sheet.—*Sir Edwin Herbert*: We can summarise the answer to the Chairman's question [7437] in this way. The difference between £1,142 million and £619 million is accounted for by four factors: investment of retained profits, £43½ million for the 255 companies; the investment of money newly raised, £92 million; the genuine improvement in the prosperity of the companies in which we invested, thereby increasing their value, for which we cannot possibly give you a figure; and the balance is due to the change in the value of money.

* Memoranda of Evidence Part VI No. 11.

7441. *Chairman*: Has the amount of new money raised been roughly the same each year throughout the years?——*Mr. Touche*: In the years immediately following the war it was not the practice of the Capital Issues Committee to permit investment trusts to raise new money. It was only later on, in 1953, that there was a relaxation.——*Sir Edwin Herbert*: So now a fairly substantial proportion of our new money must be channelled savings in some form or another. I cannot say exactly what it was. During the ten years which we cover in this memorandum there has been a growing tendency on the part of insurance companies to invest their moneys, which mainly come from premiums, which in turn are savings, in equity stocks. One of the fairly few forms of investment of the insurance companies in equities has been through the medium of investment trusts; quite a substantial part of the new money which has come in through the new issues, not all, but I should say most of it (I cannot give the figures as they are not available at all), has undoubtedly come from the insurance world. That must be regarded as channelling genuine savings into industry by two stages: through the insurance companies and then through the investment trusts.

7442. *Mr. Woodcock*: Why do the insurance companies put the money in investment trusts, when the insurance companies are investment trusts themselves?——They are; but I think the answer is that the growing venture of the insurance companies into the equity market was rather a novel thing ten years ago, and was not by any means regarded in the insurance world as being a very desirable practice, and they have gone into investment trusts to get a wider spread. Quite a number of insurance companies who have got a greater spread of their risk in the equity market by investing in investment trust shares have probably cut down on investing their own funds direct. The insurance companies only invest a relatively small part of their total assets in the equity market for obvious reasons, and it has been a real convenience to the insurance companies to get this extra spread without having to put more than a proper percentage into the equity market at all.

7443. *Mr. Jones*: To what extent would you say that insurance companies' subscriptions to the investment trusts have developed in the last ten years since 1948?——I do not think we could give you a figure, though no doubt the insurance companies could; but I would say that it is a substantially growing tendency.

7444. *Professor Cairncross*: Is the interest they have acquired part of the £92 million in cash you referred to, or are they buying on the market?——Both. I cannot distinguish between the two.

7445. Do you think the investment trusts would have raised substantially larger sums from the public if they had had freedom to go to the capital market?——*Mr. Touche*: I think certainly, because as soon as they had that freedom they started to do so.

7446. Have there been recent cases in which the Capital Issues Committee has turned down applications?——*Mr. Touche*: I do not remember any.—*Mr. Gammell*: I believe one company had an application referred back, and it was granted on second application.——*Sir Edwin Herbert*: There have been a variety of conditions imposed by the Capital Issues Committee on the extent to which new moneys might be utilised in purchasing dollar securities, etc. I would not like to define them, because they have varied from month to month and have been unpredictable.

7447. *Chairman*: Have these conditions restricted the use of your money even in buying the dollar securities which are available?——Yes.

7448. *Professor Sayers*: You say that those conditions have been changed continually. Have the investment trusts argued about them at all?——No.

7449. Have the restrictions been policed or in any way supervised?——No.

7450. The Capital Issues Committee have simply told you the money cannot be used in certain ways and they leave it at that?——Which to the investment trusts is virtually a legal obligation.

7451. How does the Capital Issues Committee distinguish between the use of money newly raised and the use of money becoming available by the sale of previously held securities?——I do not think those conditions could ever be very effective; however honestly they are carried out they are inherently much less than 100 per cent. effective for the very reason which Professor Sayers is putting to me. It is perhaps for that reason that in recent days the C.I.C. seem to have been less anxious to put such conditions than they were originally. But they have definitely acted as a brake.

7452. *Chairman*: When you send in your applications to the C.I.C., you do not have any personal contact with the Committee?——None at all, Sir. I was hoping that Professor Sayers would indicate how one could have an argument with the Capital Issues Committee!

7453. Might you not ask them to receive a deputation?——I have never heard of that happening.

7454. *Professor Cairncross*: Leaving aside the problem of dollar securities, and taking the recent decisions of the C.I.C., do you think that the rate at which the investment trusts as a group are expanding and acquiring new money is in keeping with the natural development of the trusts, or is it restricted by any of these regulations?——*Mr. Touche*: There are so many other factors which influence the raising of new money that it is difficult to know what is meant by the natural development of the trusts. For instance, we would like to raise new money when we think investments are cheap; on the other hand, that is just the time it is difficult to raise new money. Equally we do not want to have indigestion; we do not want to have more funds to invest in a given period than we can handle. It is very much a pragmatic matter, but I should have said that, since we were allowed comparative freedom by the C.I.C., development has gone on in a steady sort of way having regard to the condition of the market at the time.

7455. Would you expect the next ten years to involve the subscription in cash of something like another £100 million, or is there a prospect that you might gather a little more speed?——I find it very difficult to say. This £92 million covers a period of less than ten years, because for the first years in that period we were not able to make issues. I should have thought that it had been going on at quite a good pace and that it was likely to continue.

7456. *Chairman*: I understand that your portfolios change according to your use of new money; is the business of switching from one security to another on considerations of yield a function of an investment trust?——No, we do not do much of that. Normally, when we find an investment, we hope that it will prove a satisfactory permanent investment, and we do not have in mind switching from one to the other.

7457. Do you do much switching in the gilt-edged market?——Our holdings in the gilt-edged market consist largely of temporarily uninvested funds and would not be held for any time.

7458. You feel able to make a generalisation in those terms?——Yes, nowadays. Before the war it was fairly common for an investment trust to hold considerable quantities of gilt-edged stocks, but that is unusual now.

7459. *Professor Sayers*: To the extent that you are in the gilt-edged market, at which end are you? Do you buy predominantly shorts or longs?——That would vary from trust to trust. I do not think I can make any generalisation about that.

7460. *Professor Cairncross*: You imply that holdings of Treasury Bills are not large?——I dare say this is true in relation to the total assets of the investment trusts.

7461. Might it not in the aggregate come to a pretty big figure? Have you any indication what the total holdings of Treasury Bills would run at?——I am afraid I can give no indication of that; but I could say that the total of uninvested funds of the normal investment trust would not exceed about two or three per cent. of the total funds available to that trust. There again you must distinguish: in a rising market we would tend to be more fully invested than in a falling market. Over the last year we have been more liquid than we normally are, because we think better investment opportunities are likely to come.

7462. By how much would the uninvested funds fluctuate? Would they get as high as five per cent. of total assets?——Spread over the whole range of trusts I do not think it would get as much as five per cent.

7463. Even if you took the view that market conditions were highly abnormal?——Investment trust managers do not take an extreme view of anything, and would not go largely liquid. It would be an unusual company that would do that.

7464. *Professor Sayers*: Might it be a matter of £20 or £30 millions?——*Mr. Touche*: It might be something of that order.—*Sir Edwin Herbert*: I should like to give an illustration from one company I am directly concerned with. We hold assets worth, I suppose, about £25 million or thereabouts. We raised £1 million of new money just before Christmas from our ordinary stockholders. We are now in the unprecedented position of having practically the whole of that £1 million invested short-term, and the only emotion that stirs in our hearts is to look forward to the day when we can get it away. It is virtually on deposit; we have a high proportion of fixed interest securities which we want to get rid of as soon as possible when other forms of investment appear to be attractive.

7465. *Professor Cairncross*: In paragraph 6 you refer to unit trusts. They have not achieved the popularity in this country that they have in the United States. Have you any comment on that? Why should the predominance of the investment trust in the old style continue here while in the United States the unit trusts seem to have made much more headway?——*Mr. Touche*: I am reluctant to say very much about unit trusts, because they are not members of our Association, and I believe they are giving evidence to you on their own. What you say, of course, is true; the mutual funds in America have had a very big success. It may to some extent be due to superior American salesmanship. A mutual fund or unit trust involves two aspects: first of all, the managing of investments, which is the sort of thing we do; but on top of that to make a successful operation the unit trust has to have a considerable organisation to advertise and sell the units. It may be that the American pressure methods have been directed more into that second channel than the British.

7466. Do you find the cost of acquiring shares in your trusts a considerable impediment to expansion of the investment trust movement? Your shares have to be bought and sold on the Stock Exchange, whereas units in a unit trust can be sold back. Buying shares can involve quite substantial costs to a small investor; do you know whether this restricts investment in investment trusts to rather larger investors?——That might be so; holders of units in a unit trust can look in the paper every day and see what the price is, and they know they can buy or sell at that advertised price. In the case of our kind of trust the shareholder cannot necessarily do that. There are not necessarily dealings in a particular trust every day; and even if there were dealings yesterday, it would not follow that one could come in today and buy or sell the stock, because of the narrowness of the market.

7467. *Professor Sayers*: Have you any idea of the average individual holding in the investment trust? How many shareholders are represented by this figure of £1,100 million?——We tried to get some indication on that, but we did not think the figures that came up to us were statistically defensible. We did not therefore put anything in, but I can say something if it is not taken too seriously.

7468. An order of magnitude would be of interest?——198 trusts gave us their shareholders divided between these classes: insurance companies, investment trusts, pension funds, unit trusts, nominees and private holders. We added all those figures together to get the total number in each class; but, as you will appreciate the same insurance company, for instance, may have shares in several different trusts and may appear several times over. On that admittedly erroneous basis the number of private holders in these 198 trusts, including whatever overlapping there may be, was nearly 200,000.

7469. *Professor Cairncross*: You had no figures of the assets they covered?——The typical holding (I cannot say an average holding because this is an average of averages) was £1,200 nominal.

7470. *Chairman*: Should we distinguish further between the holders of the debenture and preference stocks, which are a fairly large element of investment trust capital?——Yes; the figures I have given relate to the ordinary shareholders.

7471. I had an impression you would find a larger proportion of the private holders in the preference and debenture stock. Would that be unfounded?——*Mr. Touche*: I should have thought so; I should have thought you would have found insurance companies more heavily represented, in the debenture stocks, certainly, and to a less extent in the preference stocks.—*Sir Edwin Herbert*: Those being, so to speak, the older holdings of the insurance companies.

7472. *Sir Reginald Verdon Smith*: In paragraph 11 you say: "A characteristic of investment trusts is their capital 'gearing'. There are few trusts whose share capital does not include a proportion of preference shares". Is that historical or is there some particular reason of convenience? Does it remain the same now as, say, before the war?——*Mr. Touche*: Originally it was quite common for a trust to be formed and issue capital of one class, and then, after a little time, for that class to be split into preference and ordinary, so providing two classes of security: one a security carrying a fixed return and a comparatively high degree of safety, and the other a more speculative security but capable of producing a higher return. It was quite common for this to be split as to 60 per cent. preference and 40 per cent. ordinary. That fashion has gone and, partly as a result of the profits tax, trust companies prefer to issue debentures rather than preference stocks now, which has slightly altered the pattern.—*Sir Edwin Herbert*: Since the Budget the preference shares may conceivably come back into their own.

7473. This would not be greatly different from the practice and position of other sorts of joint stock company?——*Mr. Touche*: No.

7474. *Chairman*: In paragraph 14 (*d*), you say:

"they subscribe to new issues which are too small for a public offering, or made at times when the public is unwilling to invest, or by companies in too early a stage of development for a public offering."

That service would be of some importance to our inquiry, if we can get a certain amount of enlargement by way of detail on it. How much can you tell us? What scale of activity does this represent on the part of investment trusts?——I really cannot say. I should not have thought it was very large. These investments would mostly be unquoted, and if you look at the balance sheets of investment trusts the unquoted investments are not normally very large, although in some groups much larger than in others.

7475. *Professor Cairncross*: How small a block would an investment trust be prepared to accept in companies of this type?——That would vary according to the size of the trust. Some would be interested in an investment of £2,000; others would not be interested in an investment of less than £20,000.

7476. *Professor Sayers*: Is this an activity related to very few of the investment trusts or do many of them undertake it?——Many of them undertake it. It is frequently done through groups of trusts in the City which have contact with the capital market, and with people who want to raise money; blocks of shares in companies which are promising but not yet ripe for being dealt in on the Stock Exchange are often placed with investment trusts.

7477. *Chairman*: Through issuing houses?——It could be, or through brokers; or even direct.

7478. Sometimes that is with a view to their becoming marketable securities?——*Mr. Touche*: Yes.—*Sir Edwin Herbert*: I do not think one ought to attach too much importance to quoted and unquoted. The existence of this sort of institution, of which the investment trust is one example, is what virtually makes possible the operation of raising money by a placing rather than by a full prospectus and public issue to the public at large. If it were not for such institutions it would be difficult to see how the system of placing could operate. It is a great advantage to the relatively small company to have that form of marketing available to them; it is possible to market quite small blocks of shares in that way.

7479. *Professor Cairncross*: How small a company would an investment trust be prepared to take unquoted shares in? I am not thinking of the amount of money subscribed by the trust, which would presumably only be a small portion of the total capital of the company, but of the size of the company. Would a company with a total capital of £50,000 be about the smallest, or would you back still smaller companies?——*Mr. Touche*: Yes. It is entirely a question of what the investment trust think of the prospects of the business concerned. They might decide to back quite a small business, if they thought highly of it.

7480. *Professor Sayers*: A company with total assets much below £50,000?——I personally would not favour businesses much smaller than that, but it might well be.

7481. *Professor Cairncross*: Do you know of any cases under £50,000 where an investment trust has taken an interest?——*Sir Edwin Herbert*: Yes; I can think of a number of companies where my own trusts have taken small holdings in quite small companies.

7482. *Professor Sayers*: Are any of the investment trusts specialists in this work?——*Mr. Touche*: Yes. For instance, the Charterhouse Investment Trust has a subsidiary, called the Charterhouse Industrial Development Company, which takes up shares in small businesses which are not quoted on the Stock Exchange, provides them with a certain amount of capital in that way and nurses them often to the point where a quotation can be got, and the capital can then be dealt in on the Stock Exchange. There are one or two companies which do that. A very similar function is carried out by the Estate Duties Investment Trust, which takes large blocks of unquoted shares in order to enable the owners to meet death duties.

7483. Does it get its capital from other investment trusts?——*Mr. Touche*: Members of our association subscribed a great deal of the capital. Maybe others subscribe also; I do not know.—*Sir Edwin Herbert*: E.D.I.T., or "Edith" as we call it in the City, is run by the same people as run the I.C.F.C. Their operations are substantially facilitated by having the institutions, including the investment trusts at the back of them. One of the difficulties that I.C.F.C. and "Edith" have is that they have not got unlimited funds available. If either "Edith" or the I.C.F.C. takes on a company and nurses it through its initial stages, there comes a time when it cannot get busy and do that for somebody else, unless it can dispose of the holding it has already got. There is a sort of recognised practice, that when it has got such a company to a certain point, the I.C.F.C. or "Edith" will go round and say: "We have brought this up so far; how about you taking it on now?", even though it may not yet be a quoted security. That is another link in the chain which makes this financing of small holdings easier than it otherwise would be.

7484. *Sir Reginald Verdon Smith*: Is the investment trust then prepared to regard that as a fairly long-term investment?——*Sir Edwin Herbert*: Yes; we regard ourselves as virtually partners in the business. There is no pressure to sell at all. We would not dream of buying unless we were prepared to stay for a virtually indefinite period. —*Mr. Touche*: Even a company having a quotation, and in which we have already considerable shareholdings, will often come to us if it needs more money.

7485. It is under the wing of the investment trust once the investment is made?——Or closely associated; it depends on the size of the holding.

7486. *Professor Cairncross*: Is there normally some limit on the total assets you seek to acquire in this way?——An individual trust would not seek to hold the whole or the majority of the assets in a company, but five or six trusts accustomed to operating as a group may very well between them hold the whole of the share capital of a company.

7487. *Chairman*: I have the impression from your answers that this is a rather more important activity of the investment trusts than your first answer suggested? ——*Mr. Touche*: Yes; but in relation to the total funds of investment trusts it is not very large.—*Sir Edwin Herbert*: That must be so, because by definition we are speaking of small companies.

7488. *Professor Sayers*: If you are holding between you the whole of the ordinary capital of a company, the amount of time you have to give to it must be quite out of proportion to the amount of your assets that are tied up in this way?——*Mr. Touche*: Yes. To hold the whole of the capital would be an extreme case; but there would be cases where we would hold enough to give control.

7489. Does the exercise of that control take up much of your time?——It may well do, and it can produce some severe headaches.

7490. Do you have specialists on your staff to take care of these cases?——*Mr. Touche*: We have on our staffs people of varying experience, but except in those companies which make this kind of thing a large part of their business one would not normally expect to find specialists devoted entirely to this side of the business. We try and get good management for these companies, and then leave them alone.—*Sir Edwin Herbert*: Quite frequently we call on the services of specialists to represent us on the board, either as chairman or as an ordinary director.

7491. Who would they be; accountants?——Sometimes accountants; it depends entirely upon the type of company.

7492. *Mr. Jones*: Would you play a substantial part on the boards of these undertakings?——Yes.

7493. Would you have three or four members on the board in certain circumstances?——One cannot lay down any rules at all, because these things are virtually partnerships. Each case is looked at on merits, considering the finances of the company and the people operating it. Sometimes we might have to have two or three directors on the board, but normally if we have one good man, particularly if he is chairman, that is enough.

7494. In a number of cases you will have an overwhelming part of the capital. In circumstances like that how do you as an investment trust manage the undertaking?——If we had put the chairman in to look after it, probably he would be an expert from somewhere or other, and the rest of the board would know he had either the whole or the majority of the shareholders behind him. He would be worth three or four ordinary directors.

7495. *Mr. Woodcock*: Generally you are not interested in control at all?——No.

7496. It seems to me that whether you have control or not it is almost accidental; it depends entirely upon the facts of individual cases. In cases where you may have substantial shareholdings, you are still not interested in using that to get representation on the board?——Indeed not. We only want representation if we think it necessary to protect the investment.

7497. *Professor Sayers*: What do you mean by the claim in paragraph 14 (*e*) that the trusts "are a stabilising influence in markets at times of temporary crisis"? Are you thinking that, when you buy, you buy to hold, so that in times of temporary crisis you are not depressing markets by throwing in your holdings? Is it no more than that?——*Mr. Touche*: Yes. We are, to use the common term, "strong" holders, not "weak" holders, and would not be frightened out of our holdings by the price dropping two shillings.

7498. You are not rushing in to support the market when the price drops two shillings?——*Mr. Touche*: Not unless we think the fall in price unjustified. If we can have it at a bargain level, we might increase our holdings. —*Sir Edwin Herbert*: In a period of depressed prices you are much more likely to find the investment trust in the market as buyers, not sellers.

7499. But if you are not in normally as sellers at all, that may not mean very much. Withholding of purchases may have a depressing effect on markets?——I would not like to give the impression that at times like the present we are entirely inactive. It would be a mistake to suppose the investment trusts are not purchasing investments today; they are, on a substantial scale. It is only a matter of relative activity.

7500. I was just wondering how much there was in this claim. It is simply that you do not easily throw your hand in?——That is so. We can never be a forced seller; we do not have to sell for estate duty purposes, and the board's policy is to buy things we are prepared to hold for a long time. For instance, in my group of companies we have invested quite heavily in Canada and the United States, on the view that we would buy things we would hold and more or less forget about for 15 to 20 years. It is a great comfort to know that considerable blocks of shares in important concerns are held by investors with that outlook.

7501. So this claim is really that you are not a destabilising influence?——*Mr. Touche*: Anybody who is a potential de-stabilising influence and refrains from de-stabilising might call himself a stabiliser.

7502. *Mr. Woodcock*: Does the 15-25 per cent. to which you refer in paragraph 15 refer purely to the proportion of income retained for investment?——Yes. That is the proportion of income returned for investment; the whole of the capital profits are retained.

7503. *Chairman*: Then you say in paragraph 17:

"In the belief that inflation was likely to be a continuing factor, investment trusts have, in post-war years, invested little in long-term Government bonds . . ."

That statement seems to take it up from 1945 till the present day without distinction; there is probably some qualification of that. Have you since the end of the war been avoiding investment in long-term Government bonds?——There has been a tendency all the time, as contrasted with our pre-war practice, to move out of all bonds.

7504. Is that because you were adjusting an unbalanced war-time situation? Had you found that you had become too full of Government bonds compared with pre-war?——No; I do not think so. It was the desire to avoid an erosion of capital caused by the depreciation of the currency to which bonds are tied.

7505. *Professor Sayers*: Ever since 1945 you have taken the view that inflation is likely to continue?——*Mr. Touche*: We are a group of people who take a number of different views, but by and large we are of one mind on that.—*Sir Edwin Herbert*: Before the war it was the recognised practice of most investment trusts to regard their fixed interest securities (there is no distinction for this purpose between Government bonds and other forms of fixed interest security) as the things which were going to bring in a steady income out of which they could pay their dividend in good or bad times. Such investment was therefore considered to be sound practice, except for certain trusts which always specialised in shares. It was quite obvious immediately after the war that they were going to lose more in the fall in the value of those securities than they gained by stability of income, and the trusts, I think almost without exception, one by one began to shift over to the other policy. They did not all start at the same time; some were more conservative than others. But I would say that by a few years ago the movement was in full swing almost universally.

7506. That would seem to imply that, if investment trusts as a whole became persuaded that inflation had come to an end they would become serious buyers of Government securities on an appreciable scale. Would a change of view change your habits?——*Mr. Touche*: I do not think that it would have that effect. It would be one of the factors that would cause us perhaps to buy more fixed interest securities; but normally we should buy debentures of commercial companies and so on, as giving a higher yield than Government securities. That would be only one of the factors, because, quite apart from inflation, the ordinary share should in a successful company tend to grow by reason of the fact that part of the profits are ploughed back every year to add to the assets. Even if there was no inflation, we would not necessarily go back in a wholesale way into fixed interest stocks.

7507. *Chairman*: Why, if you did return to fixed interest, would you return to industrial debentures because of the higher yield compared with Government loans? That difference existed before the war?——*Mr. Touche*: Before the war the great bulk of our fixed interest holdings were industrial debentures and preference shares, and not Government loans.—*Sir Edwin Herbert*: As I pointed out a moment ago, there is no distinction in our mind, for the purpose of this question, between different kinds of fixed interest security. I would agree that, if we were once convinced by experience that inflation was no longer much of a risk, there would be a tendency to go back to the pre-war policy, which I tried to describe; but I think it would take us many years to be convinced after the experiences we have gone through.

7508. *Mr. Jones*: Suppose that your gilt-edged capital investment involved no question of capital erosion; what sort of interest would you look for on the sort of capital investment you made in gilt-edged?——I think it is impossible to answer that question; it is like putting the cart before the horse. We should get the best rate we could see going at that time. That is the way these rates get fixed; we do not fix a notional rate and then work backwards.

7509. In present circumstances what would you consider reasonable?——At the present time my own trust have £1 million, as I mentioned, invested in securities which are available from six days' to six weeks' notice, and we are getting an overall yield of 6½ per cent. on that money.

7510. *Professor Sayers*: Before 1914 fixed interest securities commanded a fairly stable market value; long-term rates of interest did not vary very greatly from year to year over a period of, say, ten years. Suppose that, for reasons of policy, the authorities saw to it that the long-term rate did vary appreciably from year to year, so that the market value of your fixed interest securities varied a good deal from year to year; assuming that you had a comfortable feeling that inflation was ended, would you nevertheless want to go back to fixed interest securities on an appreciable scale?——*Sir Edwin Herbert*: It would depend whether the others could beat them in attractiveness of yield and prospects. My company have on the whole concentrated on equity investments all the way through, and I doubt very much whether, even if pre-war conditions were re-established, we should go much for fixed interest securities; but there may be other trusts with other conditions.—*Mr. Touche*: I personally would agree with that, because I think one wants to lay out one's money in a way capable of growing.

7511. Is not that a reason for leaving the fixed interest security alone entirely, or not going into it much?——Before the war we had this fixed interest quota as a stabilising influence, as has been mentioned; now that it has ceased to be a stabilising influence, it has very little to recommend it.

7512. If you got back to the days when you did not think of inflation as one of the facts of life, you have indicated that you would have some inclination to go part of the way back to fixed interest securities. I am trying to take that case, but supposing one variant from the old position: that the market prices of these fixed interest securities varied a good deal during their lives. That would be something different from the pre-1914 days. Would that variant affect your inclinations?——It introduces another factor into the position, in that it would then be very important to buy at the right time. There would then develop a kind of fixed interest market rather like the equity market, with bull markets and bear markets, and it might be important to do things like reducing the load when one thought the market was about to break, keeping one's money in some safer form, and going in again once the market had reached bottom.

7513. You think you would be in and out, and would not go in for fixed investment? At present, once you buy a security your presumption is that you are going to hold it; suppose that you were in fixed interest securities, but that their market value was up and down over the years; would you then change your habits and go in and out as the market moved?——*Sir Edwin Herbert*: I do not think so; I think we should act in accordance with our general policy: if we thought the interest yield over the life of the stock was worth having when we bought it, we should probably go on holding it.

7514. And you would try to concentrate your purchases in the period when the market rate was high?——It would not come out in quite so intellectual a way as that; it would simply be that at a given moment of time we had so much money to invest, and we should look at everything available at the time on the merits. I would accept your view that if the bugbear of inflation were removed, the taboo on fixed interest securities would be removed to some extent.

7515. And this variability of market conditions would not be a hindrance?——No; we buy ordinary shares knowing perfectly well that they are bound to fluctuate.

7516. *Chairman*: In the investment trust your capital structure has a good deal of influence on the kind of security you can invest in?——Yes.

7517. If you have a number of companies issuing their preference shares at a time when interest rates are high, I suppose that they cannot afford to take a low yielding fixed interest security to any large extent?——No.

7518. *Mr. Woodcock*: Have you any preference at all as between Government stock and fixed interest industrial stock? One has always been led to assume that in the long run the difference was a real difference.——*Mr. Touche*: The greater security behind the contract in the

case of Government stocks causes them to give a lower yield. For instance, you could buy Government stocks to yield 5 per cent., but a debenture in an industrial company would give you 6 per cent. on the money, and a preference share might give you 7 per cent.

7519. I am only representing that the market rate is proof of a real difference in risk, for large quantities and a long period?——*Sir Edwin Herbert*: All sorts of things come into it; for example, what are trustee securities and what are not. If you take a trustee security, all trust funds are eligible as buyers of that security, and therefore the price is likely to be higher and the yield lower. If you take a corresponding security, which may be intrinsically as good as the other, but for which trustees are not eligible as holders, then it is improbable that you will be able to sell that security on the market at the same price. In consequence, those who can buy it find they can get a higher yield on it.

7520. You would like to be able to take advantage of the imperfections of the market?——We cannot insure against these things. I wish we could; we should find our business much easier.

7521. *Professor Cairncross*: In paragraph 19 you give some figures on the distribution between fixed interest and equity holdings. Could you make any guess at the percentages that would be given for fixed interest and equity holdings for a pre-war year? Would it be between these two percentages?——*Mr. Touche*: Generalisation is very dangerous, because various trust managements have particular prejudices which they pursue; but I think it would be fairly typical to say that for a date in the middle 'thirties it would be much closer to the 1949 distribution.

7522. Not higher on the side of fixed interest?——It might well be higher; we might have had 50 per cent. or less in equities in the middle 'thirties.

7523. You do not show here what proportion of fixed interest holdings were in Government bonds, nor do you show the absolute figures; but on a rough showing this implies that between 1949 and 1957 you disposed of about half your portfolio of fixed interest holdings?——It does not follow that we disposed of as much as that. We must have disposed of some, but it does not necessarily follow that this change of percentages is wholly due to sales.

7524. If you do the arithmetic, it implies an actual disposal of something like £100 million. I know there has been some depreciation, which accounts for part of the total drop in percentage, and I am taking that into account. But it is impossible to judge from the figures how much of that represents Government bonds?——Very little would represent Government bonds; the kind of fixed interest stocks we are accustomed to hold are higher yield ones.

7525. Have you got the absolute totals for Government bonds?——*Mr. Touche*: No, I am afraid I have not; but I know that element would be comparatively small. Most of that would be industrial debentures.—*Sir Edwin Herbert*: Or preference shares.—*Mr. Touche*: And to some extent foreign government bonds.

7526. Even in 1949 your holdings of Government bonds were quite small?——Yes; for a permanent investment we normally want a higher yield than we get on Government bonds. If we hold Government bonds, it would be because we have temporary uninvested funds, and we should only hold them for a comparatively short time.

7527. *Sir John Woods*: You said earlier on that your holdings of gilt-edged were small, and represented money awaiting other investment; but you could not say whether you were predominantly in short or medium or long, because different trusts have difference policies. But I must say, reading paragraphs 16 and 17 together it seems a clear inference that you are in the short end; is that right?——*Mr. Touche*: Some companies certainly are, but even if one's object is only to hold for a short time, one does not necessarily buy a short bond; for instance, if last September, when the Bank Rate was raised to 7 per cent., someone thought it more likely that rates of interest would fall rather than rise over the next twelve months, he might even, for the purpose of a twelve months' investment, have bought long-dated stock, because if the rates of interest did in fact fall, that stock would rise.—*Sir Edwin Herbert*: And the leverage would be greater.

7528. It would be true on the whole that your tendency would be to be short?——*Mr. Touche*: Yes. That would be the safest course to take; if one knows one wants the money for another purpose in six months' to a year's time, one takes no risk if one takes short. The longer one goes the more risk one takes.—*Sir Edwin Herbert*: I know cases where people bought 3½ per cent War Loan or "Daltons" at that time. It is quite a sensible view; if one is convinced that money rates are only temporarily at that figure and are going to fall, then the possibility of an increase in capital values is greater on the longs than the shorts.

7529. *Professor Cairncross*: I would like to ask you a general question about the sample you took of the 150 members of your Association, which is referred to in paragraph 19. I assume that this was in connection with the general circular sent out earlier. It may be that there are some matters of detail we should want to pursue on the basis of this sample; you do, I presume, have rather more crude data than are summarised here?——*Mr. Touche*: A little more.

7530. If we wanted to know something about the size of and distribution of assets in the 150 trusts, you would be able to give us something on that?——We could give you their total assets.

7531. But there is not much detail? Are the equity holdings or the fixed interest holdings broken down?——No.

7532. *Chairman*: The two comments you make upon the working of the Capital Issues Committee (assuming the necessity for its existence) are the lack of reasons for the Treasury decisions that are based on its advice, and the time consumed going through the process. Is the time element considerable in general?——In these matters every day is vital. Supposing an issuing house has made a contract with an industrial company that it will issue £10 million debenture stock, and then it has to get approval of the terms from the C.I.C., the issuing house or the underwriters are at risk until the issue can be launched, and in the course of time before it is actually launched something may break out, like Suez, or a Sputnik, and the basis of the market is entirely altered.

7533. Must the C.I.C. come at the end of this process? Is it inevitable that the issuing house cannot go to the C.I.C. until it is at risk in this sense?——*Mr. Touche*: The C.I.C. will give some sort of discretion about the price; they may say that the stock can be issued at not less than such and such a price.—*Sir Edwin Herbert*: And they always give you six months in which to do it, and it is not difficult in suitable cases to get an extension. I do not want to be too critical of the C.I.C., because within the limits of their very difficult position they do the best they can to fit in with the mechanism of the market. But the plain fact of the matter is that one cannot do things snap, as one used to be able to do; whether the C.I.C. consent comes at the beginning or the end of the process there is inevitably a longer period of uncertainty. There must either be uncertainty as to the terms on which it will be possible ultimately to issue the new capital, or uncertainty as to whether the underwriters are really committed. There must be one or the other, and there may be both of those uncertainties; and the thing we all dread more than anything else is uncertainty of any kind.

7534. Even when the C.I.C. have approved, you have to go and stand in the queue?——It depends upon the magnitude of the issue. Issues of our own capital are almost always in the form of rights issues made to existing shareholders, and we do not have to queue up at the Bank of England for those.

7535. *Professor Sayers*: Does the C.I.C. lay down conditions about the price for each issue?——Yes.

7536. Are those conditions easily understandable?——The figures are perfectly clear. Whether one can keep within them depends how things are when one comes to make the issue. They leave a reasonably wide gap, and only in exceptional circumstances would one have to go back to them on price. But I have had cases in the past where they have fixed a price in relation to the existing price of ordinary stock which I felt was perfectly unjustified, although you would get it on the market.

7537. I do not want to misunderstand this; when you say they fix a price, is it that you have to give, as part of the information you supply, the price at which you are proposing to issue? Do they alter your proposal, and say they will approve this, but not that?——They are very

much more liberal than they used to be; but there was a time, some years ago, when they were quite rigid in fixing what they thought was the proper price. I could give you one instance where the directors refused to issue the stock at that price, although they could have got it on the market.

7538. *Professor Cairncross*: Do you know of any cases in which a new investment trust has gone to the C.I.C. for permission to make an issue?——Yes, one with which I am connected, which was formed two or three years ago; there was no trouble about it at all.

7539. *Chairman*: In paragraphs 29 and 30 you say:

"There has been a general movement of investment away from the United Kingdom, South America and the Asian countries of the Commonwealth towards the United States and Canada. Although Exchange Control has restricted investment outside the sterling area, it has been possible to buy securities in the United States and Canada within the framework of the dollar pool."

Then you say in paragraph 33:

"The dollar investments selected by investment trusts have greatly increased in value. They have strengthened the dollar resources of the Sterling Area, and increased its dollar income."

What is covered by the words "it is possible to buy securities in the United States and Canada within the framework of the dollar pool"? Do you mean that you can supplement the resources of the dollar pool with appropriate consents, by bringing in more securities from the United States and Canada, or that there is a fixed dollar pool in which you can become large investors, by taking over from other holders in this country?——*Sir Edwin Herbert*: Not necessarily in this country.—*Mr. Touche*: There is a dollar pool. Whether it is fixed or not, and precisely what its boundaries are, how it gets fed, increased or reduced, I do not know. It would be very interesting to know. We can buy what are called investment dollars at the premium which you can see in the paper every day; at the moment it is about 5 per cent. I understand that the dollar pool represents the holdings of United Kingdom residents in dollar securities as they were at the beginning of exchange control, to which are added from time to time dollar assets which come into the hands of United Kingdom residents in some way or other. We are permitted under the exchange control regulations to buy these dollars from other United Kingdom residents; it is a transaction not with a foreign resident, but with another United Kingdom resident. Having bought the dollars, at a premium, we are then permitted to invest them in any security quoted on a recognised stock exchange in the United States or Canada, and we have to fill up certain forms for the exchange control to show how we have dealt with the dollars.

7540. As persons acquiring these investment dollars in the market, you cannot tell the source from which they originate?——No.

7541. *Sir John Woods*: Is the only way in which you can get dollar securities by buying investment dollars?——The only way without going to the exchange control with a proposition and getting a specific consent to be allowed dollars at the ordinary rate of exchange.

7542. Does that happen very much?——The Bank of England would not allow that for portfolio investment, which is the kind of investment we do. If one were a British company wanting to start a company in Canada, a purchase of dollars at the ordinary rate for direct investment might very likely be allowed.

7543. So far as the operations of your trusts are concerned, these transactions are conducted solely in terms of investment dollars?——*Mr. Touche*: Yes.—*Sir Edwin Herbert*: I should not like to go on record as saying that no investment trust had ever made an investment outside the sterling area except as a portfolio investment through the dollar pool. There have been cases where such investments have been made by investment trusts with direct Treasury consent.

7544. *Professor Sayers*: They have been of the direct investment type, not portfolio investment?——Yes.

7545. *Sir John Woods*: That would not account for a significant part of the total increase in your holdings of dollar securities?——No.

7546. *Chairman*: If you are an investor in a venture, and you get a rights offer by virtue of your existing holding, do you get permission to take it up?——*Mr. Touche*: No; we have to buy the investment dollars on the market in the same way as for ordinary investment.

7547. *Sir Reginald Verdon Smith*: Did I have the impression at the beginning of this discussion that you said that United Kingdom resident holders of investment dollars were not the only possible source of dollars?——*Sir Edwin Herbert*: I would rather not go into that; the definition of a United Kingdom resident is a bit of a problem.

7548. *Professor Sayers*: Mr. Touche said that investment dollars have to be obtained in the market in order to provide dollars on the purchase of American securities through an American stock exchange. Is there no market for American securities in London? If I, as a resident of the United Kingdom, am a holder of American securities, can I not sell them in the London market and get security sterling for them, and cannot that security sterling then be bought by you at the appropriate price, for use by you in buying in the London market American securities?——*Mr. Touche*: You can sell your American securities in the London market, but you will get ordinary sterling for that, and you cannot with that ordinary sterling buy further American securities.

7549. Do I not get security sterling when I sell an American security?——I understand security sterling, for which we see the quotations in the paper every day, to be sterling assets belonging to non-resident holders; in other words, it is the counterpart of our investment dollars. I did not think that a United Kingdom resident could hold security sterling.

7550. A United Kingdom resident can switch from one American security to another?——Yes, but security sterling does not enter into it. A United Kingdom resident holding shares in General Motors can instruct his American broker to sell General Motors and buy Fords.

7551. He would have to have an American broker?——No, it could be done by an English broker, certainly.

7552. *Professor Cairncross*: The English broker would put through both transactions on the American market?——Yes; or he could do it on the London market if there was a market in that particular share.

7553. That is a switch by a resident in this country; but he must not allow dollars to accrue to his own account at any point in the transaction? You are saying there is a way out of dollars, but there is no way back?——A United Kingdom resident holds an American investment. That investment has been registered with the exchange control; it is an approved investment. He decides to sell that investment, and so instructs his broker. He can do it direct with a broker in New York, or with a broker in London. The broker will sell that investment, and the American bank which holds the investment will give it out and receive in the dollars. This will be reported to the exchange control; the seller will be allowed to hold those dollars for a limited period, at present six months. After that he must either re-invest those dollars or surrender them to exchange control. If in the course of the six months he finds another investment he wants to buy, he can operate through his American or London broker in the same way, and his bank will be instructed to receive delivery of this investment and pay out the dollars to pay for it.

7554. It is a little difficult to follow the phrase that your dollar investments have strengthened the dollar resources of the sterling area and increased its dollar income, since the main source of the dollar securities purchased by the investment trusts has presumably been other residents in the sterling area?——*Sir Edwin Herbert*: I wish I could be sure exactly how those things work behind the scenes; but I strongly suspect that the dollar pool is widened from time to time by the influx of something or other; the Committee could find this from the Bank of England better than from any other source, but I suspect that, when Americans or other non-residents sell British stocks, somehow or other the proceeds of that get into the dollar pool, because when Americans are buying British stocks the premium on the security dollar always seems to fall. There must be some connection between the two.

7555. *Professor Sayers*: If you are suggesting that the securities which have come in through the Kuwait and various other gaps have added to United Kingdom dollar investments, that is some consolation for the loss of dollars through the gap, but surely there is no additional strength in that?——The real point we had in mind is that by

making these investments in past years we have enabled the sterling area to share in the growth of American and Canadian prosperity.

7556. *Chairman*: The emphasis is really on the first sentence: that over the years they have greatly increased in value? They have been very good investments?——They have been very good investments; we may have put $10 in ten years ago which may be worth $40 or $50 today; that is unquestionably a strengthening of the dollar resources.

7557. *Mr. Woodcock*: It would be very good business to do that?——It has been done in America.

7558. *Professor Cairncross*: If the 150 members who supplied you with this information are a representative sample of your holdings of dollar securities, this represents a rise of over £300 million since 1949?——*Mr. Touche*: The figure for these 150 members is £225 million.

7559. Have you a figure for the total assets of these 150 members?——The value of their investments is £716 million; other assets would be negligible.

7560. Do you consider yourselves as holding a very large fraction of the dollar securities available in this country and traded in on the home market?——We do not normally trade on the London market in dollar securities; but, if you are asking what proportion of the total dollar securities held by U.K. residents is held by us, as compared with the proportion held by insurance companies, private individuals, and so on, I have no idea.

7561. *Chairman*: In section IV, you deal with the authorities' use of monetary measures since 1951. Does your Association have any direct contact with the monetary authorities?——*Mr. Gammell*: No. We are a protective association only. Our Association has no control or say in the day-to-day management of our member companies.

7562. Is there contact on matters of policy with the monetary authorities, either through your Association, or through some gathering of representative leaders in the investment trust world?——*Sir Edwin Herbert*: No.

7563. *Professor Sayers*: Has the Governor of the Bank of England ever invited a representative of your body to see him?——*Mr. Touche*: I am not aware of that ever having happened.

7564. *Chairman*: Do you get circulars or letters emanating from the Treasury or Bank of England distributed to you asking for your co-operation in certain things, actively or otherwise?——*Sir Edwin Herbert*: I cannot recall one. —*Mr. Touche*: The only thing of that nature that I can recall was when the Finance Corporation for Industry was formed. It was made known to us that we were expected to subscribe a certain amount of capital.—*Mr. Gammell*: It was arranged with the Governor of the Bank of England.

7565. What was the actual machinery used? Did the Governor send letters round the investment trusts?——I was not in the office at the time, but so far as my memory goes from the files it was done in conversation between the Governor and the Chairman of the Association.

7566. *Sir Reginald Verdon Smith*: You have never been asked to follow an investment policy which affected you favourably in certain directions and unfavourably in others?——*Mr. Touche*: No attempt has been made to influence our investment policy.

7567. Except for the F.C.I.?——Yes. As I say, we were asked to support that when it was formed, and we subscribed a certain amount of capital to it.

7568. *Professor Sayers*: You say you have no doubt that monetary controls since 1951 have had a marked effect. Are you able to differentiate between the various controls, and say which of the various things that have been done has seemed to you to have most effect?——The raising of the Bank Rate has had an effect in discouraging certain business undertakings, which were rendered very much less profitable by that. Then the restriction on the amount of advances by banks has had the effect of stopping certain activities which could not be financed because no one would lend money. There was also a considerable effect created by the hire purchase restrictions.

7569. Have any of these effects come under your notice in the course of your business?——Yes. Taking the last first, the companies in which we had investments which made goods for selling on hire purchase suffered a decline in profits. Then there was the difficulty of raising capital; I personally experienced that in trying to raise some money to finance the building of ore carriers. It was so difficult that the financing of one ship had to be abandoned altogether.

7570. Was it the restriction of bank advances which caused that?——Yes.

7571. The two examples you have given do not refer to the Bank Rate. When I asked you this question, the Bank Rate seemed to be the thing that leapt to your mind as the outstanding measure. Have you seen any effect of that?——The effect of raising of the Bank Rate is to raise interest rates all along the line; companies are deterred from borrowing, if the rate gets so high that they think again about going on with their capital investment.

7572. Have you seen such cases in the businesses in which you are invested?——It is difficult to know under what heading a thing like this would come. For instance, we have an investment in a company which is short of funds. It was proposing to raise funds, and then the Bank Rate was raised, and restriction was imposed upon further advances. It decided to postpone some development that it had in mind, in the hope that the market for borrowing would become easier.

7573. You have seen such cases?——Yes.

7574. Many?——I would not say many, although my opinion is that it has had throughout industry quite an effect; it would only impinge upon those companies who were at the point when they were actually needing to borrow at that moment.

7575. *Chairman*: In the instance referred to there was the double influence of the rise of the Bank Rate and the credit squeeze; it would be difficult to differentiate as to which is the prime mover in the decision not to go ahead? ——*Sir Edwin Herbert*: One has to test by looking against the background of what would happen if controls were not there, and whether one knows about the internal workings of a particular business or not is largely a matter of chance. I can think of more than one case where the sequence of events has been this: if these controls had not been there, the company would have said: "We are going to do so-and-so; we shall therefore want some more capital. We want to make an issue of perhaps debentures in twelve months' time, and we shall probably want to make an issue of ordinary capital in a further twelve months' time"; or the other way round as the case may be. Then up goes the Bank Rate, and they say: "It would not be economical to issue those debentures in twelve months' time on these terms, so we shall have to carry on with bank finance in the meantime." The bank would say: "Splendid; we can extend our business with you"; but then there is the restriction of bank advances, and the bank manager says: "I am very sorry, but I cannot do that as a result of pressure put upon me by the Treasury." The net result is that either more money is provided from internal finances, or certain capital projects are abandoned or postponed for some time, or both those things happen. I am certain that the cases I know of personally are fairly typical cases; that there has been quite a substantial postponement of capital expenditure projects by reason of the conjoined effect of the Bank Rate and credit restriction operating in the sequence I have tried to describe.

7576. *Sir John Woods*: Would that sequence have applied before the Bank Rate went up to 7 per cent. in the cases you quote?——I think it always operates when there is a rise in the Bank Rate; when one can borrow money at *x* per cent., and then suddenly finds that one has to pay 1½ per cent. more, one says: "Let us put it off as long as we possibly can."

7577. *Professor Sayers*: You mean that, whenever the Bank Rate goes up, a good many people think that rates are going to be lower later on?——I think so.

7578. Mr. Touche said that the rise in the bank rate raises rates of interest generally. Is that your view of how the market has behaved? You would say that the falling tendency of gilt edged prices over the last seven years has been to a considerable extent caused by the raising of the Bank Rate?——*Mr. Touche*: Yes.—*Sir Edwin Herbert*: It is not the only factor.

7579. But to a considerable extent?——Yes.

7580. *Professor Cairncross*: You did not mention anything about exchange control; have relaxations in exchange control had any effect on the investment policy of the investment trusts?——*Mr. Touche*: We would like relaxations of exchange control, because it would be much easier for us to carry on our business and to make investments in any part of the world we thought most favourable for investment.

7581. You do not think that anything that has happened in the management of the system of exchange control has really had any effect on your business in the last five or six years?——The fact of exchange control itself has had an effect upon our business; are you referring to something in particular?

7582. The decision to support the transferable sterling rate in the spring of 1955?——The transferable sterling rate would not affect us at all. We deal almost entirely through the dollar pool, or else we cannot deal at all.

7583. The premium may be affected?——*Mr. Touche*: Yes, the dollar premium goes up and down; it is not always easy to see the reasons for the movement. It must be to some extent related to supply and demand, but it is often very puzzling.—*Sir Edwin Herbert*: I never understood why it shot up to 15 per cent. shortly after the Bank Rate was raised. I do not see how you can relate it to the raising of the Bank Rate. There must have been a sudden cessation of demand by United States citizens for British securities, which must in turn have caused some contraction in the dollar pool; but how it works, I do not know.

7584. If there were no restrictions on the purchase of foreign exchange would your distribution of investments between American and other British and Commonwealth securities and so on be very different from what it now is?——*Mr. Touche*: There might be a little more movement out of the United Kingdom to the hard currency areas. We can move there at the price of paying the premium; if the price was lowered by the removal of the premium, we might move a few more pounds there, but I do not think it would be very major.

7585. You regard the impediment as no more than the premium you have to pay for the security dollars?——As regards the United States and Canada, that is so. There is a further impediment in that we are restricted to well known stocks quoted on the Stock Exchanges over there, and from time to time there arise opportunities for investment outside that in private companies and private ventures, from which we are at present excluded, and in which we would like to participate.

7586. *Professor Sayers*: Is that an exchange control restriction?——Yes; I understand the object of that to be that, if those securities have to be commandeered at any time, they will be readily marketable.

7587. *Chairman*: As between equities, what makes you such determined switchers from United Kingdom equities into United States and Canadian equities? Is it not the yield factor?——*Sir Edwin Herbert*: To some extent.—*Mr. Touche*: Ultimately, everything is a yield factor; if you take the long view over the whole life of the investment, it is the yield factor which decides. But it is based upon what we believe is a better economic climate and a better political climate.

7588. The insecurity of capital in the United Kingdom?——On the political side there is the insecurity of capital in the United Kingdom, compared with the very capitalist-minded economy on the other side of the Atlantic; and also on the economic side they have a much bigger investment per man in their industry, and they keep on putting up this investment; and their industrial growth is greater. Also they are not as mature a country, in the sense of industrial development, as we are; they are still to some extent in a pioneering phase, particularly in Canada.

7589. *Professor Sayers*: Would you expect the proportion to show a further rise in the next ten years?——In value, yes. These figures are based on values, and therefore reflect not only the movement of funds, but changes in value. I would expect it to rise rather than fall.

7590. I am not speaking of appreciation; I assume that would be an automatic adjustment on the portfolio?——*Mr. Touche*: I would think that funds are more likely to flow westward than eastward.—*Sir Edwin Herbert*: Quite a number of the American securities have been very attractive from the point of view of yield.

7591. *Chairman*: Over the period of years?——Yes; and not only attractive from that point of view. There is a whole range of attractive investments still available to the public in the States and Canada which, owing to nationalisation, is no longer available here; for example, the whole range of public utilities, electricity, gas, water, pipe lines, etc. These are excellent investment in themselves, and particularly attractive having regard to double taxation relief, because they have a high tax component in them. In the investment trusts we have invested very largely in that range of securities. If we still had electricity and that kind of thing to invest in over here, we might not have been so attracted. It is part of the process of spreading one's funds over as many industries as possible; when there are these opportunities available with excellent rates of yield and good growth prospects, it seems foolish not to take them. They have all risen substantially in price since we acquired our holdings, and we are pretty well spread over the United States and Canada in the public utility field.

7592. *Professor Cairncross*: Does it not strike you as odd that you should be able to find high-yielding investments in a country which has such an abundance of capital compared with this country?——It may present an interesting economic problem; but when the money comes in, we are very pleased to see it.

7593. *Professor Sayers*: Is there a bigger gap between the yield of these securities in the United States and United States Government securities than one could find between any securities near that class here and British Government securities?——*Sir Edwin Herbert*: There has been. Take a stock like American Telephone and Telegraph: I believe that, with double taxation relief, profits tax and everything else taken into account, the effective yield on that stock here is of the order of 7½ per cent.—*Mr. Touche*: It would be to a company that did not pay profits tax, and it would be very nearly that if the company was liable to profits tax.—*Sir Edwin Herbert*: That is a stock which has paid the same dividend for thirty years, and is virtually a gilt-edged stock for all practical purposes. One can go through the whole range of public utilities in the United States and in Canada and find many similar stocks.

Chairman: I think that completes our questions; thank you very much, gentlemen.—*Sir Edwin Herbert*: May we leave with you some specimen reports of two or three of the better known investment trusts, in case members of the Committee would like to see them?

(*The witnesses withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

LEWIS G. WHYTE, ESQ., and J. G. S. GAMMELL, ESQ., M.B.E., Directors, Bank Insurance Trust Corporation Ltd., called and examined.

7594. *Chairman*: Would you mind having in front of you the memorandum* which you sent to us? How long have the Bank Insurance Trust Corporation been in active life?——*Mr. Whyte*: Since about 1933.

7595. Were you one of the first in this country?——One of the first, but not actually the first; in about the first three.

7596. You say in paragraph 2 that there is no published figure, but that the total amount of money invested in unit trusts in Great Britain is believed to be about £75 million, of which you are responsible for one-third. What are the fields of investment, roughly speaking, of the other two-thirds?——Nearly all the others are general unit trusts covering a miscellanea of industrial investments. There are one or two that specialise like ourselves in particular types of securities, but by and large the majority are a general collection of industrial securities.

7597. Would that be industrial equities?——Yes.

* Memoranda of Evidence Part VI No. 2.

7598. *Professor Cairncross*: The amount you mention here is rather less than the usual estimate for pre-war years. Has there been a fall?——The figure before the war was estimated to be over £80 million. During the war and for some period afterwards the Treasury did not allow any new issues beyond £50,000, so that there was a gradual seepage; I think that was the reason for the fall.

7599. In recent years has there been a substantial increase?——It is just beginning to increase, I should say, in the last two years. In our own experience those are the only two years in which there has been a positive increase, and in some of the other groups we believe that to be also the case.

7600. Would the figures you give here approximately represent the value of the underlying assets?——Yes.

7601. *Chairman*: You compare the situation in this country with the "open-end" investment companies situated in the United States of America. Why do you think that there is such a comparative paucity of opportunity for this type of investment in this country?——I think there are two main reasons: the positive reason is that in America they are sold much more aggressively, and the negative reason is that in this country we operate under a somewhat restrictive Act of Parliament, and any legislation on this matter in recent years has really been to curb the activities of the unit trusts rather than to expand them.

7602. Is there any reason in our set-up why more vigorous selling should not be possible; is it some statutory difficulty?——There is one statutory difficulty: there is a reluctance to allow unit trusts to charge more than 2 per cent. in their selling price to cover promotion expenses. In America they can charge about 8 per cent. I think that in the case of one unit there was a little relaxation recently, but at any rate the loading charge would not allow a very large selling organisation.

7603. *Professor Sayers*: Who controls this?——The Board of Trade, by regulation.

7604. *Professor Cairncross*: But the Board of Trade have discretion to raise the percentage?——They have discretion, and recently they did.

7605. *Professor Sayers*: Have they been asked to raise it?——We know they have been asked by one trust; we have not asked ourselves.

7606. *Chairman*: Would it make a very significant difference, if you were allowed up to 8 per cent.?——It would help very much. I do not think the traffic could bear anything like 8 per cent., but some modification, perhaps to 3 per cent., would undoubtedly help.

7607. *Professor Cairncross*: Surely it is not your contention that the American average is 8 per cent.; is not that the upper limit?——That is the upper limit, but in some cases it is very near that, I believe.

7608. *Chairman*: How do you sell today?——My own corporation sell by advertising, and we have three outside representatives who call on the professional agents: the stockbrokers, bankers, accountants and solicitors.

7609. *Sir John Woods*: For the private individual you rely entirely on advertising?——Yes.

7610. *Chairman*: You mentioned the retarding influence of legislation as the other reason for the slowness of growth over here?——I think another one is that there is somewhat of a reluctance in this country when it comes to people advertising or pushing any type of investment, and I think that is a thing that can only be gradually overcome.

7611. Reluctance at what end; in the investor to take the investment?——At the receptive end, yes. Perhaps it is a legacy from the old days of share pushing. I think this is gradually being overcome, but a lot remains to be done before it is wholly overcome.

7612. *Sir John Woods*: Is that the reason why the unit trusts as a whole have not gone to the Board of Trade and asked for an increase in the percentage allowed in the price of the unit?——*Mr. Whyte*: I think that is one of the reasons. They are still a little bit shy of doing anything that might be classified as aggressive share pushing.—*Sir John Woods*: I ask because I suppose this was going on when I was at the Board of Trade and I do not ever remember having heard the subject mentioned.

7613. *Professor Sayers*: You mentioned legislative restriction as though there was some difference here between this country and the United States of America. Is the unit trust here hindered to some extent by greater legislative restrictions?——Yes. I think in a way the title of the Act under which we operate is unfortunate: it is called the Prevention of Fraud Act. This Act was brought in to stop abuses, and there is nothing in the way of official encouragement.

7614. Is there in the United States?——The climate of opinion is encouraging.

7615. But on the matter of legislation, is not the United States' legislation on this subject at any rate more intricate, on the face of it more forbidding, than the English?——I have not studied the Acts under which the United States mutual funds operate, but I do know they are allowed very much greater freedom in the way of their loading and promotion expenses.

7616. *Professor Cairncross*: Is there any inter-connection between the mutual funds and the insurance companies in the United States?——Some of them have arrangements with insurance companies for temporary assurances to cover unpaid balances of these amounts sold on the instalment plan, but I think the connection ends there.

7617. The insurance companies do not make use of the mutual funds for the investment of their funds?——I should be surprised if they do, but I do not know for certain.

7618. *Chairman*: You refer in paragraph 3 to a period of enforced standstill. What is the actual reference you have in mind?——The Capital Issues Committee did not give any sanction for any new creation of units beyond the ration of £50,000 from the beginning of the war until 1953; that was the enforced standstill, and there was no way of getting round it. That no longer applies.

7619. *Professor Sayers*: Did you protest against this?——Yes, we tried many times. We could get sanction for conversion or replacement, but not for the creation of new units.

7620. *Chairman*: When you speak of the creation of new units as something involving C.I.C. consent, what would actually be involved: liberty for you to advertise an expansion of money?——It meant that in those days we could not enlarge the unit fund by more than £50,000.

7621. That would mean a selling operation under which you took in money for more unitholders?——Yes; we were able to supply people from those who were selling back to us, but we could not expand the total sum by more than £50,000 in any one year for any one unit.

7622. *Sir John Woods*: Whatever the size of the unit?——Yes.

7623. *Chairman*: Out of what resources does the man who sells his unit back to you draw his money?——By normal practice and custom the managers buy that back from him at a price rather in excess of what he is entitled to receive under the Trust Deed, which is really a bare minimum *pro rata* to the selling price of his underlying securities.

7624. What resources are used?——The managers' own capital.

7625. What is the system under which the managers put up the reserve capital to be used for these purposes?——In a sense the managers are really corporate jobbers. They buy back from people who want to sell to them. If they have enough bought back, they can supply to new purchasers. If the new purchasers out-number the sellers, they have to create new units. We still have to get C.I.C. consent to any new issue above £10,000, but we have always had that consent so far, since the enforced standstill was removed.

7626. Are there any rules as to the amount of jobbing capital that must be put into a unit trust?——No, but I think the Board of Trade must approve every unit scheme, and in considering that approval I imagine that they must be satisfied about the finances of the managers.

7627. *Professor Cairncross*: Are there large numbers of willing buyers of additional units? Do the unit trusts have to go to the C.I.C. frequently for approval of further issues?——Our own experience has been that we go and ask for, usually, £500,000 at a time (on the last occasion it was £1 million) and that lasts us for six or twelve months; so there is not a great frequency of application.

7628. *Mr. Jones*: Have you a queue of applicants for units at any time?——We have never had any unsatisfied

applicants since the C.I.C. conditions were relaxed. During the ban we did have a queue of unsatisfied applicants.

7629. Was it material?——It was difficult to measure them, because all we could do was just to say no. We quoted a bid price, but none were on offer.

7630. *Professor Cairncross*: At the moment you are not limited by the operations of the C.I.C.?——No; since 1953 we have always got consents, and we have no fear that they will not be forthcoming in the future.

7631. Does this inhibit you from a promotion campaign, or is it the 2 per cent. you referred to earlier?——The fear of not geting consent from the C.I.C. does not inhibit us at all in our promotion campaign.

7632. *Chairman*: In your own concern, which is obviously one of the very big elements in the whole movement, you are concerned with the equity shares of banks, insurance companies and investment trust companies. That seems like spreading the unitholders' risk over the people who themselves spread the risk, in effect doing it twice over?——The origin of confining it to banks and insurance companies was that, when these units were formed, these share prices, particularly in the case of insurance companies, were very high, and a lot of people shied off. That applied to a limited extent to banks. Because of capital changes that argument does not apply very much now. As regards investment trusts there is a duplication of spread, but one of the great difficulties of investment trust stocks is that the market is pretty restricted; we really convert that restricted market into an extremely free one.

7633. By your undertaking always to purchase the unit back?——Yes. We advertise and undertake to maintain a market both ways in 10,000 units.

7634. What can you tell us about the habits of the unit holders, with your 25 years' experience? You claim that one of the advantages is that these are long-term investments. What figures can you give which would demonstrate that?——I do not think there are any specific figures I can give, but it has been our experience that in times of crisis, when prices have been knocked downwards, if anything the unit holder has come in and bought. He has not been at all prone to panic. And, equally, when there is a boom on and prices are going up, that is the time that normally we get more sales back.

7635. That suggests he is a rather sophisticated investor?——He is, curiously enough. We have the greatest admiration for him.

7636. Where does he come from?——The average holding is about £600. He is the smaller investor (though we have a few bigger ones); he is the professional man, the artisan, the man who is perhaps frightened of dealing directly with the Stock Exchange because he feels that he does not quite understand it. It is rather difficult to generalise, but it has certainly not yet reached the weekly wage earner except in a very minor way.

7637. If you get these movements in favour of selling and buying, he must be a man who follows the movements of the Stock Exchange very closely?——He can see the price quoted every day, but we have no idea to what extent he watches it every day. All one can say is that basically he does seem to be rather a long-term investor.

7638. *Professor Cairncross*: What is your turnover?——In our last financial year we sold approximately 3 million units and we bought back 1½ million. For the current year our turnover is a little bit more. It is something like sales of 3 to 4 million a year and perhaps rather less than that bought back.

7639. *Chairman*: What is your average number of units outstanding in the year; how many millions?——Just over £25 million in money, which in terms of units must be about 30 million.

7640. And in the course of a year how much comes in for you to re-purchase?——1½ million units; about 4 per cent. of the total.

7641. *Professor Sayers*: Are those sales back bunched at all over the year?——No, I do not think they are. There are a few professionals who watch the price rather carefully, but I think the main reason for sales back is that estates of deceased persons, or people who require the money, look to these units first when security prices on the market are depressed. I would say that selling for reasons of price is a minor factor.

7642. I was thinking not so much of reasons of price; is it a matter of fright occasionally?——There is a small amount, naturally, but it has never been a significant factor.

7643. *Chairman*: Do you by your rules limit the permissible amount of units that any one person can hold?——No, Sir.

7644. Is there any scheme that is related to regular contributions adding to the number of units over a period?——We have no organised scheme, but if anyone wants to pay £5 a month we accept it willingly. We are discussing at the moment whether we cannot make this more organised.

7645. Do you find it a feature that you have regular increments?——Yes; we are noticing more and more people are putting in £10 or £20 every few months, and quite a lot of them sign forms for the automatic re-investment of the dividends.

7646. *Mr. Jones*: Systematic saving?——Yes.

7647. *Professor Cairncross*: Do you have arrangements with any firm to undertake collection of savings?——There is no firm that organises the collection of instalments. We have an arrangement with the Scottish banks, but that is rather different.

7648. I understood this was done by some other trust?——One trust has recently arranged with the banks here to receive savings and pass them on to the managers, but I do not know of any trust that has employed any outside firm to collect the savings.

7649. *Sir Reginald Verdon Smith*: Did you mean, Professor Cairncross, that employers of large numbers of work-people might perhaps provide a service for their employees?——*Professor Cairncross*: I was thinking of the arrangement between Municipal and General Securities Ltd. and the United Steel Company.——I have studied that, but I do not know what success that has had.

7650. They refer to that as a thrift plan. Does your trust run anything of that general description?——Not yet, but we have in mind that we should do something.

7651. *Mr. Jones*: Your figures are in relation to the Bank Insurance Trust Corporation, which is responsible for assets of £25 million?——Yes, I am speaking only for that.

7652. You told us that you bought back from holders 1½ million units, and that you had investment in new units of 3 million; that would be a growth of 1½ million units per year. Is that about the basis of your extension and development today? Would that represent the development that is taking place in the funds of the Bank Insurance Trust Corporation?——Yes. It is probably the first year since before the war that there was any substantial progress made by any one group, and we hope this is really just a very small beginning of what can be done.

7653. *Chairman*: When you say you have in mind possible thrift schemes, could you tell us in a little more concrete way what you have in mind? A favourable concession to those who have paid regular instalments?——What we have in mind is to devise some scheme, probably by bankers' orders, whereby payments are to be made in multiples of one figure at regular intervals. We are dealing in our group with pretty sound investments, and for that reason have a very low management charge. We feel that, if we made the instalment facilities too complicated, it would increase our expenses so much that we would have to pass it on to the unitholder, which would not be desirable. So we should have such a scheme in a very simple straightforward way.

7654. What figures would you put forward which justify the view that you were a natural resort of the small investor?——One reason is that he gets a very wide spread: he is not running any particular risk in any one industry. Another is that he has his money managed by expert managers. We could demonstrate that with our experience over the last ten or twelve years, where there has been, particularly in the units with a large element of investment trusts, a very remarkable growth.

7655. Those are the arguments why the small investor should go to the unit trust. Have you any figures to show that he does? Have you figures which show what the average unit-holding in your organisation is?——Yes; it is £600.

7656. *Professor Cairncross*: What has been the capital appreciation in the underlying assets over the last ten years?——It varies for each unit. The most successful have been investment trust units, on which over the last ten or eleven years the income has almost trebled, and the capital gone up about 2½ times. The average in another one which has a large element of investment trusts is very nearly the same.

7657. *Chairman*: And the difference between going direct to the investment trust and being a holder is that you give him marketability?——Complete marketability; and he is never in a position of not being able to come to us at any time of the day and sell back to us.

7658. *Sir Reginald Verdon Smith*: You say the average holding is £600. Have you any evidence of who those holders are, or what their income groups might be?——We have them analysed to quite an extent according to profession. I am afraid I have not got the figures with me, but they do consist of a large collection of different professions and occupations. I would say that the main concentration is in the £500 to £1,500 income bracket; not below that so much.

7659. *Chairman*: Have you ever done any professional sampling of your holders?——Not yet; we contemplated doing it, and got part way, and then did not go any further with it.

7660. *Professor Cairncross*: What is the normal way of introduction of unitholders? Do they generally come to you through the banks, or is there any particular group of agencies who predominate?——The banks provide a lot of our customers; stockbrokers also a lot; accountants and solicitors provide rather less. There is recurrent advertising, and then every now and then we have a bulk offer of units which is supported by fairly extensive advertising; that we find brings in a lot of new unitholders.

7661. Is one of the principal attractions of the scheme that that brings in the banks as interested parties; not that they necessarily advertise, but they may be able to give favourable terms for their intervention or assistance?——Yes.

7662. You refer in paragraph 16 to the Trustee Savings Banks. When you make use of the Trustee Savings Banks is this only for particular types of units?——The Trustee Savings Banks are agents who produce a very limited amount of business; it is almost, you might say, casual part time employment.

7663. *Mr. Woodcock*: What do you pay them?——Exactly the same rate of commission as any other agent; that is, two-thirds of the Stock Exchange commission. It varies with different sizes of units.

7664. You say in paragraph 17 "The managers are required to conform to the regulations of the Board of Trade but although they are numerous and circumscribed they have not felt them to be serious deterrents to the expansion of the movement." This seems to contradict what you said earlier; I thought you were making a complaint about the regulations?——There are two facets of this. There are the actual regulations, which we have found can be coped with and do not really hinder us; but as regards the general atmosphere, it is the title of the Act, and the mere fact that the Government had to bring in this Act at that time that has been a restraining influence.

7665. *Chairman*: Do you have to bring in a reference to the Prevention of Fraud (Investments) Act of 1939 in your literature? Otherwise I do not quite see how it is brought to the mind of the potential investor?——I am not quite certain whether we are bound to do that. I think it is more the fact that before the war the whole unit trust movement got a thoroughly bad name. It has taken a long time to live that down. We had a feeling four or five years ago that it was really being lived down and we were in the early stages of convalescence.

7666. It is the bad name that the movement had in the late thirties rather than the fact or the title of this law that is a hindrance to your development?——I think that is so.

7667. To whom would you look for help in the furtherance of your work? You have banks and Trustee Savings Banks already. There are the authorities; who else? Would you look to the Stock Exchange?——The Stock Exchange help quite a bit, but there is still a surprising amount of jealousy; they think we are taking business from them. In fact we really help them, because we buy the underlying securities; but there is that atmosphere of competition. What would help more than anything else is an expression of opinion by the Government that this was considered a very satisfactory means of saving, along with the package of Government savings for the small saver.

7668. *Professor Sayers*: Do you want the Governor of the Bank of England to give an after dinner speech for you?——It would help.

7669. *Chairman*: You would like some mark of fiscal recognition of your movement?——That would help, not only for whatever fiscal benefits there would be but for the implication behind them.

7670. *Mr. Woodcock*: In paragraph 19 you say: "If administrative facilities could be arranged whereby distributions amounting to not more than, say, £15 gross (comparable to the concession in respect of P.O. Savings Bank interest) could be paid before deduction of tax, the small investor would be encouraged." When you say before deduction of tax do you mean that tax would not be charged?——It would be liable but not charged.

7671. The depositor in the Post Office Savings Bank is limited as to what he can put in: £500 a year, with a total of £3,000. Would you accept the same limitations if you had the concession? Would you be prepared to limit it to the small saver as defined in those terms?——I think the larger saver would not bother to claim this benefit if granted. It would only be the small person who, if he comes in now, gets taxed at the full rate and would probably not get it back because he does not know how to claim it.

7672. *Professor Sayers*: He would get no financial advantage?——Not in the end, except in so far as he does not at present claim it or know how to claim it.

7673. The Post Office Savings Bank limits its interest to 2½ per cent. a year. Would you accept that limitation?——A limit of 2½ per cent. would be quite contrary to the terms of the trust deed under which we operate.

7674. *Mr. Woodcock*: I do not see why you are claiming the equivalent concession unless you are prepared to accept the equivalent limitations?——The motive behind this is looking to the future. We hope that we shall reach the wage earner on the factory floor as they have done in America. If he is putting £50 or £100 in, he is really going to be deterred by the income tax.

7675. *Professor Sayers*: Is not the analogy wrong? Should not the analogy be not with the Savings Bank depositor but with small holders of public bonds on the ordinary Bank of England or Post Office register, where, if the half-yearly interest is under £5, the tax is not deducted at source?——I agree; that would be a much better analogy.

7676. *Chairman*: Then the Revenue authorities are left to chase the receiver of the small amount of interest instead of him chasing them?——Yes.

7677. *Professor Cairncross*: You make no analysis of the proportion of distributions which would be under £15 gross?——No; if I could guess, it would be something like one quarter of the total.

7678. *Mr. Woodcock*: You say: "Many small investors have difficulty, through lack of knowledge, in reclaiming the amount of tax to which they are entitled and they are deterred from investing for this reason." That is not my experience; mostly small people know much more than big people about these things. Is this just an opinion or is it your experience?——It is very largely an opinion, because normally we are not in direct touch with the would-be investor; he goes through the recognised channels. Perhaps in a few months' time we shall have better experience, as a result of the over-the-counter scheme in Scotland.

7679. *Chairman*: Would it not be worth your while to attach a small tax advisory branch to these organisations?——Yes, it might well help.

7680. *Professor Sayers*: You say in paragraph 21 that you think that the unit trust movement is capable of playing a very much larger part in swelling the total of personal savings. In what ways are you thinking that it can play a very much larger part?——*Mr. Whyte*: The

justification for that is the incipient growth at present, and the feeling that if we could get this movement known over a very much wider field there would be a very big growth in the amount of money invested in Unit Trusts—*Mr. Gammell*: The start of this over-the-counter scheme in Scotland has uncovered the fact that there is a latent demand of savings seeking investment of this type. We do not pretend that what we have done so far has solved the problem, but we do feel that there is real evidence that the demand is there, if we can find the right way of meeting it.

7681. *Sir John Woods*: I am not sure what you mean by "helping indirectly to provide capital." Do you imply by that that, if you expand, you can tap an additional source of savings which is really seeking employment, or would you simply be taking money away from another form of such investment?——*Mr. Whyte*: We think we can encourage saving; we think that, if we can make a man who does not know whether to save or spend see that he would have a profitable investment, we can induce him to save.

7682. What would happen to the additional savings?——They would supply money for the underlying assets and thus, at one or two removes, for commerce and industry.

7683. *Professor Cairncross*: You do not think you might be diverting the money from gilt-edged?——*Mr. Whyte*: Quite a bit would be; but we do think that, in addition to that, if we can get a man to believe that he really has got a good form of investment which will give him a good and safe return for his money, we could influence him to save a bit more than he is doing at present.—*Mr. Gammell*: In Scotland there are large quantities of money still wrapped up under the mattress; it is still the experience of every Scottish bank that every week a large number of notes are returned which have been burnt accidentally in the home, and that sort of thing. That is the type of savings we feel could be mobilised by a scheme of this kind; instead of being sterile in the teapot it would be helping the economy.

7684. *Professor Sayers*: It is not an increase in total savings you are thinking of but replacing part of the national debt on which the Government has to pay no interest at all by other forms of security; is that right?——Not entirely. I think that, once they had started getting the habit, we could foster the whole savings habit. Certainly we have found with this over-the-counter business that we have had a very remarkable number of repeats; a man who has come in and bought his original £10 comes back the following month. We have tapped a completely new range of people that we were not tapping at all before.

7685. *Mr. Woodcock*: New to you; but they may not be new savers?——We cannot tell where they found the money.

7686. *Professor Cairncross*: You are hopeful of spreading thrift in Scotland?——Yes.

7687. *Chairman*: How do you handle the underlying investments? Are you free to change at will?——*Mr. Whyte*: Yes, within the limitations of the trust deed. Although theoretically we require the consent of the trustee, as long as the trustee is satisfied with the general manner in which they are managed we are really free to change them at will.

7688. Do you subscribe for new issues at all?——Usually where there is a new issue of a stock already held in our portfolio we try to take it up if we can.

7689. *Professor Sayers*: Do the unit trusts do underwriting?——The unit trust as such does not do any underwriting. The managers do so in a small way, but it is a very small part of their business.

7690. *Professor Cairncross*: How do you rate the danger that the unitholders might seek to liquidate their holdings at some moment of time and oblige the managers to indulge equally in liquidation in the Stock Exchange? Is it a real danger or not?——*Mr. Whyte*: In all the years of our experience it has never been an embarrassment. We have never had so many units sold back to us that we have had to force our own holdings of stocks on the market. It has been one of the surprises, because I believe that one of the great fears when unit trusts were formed was that there would be excessive liquidations of units. It has not happened yet, and we doubt very much if it will.—*Mr. Gammell*: I was in New York last autumn when they had a fairly substantial break on Wall Street; I think prices fell more than they had done for 25 years. I made particular inquiries about this point, and I understand that the Massachusetts Investment Trust, which is the biggest in the United States and has, I think, funds of $1,000 million, was a continuous buyer throughout the break. It was buying before and during the break and afterwards; it had no experience whatever of its fund unwinding. I talked to some managers of funds in America, and their experience is that their funds grow more or less continuously; during periods of great public hesitation and alarm they find the thing flattens out, but they have never, within the last 25 years, had experience of unwinding funds.

7691. *Chairman*: As more units are sold and therefore the potential liability to buy them out in a bad time increases, do the reserves available to the managers rise?——*Mr. Whyte*: They have been rising more or less in conformity with the increased amount of units outstanding. In relation to the present amount we are satisfied that our resources are more than ample. In the last year only half of them have been employed at any one time in looking after stock bought back by us.

7692. Where does the additional rise in reserve come from? Is it from money put in by the management?——No, it is an accumulation of past profits.

7693. *Sir John Woods*: Do unit trusts have any sort of convention as to the ratio between managers' capital and the value of the underlying assets?——I do not think so. I think the Board of Trade may have their own idea as to what is acceptable and what is not: we do not know.

7694. There is no one idea which is commonly held among unit trusts themselves?——*Mr. Gammell*: No.

7695. *Chairman*: Do the American trusts claim some tax position which is more favourable to the unit trust, as against some other forms of investment, which is not available in this country?——No, Sir; the difference is the stamp duty difference. They operate on a very much wider margin as far as their expenses go, but their published quoted prices of buying and selling do not look very different from the corresponding prices in this country. The possible spread between the buying and the selling prices per unit in this country is about 20s. to 21s. or 21s. 3d. That is a very wide spread, and a very large part of the addition is made up of stamp duty. The Americans can operate on an equivalent spread, but instead of part of it being stamp duty they use the extra for promotion expenses. Their tax system is, of course, different from ours in that they do not have this deduction of tax at source, as you know; so they do not have the complication of reclamation for the small investor which we have here. That is a distinction which makes it more favourable.

7696. *Professor Cairncross*: If you make a comparison with endowment assurance, in this country there is a tax concession on that which you do not enjoy. Is that also the position in the United States?——The United States have no comparable concession on endowment assurances. In the United States and in Canada whole life assurance forms the vast bulk of the policies written, whereas in this country endowment assurance probably forms the bulk of it. But, as with the life assurance movement, so with the unit trust movement: both are sold from door to door in the United States and in Canada by individual salesmen to the individual customer or client, whereas in this country the majority of British assurers, other than life, operate through agents, and the unit trusts also operate through agents. There is a difference in technique there, which is not due so much to differences in law as to differences in habits between the countries.

7697. Is the 2 per cent. stamp duty levied on sales? I am speaking now not of transactions in the underlying assets but of your transactions with unit holders——*Mr. Whyte*: They do not pay twice; it is paid on the purchase of the underlying securities, and when we quote a price for the unit, it includes all expenses, including the 2 per cent. stamp duty.

7698. *Professor Sayers*: If a fund is never in the position of having to unwind at all, why does the stamp duty have to be passed on to the unit-holder?——*Mr. Gammell*: Stamp duty is payable when units are bought back.

7699. But I thought you said that the stamp duty is only payable on the underlying securities and not on transactions in units?——*Mr. Whyte*: The offered price at which the unit is sold is calculated on the basis of the offered price of all the underlying securities, whether they have recently been bought or not, plus the stamp duty, plus the normal Stock Exchange commission and plus the agent's commission; so with every purchase the purchaser is indirectly paying stamp duty.

7700. Yes, but the question is of direct payment. You said, as I understood it, that the stamp duty has to be paid to the Government when there are transactions in the underlying securities but not when there are transactions in units. Did I understand you correctly on that?——*Mr. Gammell*: No; 2 per cent. stamp duty is payable to the Government if we buy back a unit from an existing unit-holder. Where the creation of new units is concerned, the new unit-holder only pays stamp duty once; he effectively pays to the managers the cost of the underlying security, plus stamp duty, and as far as he is concerned that is the end of it. If units are bought back, 2 per cent. stamp duty is payable. If a unit is resold to another holder within two months, the second transaction goes on a ten shilling stamp; if the resale takes place after two months another 2 per cent. stamp duty is payable. So, if the managers keep a book and do not liquidate within a period of two months, then stamp duty is payable again. If a unit-holder sold units to another unit-holder stamp duty would be payable.

7701. *Chairman*: Then in paragraph 22 we come to points which, you say, "would help materially to enable the unit trust movement to fulfil its proper role in the financial system." They really boil down to helping the unit trust movement. Some lead to ease of access as between the intending unit trust holder and the unit trust: then there is cheapness of acquisition; and the third point is the possible inducement by tax concessions, absolute or such as would relieve the interest of deduction of tax at source?——*Mr. Whyte*: Yes; and perhaps also direct encouragement to the Trustee Savings Banks either to form their own unit trusts or to adopt an attitude of official approval to unit trusts.

Chairman: I think that completes our questions. Thank you very much, gentlemen; we are much obliged to you.

(*Adjourned until Friday, 25th April, 1958, at 11.00 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTIETH DAY

Friday, 25th April, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
PROFESSOR R. S. SAYERS, F.B.A.
GEORGE WOODCOCK, ESQ., C.B.E.

SIR JOHN WOODS, G.C.B., M.V.O. (Questions 7702 to 7865 only)
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

L. A. ELLWOOD, ESQ., Vice-Chairman, G. H. ROSS GOOBEY, ESQ., J.P., and F. W. BACON, ESQ., representing The Association of Superannuation and Pension Funds, called and examined.

7702. *Chairman*: Would you take the memorandum* which you were good enough to send us, so that we can ask you a few questions?——*Mr. Ellwood*: First of all may I apologise for the absence of our Chairman, Mr. Henry Lesser, who had hoped to be here, but has unfortunately had a recrudescence of an influenza-like germ, and is in bed with a fever this morning. I propose to deal with the introduction in general terms, and when it gets into figures to ask my colleagues, who are actuaries, to explain a little more the details. We have said that we have not sent a questionnaire to our members, and I should perhaps first explain why we took that view. When one is asking for voluntary replies to requests for information one has to convince people of the purpose of one's questions, their relevance and so on. We felt that a questionnaire which we had sent out in 1954, and which was analysed and put into the leaflet of statistics, dated 1st June, 1956, which you have, gave the information at that date; but if as a result of the oral evidence this morning it appears that there are questions we could ask of our members to elicit more definite facts, we should be only too pleased to put that in hand.

7703. You can take it that we have all read your memorandum carefully and discussed it among ourselves, so I do not think there will be many questions. In paragraph 4 of your memorandum you say that your Association represents some 1,150 schemes. Each one would have its own trust deed governing it, I take it. Is there any model form of trust deed to which they are expected to conform, apart from revenue purposes?——No. We analyse the various kinds of schemes in paragraph 17; there is such a variety that there could be no one model form. We have been asked to prepare one, but the lawyers will understand the nervousness of any lawyer to put forward a model form which may not meet particular requirements which ought to be more closely analysed at the start.

7704. The powers of investment would depend in each case entirely upon the plan formed by those who founded the trust?——Yes, and one hopes there were powers to alter the trust deed, so that those investment clauses may be revised every ten years, which is the experience of the funds.

7705. That is the experience of the older ones being from time to time brought up to date, and extended investment powers taken?——Some of the very earliest ones did not give power to alter at all, and there they might need to go to the Court.

7706. Did the earlier ones tend to tie the trustees down to the ordinary definition of a trustee security?——That was current thought at the beginning of the century, until the thirties, I should say.

7707. And one would begin to mark a tendency to extend the range for permitted investment from that time on?——That is so.

7708. *Professor Cairncross*: Would many schemes still require investment in gilt edged and other trustee securities?——Many of the small schemes have that still, and are hesitating, waiting for a lead as to how they shall alter them.

7709. *Sir John Woods*: Have there been many applications to the Court?——I do not think so.

7710. *Chairman*: Any new scheme formed now would be unlikely to restrict investment to trustee securities?——Most unlikely.

7711. What kind of range would you expect an up-to-date trust deed to permit?——*Mr. Ellwood*: The fashion now is to make it as wide as possible and then put a few limitations by way of direction to eliminate foreign and very risk-involving investments.—*Mr. Ross Goobey*: It is the practice nowadays not to put limitations in the trust deed but leave it to the good sense of the committee operating the trust deed to make their own limitations from time to time.

7712. They are given really the full power of an ordinary investor?——That is the general tendency today, and the policy we advocate as an Association.

7713. *Professor Sayers*: Do most trustees now have freedom to go into unquoted securities?——Yes.

7714. And do they commonly do so?——*Mr. Ross Goobey*: Sometimes, but not to any great extent.—*Mr. Ellwood*: I would say it depends on the size of the fund and the ability to obtain advice on that sort of thing. Smaller funds will keep out of them.

7715. Where do they go for advice?——*Mr. Ellwood*: Again it depends on size. Some have whole time investment managers and actuaries like Mr. Ross Goobey. The smaller funds rely on their actuaries to find suitable advice. One tries to take it beyond the stockbroker or bank as soon as one is large enough to get a check-up of market opinions, the requirements of the funds being long term and the advice normally available being short term.—*Mr. Bacon*: Some firms employ one of the merchant banks to advise them.

7716. *Chairman*: There is quite a close tie-up between a number of those houses and particular pension funds?—*Professor Sayers*: Presumably it would be through those houses that the funds would obtain unquoted stocks?——*Mr. Bacon*: I would say unquoted were the exception rather than the rule if one means securities of companies as distinct from mortgages.—*Mr. Ross Goobey*: These private companies come from a variety of sources; I would not say necessarily only from merchant banks. But I do not think it is a significant amount yet.

7717. *Chairman*: Would the lack of marketability be a deterrent?——*Mr. Ross Goobey*: Not at all, because we take the view that we are investing, we hope, for all time, and are only interested in the income. The likelihood of sale does not cross our minds at the time of investment.—*Mr. Bacon*: Marketability is a growing need of closed funds.

* Memoranda of Evidence Part VI No. 18.

7718. *Professor Cairncross*: You are speaking of an industrial company?——Yes.

7719. Has there been a tendency to switch to mortgages or advances on house purchase?——*Mr. Ross Goobey*: There has been a slight increase in the amount. Not many companies, I think, use their pension funds as a means of providing loans for the employees. That is, I gather, the point behind your question. We do not. I think Mr. Ellwood has experience the other way.—*Mr. Ellwood*: In times of low interest they were useful. Again one must go outside the Trustee Act, which regards seven years as the limit of a term, to take a term of 20 to 25 years; but even that is a short term, and one may not be able to fix long term, so one may have one's money coming in at inconvenient times. They were regarded as useful, but the growing opinion is that you must look to the long-term nature of funds for investments, and that may make mortgages less attractive. My own fund, for example, found it useful for a time for house purchases, especially to staff, but we stopped that on growing interest rates because it was better for us to go long term, longer even than twenty years.

7720. You regard long term as over twenty years from this point of view?——*Mr. Ellwood*: Perhaps forty years; but the actuaries must speak to that.—*Mr. Ross Goobey*: Yes, forty years. In fact the general tendency in the pension funds is to be as undated as possible.

7721. *Sir John Woods*: With all the risks?——*Mr. Ross Goobey*: In gilt edged, yes.—*Mr. Bacon*: Other things being equal, and on the assumption interest rates are likely to fall.

7722. *Professor Cairncross*: The figures in paragraph 4 together with the ones in paragraph 6 suggest that you cover two-thirds of private pension funds?——*Mr. Ellwood*: In amount, not number. There are a lot of small firms which just exist on their own, with no need of a central association.

7723. Are the total assets of the funds increasing fairly rapidly?——*Mr. Bacon*: Yes; one would expect the figure to increase as the size of the funds grows. I should imagine it would be many years before most of them would reach a stationary position.

7724. *Chairman*: What are the sources of that £100 million annual increase?——*Mr. Ross Goobey*: Employees' and employers' contributions, and interest on existing investments. Most funds are in the state where the contributions of the employees and of the employers are themselves quite sufficient to meet all outgoings, and the whole of the interest income falls to be immediately reinvested.

7725. *Professor Cairncross*: Have you made any estimate of what the eventual size of the funds will be?——My own fund anticipates being about 50 per cent. greater than it is at the present time.

7726. *Professor Sayers*: You mention the number of members covered by the scheme as about two million. Is this number increasing?——*Mr. Ross Goobey*: I think so.—*Mr. Ellwood*: The sources of entries are new funds being formed by employers and by the growth of employers' concerns. They are still on the increase.

7727. *Chairman*: You find a constant accretion of new funds every year?——Yes.

7728. *Mr. Woodcock*: Has this speeded up at all lately?——I do not think we have any means of knowing the rate. It seems to be steadily going on. Perhaps just at the moment it is the reverse because people are saying: "We will leave over for a year the formation of a scheme, until we know what sort of changes are coming on a national basis".

7729. Do you think the shortage of labour since the war has encouraged employers to try to hold their labour more by pension schemes than before?——There has been a notable increase since the war, year by year.

7730. *Sir John Woods*: Are members in industrial schemes mainly salaried staff, or are there many weekly paid staff in these schemes?——Both, but generally in separate funds.

7731. *Professor Cairncross*: The figures in your pamphlet show that, out of 282 new funds since 1945, 171 are for office staff only, 19 for works staff only, and 92 for both. Do you know whether there is any marked tendency for the third or second of these groups to increase in relation to the first? Are the newer schemes beginning to apply more to works staff?——*Mr. Ellwood*: I should say they are, subject to the temporary hesitation I referred to just now.—*Mr. Bacon*: A firm will quite often start off with an office staff scheme and extend it to cover the works at a later stage.

7732. *Sir John Woods*: When they get to that situation, is it true that most of the schemes are compulsory, that it is a condition of employment to join the scheme?——*Mr. Ellwood*: On the staff side they can be compulsory. On the works side, because of the Shops Act, 1902, it varies; we are not sure whether a fund of this kind is to be regarded as within that Act. Many take the view that it is, and make factory schemes optional and not compulsory.

7733. *Mr. Woodcock*: How do you classify the miners' scheme? Is that a classified scheme by your standards?——*Mr. Ross Goobey*: They have both staff and works schemes.—*Mr. Bacon*: The same would apply to other nationalised industries.

7734. I thought the miners' scheme was rather unique, in its range at any rate?——*Mr. Ross Goobey*: No, I do not think so, but it gets a lot more publicity.

7735. *Chairman*: In paragraph 6 you say: "The estimated value of the assets of all the pension schemes in the United Kingdom, excluding those arranged with Life Offices, is about £1,700 million, and these assets are believed to be increasing at the rate of about £150 million annually".——*Mr. Bacon*: These figures have been superseded by the figures quoted in the House of Commons on 31st March last. A comparable figure to the £1,700 million is probably about £1,625 million, which is the figure for internally administered schemes and nationalised industries.

7736. What would be the source of the figures quoted in the House, to which you are referring?——As far as I know, a survey undertaken by the Government Actuary's Department.

7737. *Professor Cairncross*: The figure here of £1,700 million is your own independent estimate?——That is simply a build-up from the figures given in the Phillips Committee's Report.

7738. *Sir John Woods*: Can you give a revised figure for the rate of increase?——That is more difficult, because that figure was not among the figures quoted in the House. They gave the contributions and the pension payments, and the difference between those two was £124 million; we have to add on to that the interest income, which might be between £50 million and £60 million, and knock off the other outgoings such as returned contributions, lump sum benefits and so on; so I should think the £150 million is not very wide of the mark. It might be a little more than that.

7739. *Professor Cairncross*: Do the figures in paragraph 6 relate to 1954?——*Mr. Ross Goobey*: No; they were brought up to date on the basis of the 1954 figures.

7740. You give no indication in paragraph 6 as to the way in which these assets are invested. Have you any data on that subject showing the distribution between gilt-edged and other investments?——*Mr. Ellwood*: Some information was compiled by Professor Morgan of Swansea, who addressed his own questionnaire to members of our Association and received replies from a little more than half of them. So there is available the result of that somewhat limited enquiry. I can put in copies of that if that would assist.

7741. I think it would be very useful if we did have that. Has this been published?——It was published in our own periodical *Superannuation* for July, 1957. I have some copies available; may I draw your attention to the table?

PENSION FUNDS ASSETS AND THEIR DISTRIBUTION

	Commercial and Industrial				Banks and Insurance				Nationalised Industries				Miscellaneous				Total	
	1953		1955		1953		1955		1953		1955		1953		1955		1953	1955
	£m.	%	£m.	%	£m.	%	£m.	%	£m.	%	£m.	%	£m.	%	£m.	%	£m.	£m.
Brit. Govt. ... Other Govts. ... Brit. local auths.	129·3	51·3	135·8	41·6	13·8	54·1	15·0	47·3	69·0	67·8	98·9	59·8	11·4	62·9	13·2	58·4	223·5	262·9
Debentures ...	29·4	11·7	41·5	12·7	3·9	15·3	5·6	17·7					1·1	6·1	1·7	7·5		
Preference ...	23·1	9·2	26·0	8·0	1·5	5·9	1·8	5·7	26·7	26·2	51·6	31·2	0·9	5·0	1·5	6·6	138·7	233·7
Ordinary ...	48·7	19·3	97·0	29·7	2·4	9·4	4·6	14·5					1·0	5·5	2·4	10·6		
Mortgage and Real Property	14·9	5·9	18·1	5·5	2·5	9·8	2·9	9·1	1·8	1·8	6·0	3·6	2·7	14·9	3·0	13·3	21·9	30·0
Other investments and Cash ...	6·7	2·7	8·3	2·5	1·4	5·5	1·8	5·7	4·3	4·2	8·9	5·4	1·0	5·5	0·8	3·5	13·4	19·8
Totals ...	251·9		326·7		25·7		31·7		101·8		165·4		17·8		22·4		397·5	546·4

(Reproduced from "The Assets of Superannuation Funds and their Distribution", by Professor E. Victor Morgan; *Superannuation*, July, 1957.)

7742. *Chairman*: Would you describe the members of your Association who contributed to this as providing a representative section?——I think it is fairly representative, so that one can use it as a "Gallup poll", if I might use that convenient expression.

7743. *Professor Cairncross*: Would it be fair to conclude from the figures collected hy Professor Morgan that the distribution of your assets is not very different from that of the insurance companies?——*Mr. Bacon*: I should think that the insurance companies on the whole had a smaller proportion in equities.—*Mr. Ross Goobey*: The difference in the taxation position of pension funds, the fact that their income is free of tax, tends to make equities more attractive to pension funds.—*Mr. Bacon*: The Life Office figures are affected, of course, by the fact that during the war they put all their money into Government securities. The distribution they actually have is not necessarily the distrihution they would like. That is why their percentage in equities may be lower than they would like to have.

7744. Are not their figures in terms of nominal values and yours in terms of market values? That, I would think, rather alters the apparent balance of assets in the portfolio. If the necessary corrections were made, your figures might come more close to those of the insurance offices?——*Mr. Ross Goobey*: Yes, hut I think on balance the pension funds have a larger proportion in equities.

7745. If this Committee were to conduct some further survey on this as a committee, would you be sympathetic? Would you feel this was something worth doing?——*Mr. Ellwood*: We should certainly assist you, through the membership, to get information. The only reservation our members would want to make would be that aggregates should be used and not figures for individual funds. —*Professor Cairncross*: We could certainly give that undertaking.

7746. *Chairman*: Do you think there has been any marked change in distribution since 1955?——*Mr. Ross Goobey*: I should say there has been a steady tendeney for the proportion in equities to increase.

7747. It showed a very sharp increase between 1953 and 1955?——I should imagine that rate of increase has at least been maintained.

7748. *Professor Cairncross*: It would not be your view however that there had been any disinvestment in Government securities, hut rather an increased flow of funds to equities?——I think there would be outstanding cases of sales of Government securities.

7749. *Professor Sayers*: Big cases?——Yes.

7750. *Chairman*: Would any conditions you can envisage alter that movement? What about rates of interest, bearing in mind that one of your points is that the primary consideration for a pension fund in determining its investment policy is the overall rate of interest? ——I do not think any improvements could be made that would alter that. I think there is a growing awareness on the part of investors for pension funds of the historical advantages of equities. We all know the future is veiled in mystery; that is no doubt the only thing which prevents more advantage being taken of the higher yields and other advantages ohtainable on equities.

7751. *Professor Sayers*: If you stress the yield factor so, it would seem to follow that, if the yields on Government securities rise relatively to other yields, the funds will tend to huy more Government stocks rather than less?——Relatively; but it is a question of actual yields. They have not yet achieved the state, which I have often said might be attained, when the rate of yield obtainable on equities is very much lower than British Government securities.

7752. I was not suggesting that the yield on Government securities might hecome higher than that on equities, but that the relation hetween the two changed in favour of the Government securities. What if that happened?——It does happen from time to time now.

7753. It does; hut if that was a clear tendency over a considerahle period, would the funds he attracted back into the gilt-edged market?——I suppose they might be. But the yield of an ordinary share has quite a different meaning from the yield of a British Government security. That is really the basic question: what is the yield of an ordinary share? History has shown that it turns out to he quite different from what it was when it started out, because of the increase in dividends which is possihle and has been experienced in ordinary shares, and is not possible in British Government securities.

7754. Yes, but you do in fact take a view on these things when you buy then?——It is just looking at the facts of the past two hundred years.

7755. And looking to the next two hundred?——The facts of the past are so obvious to read. There is an appreciation of those facts, and willingness to take sufficient risk.

7756. *Professor Cairncross*: Is it trust in equities or distrust of gilt-edged?——There is no distrust of gilt-edged, because after all a pension fund is only interested in income. Nobody has questioned the income of gilt-edged. It is the greater trust in equities, or appreciation of the possible advantages, and a greater willingness of trustees to take an overall risk.

7757. *Chairman*: You make the point in paragraph 16 that constant adjustment upwards of salary scales throws out the actuarial calculation on which your investments have been based; the equity seems to be the natural hope of dealing with that maladjustment?——*Mr. Ross Goobey*: There are two schools of thought on this subject. One looks upon equities as the means of overcoming inflationary tendencies, and the other considers that a trustee wishes to get the best possible result with his investments, and chooses equities for that reason, not because he is

forced to try to use them to keep up with inflation. Another way of dealing with inflation is by the actuary making an allowance for inflation in his calculations. Mr. Bacon may say this is a very difficult thing, but it can be done that way.—*Mr. Ellwood*: There is a changing philosophy on these things, and there are two factors putting the brake on the change towards investing 100 per cent. in equities: one is the lawyer saying that equities by their very nature must have a risk in them, and the burden on the trustees in selecting them is a heavy one; and the other is the accountant who says: "You must show the position periodically to your members, and when you get a great depreciation during a year or two of your equities, showing what may be £2,000,000 lost, that is uncomfortable." Mr. Ross Goobey will say that it does not matter because it is ironed out in the end; but there are those two voices of caution, and they may be the more heard in the smaller firms.

7758. Under these trust deeds you probably provide for quinquennial revaluations. From time to time in recent years you must have found deficiencies emerged. Do they normally provide for the company making additional contribution?——*Mr. Bacon*: That is very much the current practice; the employer in effect guarantees the fund and undertakes to pay in what is required over and above what the employees pay. There are some older funds where there is a fixed contribution from the employer, and if there is a deficiency the decision has to be taken how it is to be dealt with, whether the benefits are to be reduced or contribution by either side increased. The current practice, I would say, is generally that the employer undertakes to make the deficiency good, and that is one of the reasons why there has been an increasing tendency to invest in equities. It is true that the actuary may be able to make more allowance for increasing inflation; nevertheless the employer has to pay for the additional cost, and if he can reduce that cost by investing in some security that is going to appreciate, that is obviously an advantage to him.

7759. *Professor Sayers*: Is it your peculiar taxation position that makes the equity so very attractive to you?——That is one of the contributing factors. Hitherto the yields on equities in general have been higher than gilt-edged securities, and that additional income is free of tax and accumulates free of tax. That makes quite a considerable difference, but it is not the only point.

7760. For the private person the difference is absolutely trivial, if you take a long view?——*Mr. Ross Goobey*: Yes, but the accumulating effect of an extra 2 per cent. per annum is quite significant.—*Mr. Ellwood*: We should just mention here the point in paragraph 19, that there are many companies whose investments are not attractive to a fund because the rate of income tax when allowing for double taxation relief is a low one.—*Mr. Bacon*: In very round figures a difference of 1 per cent. in the rate of interest may make a difference of 20 per cent. in the cost.

7761. *Professor Cairncross*: Are there many funds which have gone over to the 100 per cent. equity proportion?——*Mr. Ross Goobey*: I do not think there is any fund which has achieved 100 per cent. in equities. There is at least one fund which has that as its ultimate goal.

7762. Do you think there is an increasing tendency for the private pension funds to aim for something like that?——*Mr. Ross Goobey*: No, I think it will be a long while before we get to that stage, but there is a movement towards a much higher percentage.—*Mr. Ellwood*: One might put it this way: advisers of funds ten years ago would have regarded 50 per cent. in equities as an unreasonably high average, but now they would regard it as one they want to attain as quickly as they can.

7763. *Sir John Woods*: The broad picture is that you are interested in income; partly because of fears about inflation, there has been a considerable switch from gilt-edged into equities, and it looks as though that is continuing; but if you are in a fixed interest security you are not worried about gilt-edged depreciation from time to time? You would in fact be in the very long end of gilt-edged?——*Mr. Ross Goobey*: Yes. Generally, if we are going to be in gilt-edged we would normally be in the undated or very long term.—*Mr. Bacon*: That is subject again, of course, to the actual yield. At the present time one has to give up a yield of something like a half per cent. to go into a dated stock. One has to make up one's mind whether that is worth while on a twenty year stock. Similar circumstances often apply.

7764. *Professor Sayers*: Before 1914 the prices of the undated Government securities were fairly stable. In the last fifteen years they have lost a great deal of their value, and gone down and down. If the future pattern of things was that these gilt-edged prices at the long end suffered not a continuous depreciation but big swings up and down, would that bother you at all?——*Mr. Bacon*: Not from an actuarial point of view, as far as the market value of securities is concerned; because in a growing fund you do not have to realise. There are occasional difficulties from the accounting point of view. If you want to make an exchange, for example, you might have to realise a book loss. That is a different question.—*Mr. Ross Goobey*: There is a reluctance on the part of many trustees to take a book loss. As far as periodical valuations go, I think those funds which are more greatly in British Government securities are more embarrassed today even than those who invested a great deal in equities. Those that started their equity campaign in 1955 must obviously be embarrassed.

7765. *Sir John Woods*: Embarrassed in what sense? Showing a loss on their balance sheet?——Yes, in that the quinquennial valuation happens to take place now when prices are down. The question arises what happens when the valuation shows a deficiency. In the past, when the majority of the fund was in gilt-edged securities, the actuary quite rightly took the view that this was only a valuation in point of time, that there was no question of winding the fund up, and that the securities would come back to their value in due course; generally speaking no account was taken of that temporary depreciation. Now, with the increasing number of equities included in the portfolio, a fund may come to a position where a deficiency occurs and they cannot make the same obvious statement, although there is no doubt that there are fluctuations, and it just depends which day of the week the valuation is made what answer one gets. Accountants are coming more and more to the opinion that these valuations in point of time, so far as our investments are concerned, need not worry the trustees quite so much. It is more a question of making sure that one's actuarial forecasts are kept more up to date.

7766. *Chairman*: Under this scheme the company making good any deficiency shown by the quinquennial valuation does not get it back when the fund has a good year?——*Mr. Ross Goobey*: That is the point.—*Mr. Bacon*: Only in the sense that the contributions may be reduced at a later stage if a surplus emerges.

7767. The company do not get much out of that?——No.

7768. *Professor Sayers*: Coming back to the book loss that has to be taken when you switch from gilt-edged, I thought you said earlier that in general you reckoned, once having made an investment, to hold it?——*Mr. Ross Goobey*: We were speaking then about unquoted securities.

7769. I thought your statement was more general?——It is general; that is, provided that circumstances do not change. But I think that you are leading up to the fact that we may have a British Government security and circumstances may have arisen when that stock gets out of line with another stock, and it may be advisable to go to the more attractive stock at that moment.

7770. More attractive from the point of view of yield; on the long view you have gained?——Yes.

7771. Do you do a lot of this switching?——There is a certain amount done. If your question is addressed to my fund, we have no gilt-edged.

7772. When such a switch takes place, need the book loss be an embarrassment?——*Mr. Ross Goobey*: It need not be, but one of the traditions trustees have is that they do not like showing a loss.—*Mr. Bacon*: From the long term point of view obviously one only makes the exchange if it is going to improve the position of the fund; but the accountants usually take the view that, when a stock is sold at a book loss, the loss has to be written off; therefore there is an apparent reduction in the size of the fund, and if there is no investment reserve

to balance it, that has to be shown in the accounts at the end of the year. That is a psychological obstacle, because the trustees have to show a loss to members.

7773. I am trying to find out how attractive long term gilt-edged may be to you in the future, and to see how far your point of looking simply at the yield will carry you. If you have the opportunity to buy gilt-edged "Eternities" with a yield of 6 to 7 per cent., the fact that during the lifetime of the fund those securities may go up and down a good deal does not seem on the face of it to be a matter of grave concern to you?——*Professor Cairncross*: You would rather have a high yield in gilt-edged than a low yield on something else?——It may be a matter of concern if they go up too far, because that means that the return on the investment of new money is going down. That is much more important than a book loss on existing assets.

7774. *Professor Sayers*: But it is not a reason for selling out?——No; you asked the general question whether it was a matter for concern. I was saying that the reduction of return on new money is more a concern than the reduction of market value.

7775. *Chairman*: In paragraph 21, you are saying in effect that from time to time you pause; you gather in your resources for the time being and keep them liquid while you try to measure the future course of interest rates?——*Mr. Ross Goobey*: Or hope to sit back watching prices go down.

7776. *Sir John Woods*: You are taking a view on yield?——Yes.

7777. *Chairman*: Do you find that these pauses take place from year to year, or only on special occasions?——*Mr. Ross Goobey*: I should think only once every three or five years.—*Mr. Ellwood*: On some occasion of political nervousness, or that sort of thing.—*Mr. Ross Goobey*: There may be short periods where some people "take a view"; they may decide not to buy before the Budget, or there is a saying: "sell in May and go away": that is taking the view markets are going to soften in the summer. One hears all these little sayings by investment managers.

7778. *Professor Sayers*: We are thinking here of funds accruing for investment at the rate of something between a hundred and two hundred million pounds a year. In any one year when there is a scare for some reason or another, how much of them would be put into shorts because of the current fears?——A fairly insignificant figure.

7779. A few millions?——A few millions would cover it.

7780. *Professor Cairncross*: Have you any idea what proportion is normally held in Treasury Bills, short bonds, or anything of that kind?——I should say less than 1 per cent.

7781. *Professor Sayers*: The amount becoming available for investment is something of the order of £3 million a week. How much might be deferred for a matter of weeks, not years? How much might go into Treasury Bills or other very short term paper, because you thought that this year April happened to be a rather bad month for going into long term securities and you felt inclined to wait till the autumn or at any rate till the summer and see how wage claims go?——*Mr. Ross Goobey*: We have no concrete figures as an Association of that sort, but I should say it is very small.—*Mr. Bacon*: I would agree. I should have thought it was only when there was a fairly strong expectation of some sort of financial upheaval.—*Mr. Ross Goobey*: Our job is investment. Every time we are not investing we are losing ground. One can be too clever at holding back, and one is liable to be shot at if one is not doing the job.

7782. *Sir John Woods*: In the recent months you would have been all right in shorts?——Yes.

7783. *Professor Sayers*: On some views you might very reasonably take, you might well run up your holdings of shorts by £50 million or so during a period of two months; but you do not in fact?——No.

7784. *Professor Cairncross*: Your eyes are all the time on the price of longs and never on the price of shorts?——Yes.

7785. If you ran up Treasury Bills it would be because you did not like the price of long term investments?——Yes.

7786. *Sir John Woods*: In the last sentence of paragraph 22 you make the obvious point that, where people have had to sell recently, they have made heavy losses. The general case you are putting to us is rather on the basis that you never do sell; you only change a security if you see one that on the long view looks better from the point of view of yield. What circumstances have you in mind here?——There are some funds which are running down: closed funds. The company may have made a decision that a certain section should be wound up, and that the next batch of employees should go into another fund. In those circumstances, as the assets are kept entirely separately, it may from time to time become necessary to realise funds to pay beneficiaries of the closed fund. But these closed funds are a very small proportion of the whole.

7787. *Professor Sayers*: Are these closures foreseen or unforeseen?——*Mr. Bacon*: Quite a lot of closed funds arose as a result of nationalisation of industries.—*Mr. Ellwood*: The unforeseen element is the decision of an employer to go out of a branch of business; that has its effect on the fund.—*Mr. Ross Goobey*: There may be decisions by employers to make a new scheme contributory rather than non-contributory, and the other one gradually runs down; then one has to apply a different approach to investment than on the continuing ones.

7788. *Chairman*: On paragraph 24 (i), what have you in mind as to the permissible range of expansion of trustee securities, or is that quite general?——*Mr. Ellwood*: It would be a question rather of finding some flexible means of indicating a large range of companies and undertakings whose ordinary shares have proved right in the past and look like proving so in the future.

7789. It is equities you have in mind as things to be included in the extended range?——*Mr. Ellwood*: Yes; but we realise the need for review and flexibility. We could not just have a Trustee Act that specified them once for all.—*Mr. Ross Goobey*: That was put in more for the benefit of those funds mentioned earlier with more restricted trust deeds, that may have to go to the Court to get them changed.

7790. You handle these large accretions of new funds every year. Do you have any contact with monetary authorities about policy in the use of them?——*Mr. Ellwood*: No, only in an indirect way like any investment corporation. We have nothing as an Association.

7791. Do you get circulars addressed to you?——No.

7792. *Professor Sayers*: Has the Governor of the Bank of England ever to your knowledge invited any representative of your organisation to go and see him?——No.

7793. Have the Treasury ever invited you to go along?——No.

7794. *Chairman*: Would it embarrass you, or would you welcome it?——I do not think so.

7795. *Professor Sayers*: Have you ever felt you would like to go and talk to them?——No; only on the Inland Revenue side, where we have excellent relations. Beyond that it is not apparent that there is a need for it.

7796. In the last ten years you must have wondered a good deal what was going to happen to interest rates. Have you never felt in that context that you wished you could understand what the monetary authorities were up to? Do you think that the monetary authorities have been unreasonably secretive about their motives and intentions?——I think they are bound to be.

7797. You accept the position?——*Mr. Ross Goobey*: It never occurred to me that we were in a position to go and ask them. I presume no other branches of investment think they have the same powers.

7798. I am not thinking here of what the monetary authorities would say to you, but of what the monetary authorities might say to the public at large that would help you in your understanding of what was happening about interest rates. Have you never felt that there was this secretiveness?——*Mr. Bacon*: It would certainly be helpful from the actuarial point of view to be told more about interest rates, because in the valuation one of the elements is the interest rate; and the more light one could get on it the better.

7799. But here is a field in which the Government authorities take action that leads to very big changes in the climate in which you work. Have you never felt that those actions taken by the authorities require defence and explanation, or are they to be taken as changes in the weather?——*Mr. Ellwood*: I should have said that more illumination would be welcome, but that it had not occurred to us that we could put forward any constructive suggestions for the giving of that illumination which would not embarrass the authorities; light shed abroad will shine on others as well as us.—*Mr. Bacon*: My own feeling is that the authorities face difficult circumstances from time to time, and we have had to take what they do as the best that could be done at the time; to take it for granted so to speak.

Chairman: Thank you, Mr. Ellwood; we are very grateful to you and your colleagues for your help.——*Mr. Ellwood*: If there is any way in which we can help to throw any further light on questions prompted by your inquiries, we shall be only too pleased to do so.—*Chairman*: We are much obliged.

(*The witnesses withdrew.*)

F. R. ALTHAUS, ESQ., senior partner in Pember & Boyle Ltd., G. H. GREENWELL, ESQ., M.C., D.L., senior partner in W. Greenwell & Co., and C. D. MORLEY, ESQ., Secretary of the Council, representing the Council of the Stock Exchange, called and examined.

7800. *Chairman*: We are much obliged for the memorandum put in by the Council of the Stock Exchange.* You can take it that we have all read it through, so that the questions that we put will mostly be enlargements of the points you have made to us. In addition there may be some new points we want to travel through with you. You say in paragraph 1: ". . . the departure from the gold standard in 1931 imparted an entirely new look to investment . . ." What have you in mind when you say that?——*Mr. Althaus*: A new concept of the control of credit and its repercussions on investment in general. The market was previously very much influenced by the movement of gold from one centre to another. After 1931 that became a more remote factor.

7801. *Professor Sayers*: Is it entirely new? Do you not watch the movement of the reserves from month to month very much? The behaviour of the market seems to suggest that you do?——We do indeed; but I think at that time the general background was not quite so marginal as it is today.

7802. You are thinking here of what happened in the years immediately following 1931, rather than comparing now with before 1931?——Yes.

7803. *Chairman*: You say in paragraph 2:

"The war led to an enormous growth in the National Debt although, unlike its predecessor, it was financed by the issue of consistently low-interest securities. It was inevitable, therefore, that the gilt-edged holdings of all types of investor should be quite disproportionately increased."

Then you refer to the new financing of the undertakings which have been nationalised "by the issue of still more gilt-edged stock, destined, in the first instance, for the Departments, and not necessarily related to the resources or inclinations of the general body of investors." How far does your criticism in that last sentence go? I think I am right in saying that the occasion for these issues was a situation as between the industry and its bankers; that was watched, and when the level of the industry's bank advances was seen to be approaching a certain figure a new issue was expected to provide more permanent finance. Are you saying those came at times which were really ill adjusted for the market?——We had in mind that the superimposition of financing of this type, which replaced other types of investment which had been open to the liking and convenience of investors, on top of the already swollen amount of gilt-edged securities created by the war, created additional embarrassment.

7804. But was not the type of investor who had been in these nationalised industries before largely the same type of man who would be interested in gilt-edged?——Not entirely; diversification of investment is one of the things which investors look for and like.

7805. Diversification because of the interest or the kind of activity which they represent, or because of the maturity or the terms?——Mainly diversification of the type of activity.

7806. *Sir John Woods*: I am puzzled by some words at the end of paragraph 2: ". . . the determination of investors to adapt their policy as far as they could to a situation which attracted as well as threatened them." What situation was that?——The situation which attracted them was the tendency for interest rates to be driven down at the time; and the threat was first of all the removal of a type of investment which might suit their purposes better, and also possibly the greater threat which ultimately lay in the over-cheapening of money.

7807. *Professor Cairncross*: Would you think that the market value of gilt-edged at present is a higher proportion of the total dealt in on the Stock Exchange than before the war?——I could find that out; I would rather not say off hand. I should say in all probability yes, because the total amount of gilt-edged before the war was some £8,000 millions nominal, and the present nominal value of Government and Government-guaranteed stocks is £18,300 millions odd out of a total market value of £35½ thousand million.

7808. There was a displacement in the early post war years in favour of gilt-edged?——Yes, in so far as industrial securities were being removed from the market, and investors were receiving gilt-edged in substitution.

7809. And because of the increase in the National Debt?——And because of the increase in the National Debt.

7810. Has there not been a substantial change in the position since 1945 rather in the opposite direction, speaking now in market values?——Yes.

7811. Would you agree too that there have been a number of clients for securities of all kinds, who have increased in importance since the war, and who normally would be attracted by gilt-edged investments: insurance companies, pension funds, and so on; although in practice they do not seem to have shown very much appetite for gilt-edged?——Yes, I think that would be fair. I think part of their disinclination arose not entirely from inflation, but because they got so heavily over-loaded with gilt-edged securities during the war, when there was an understanding that they should apply their new money in that way.

7812. *Chairman*: That would be particularly true of the insurance companies, I imagine?——I was thinking especially of those.

7813. Would it be your impression that the position has now stabilised itself, and that they have adjusted their proportions?——I should say that with the appearance of rather greater stability in the economy institutional investors generally, and insurance companies in particular, are more inclined to regard gilt-edged purely as investment, and to measure them against other investments.

7814. My question was more limited: has the disequilibrium in their portfolios as a result of the war now worked itself out?——*Mr. Althaus*: I would say yes. I think it is probably in the course of adjustment in the contrary sense; but I would like to know my colleagues' views on that.—*Mr. Greenwell*: I should think not from recent conversations. It is difficult to generalise, because they pursue different policies to some extent, but I would say that the disproportion still exists in a good many companies. Taking the question as a whole, the investment policy of the pension funds has, I think, tended to create a disproportionate amount of buying of ordinary shares, because they have to make provision for rather different eventualities from those which an insurance company has in mind. The insurance companies' liabilities are in pounds sterling for a certain amount at a certain time in the original contract; the pension funds are not quite in that position.—*Mr. Althaus*: If I may qualify that

* Memoranda of Evidence Part VI No. 17.

a little, there is always the spur of competition with insurance companies. In so far as their with-profits policies are concerned, that element of pound for pound is not absolutely everything in their consideration. But I agree in general with what Mr. Greenwell says.

7815. *Sir John Woods*: The first movement of Bank Rate in 1951, to which you refer in paragraph 4, was in itself very small; nevertheless you say here that many institutional funds had to revise their portfolios drastically. Am I right in thinking that was because of the feeling: "Now we are getting movements of rates 2 per cent. is unnaturally low. This may not be the end of the matter; we may see the rates going considerably higher"?——I think that would be fair.

7816. It was more a psychological thing than the actual movement itself?——What matters about Bank Rate movements is what the trend is, as we say in our memorandum. It is not whether it is going from 2 to 2½ per cent., but what happens after that.

7817. *Professor Cairncross*: You say: "The first half of 1952 accordingly saw markets in which large quantities of undated and long-dated stocks were jettisoned . . ." Of course they were not torn up; somebody bought them. Have you any idea who the buyers would be in those circumstances?——I could not be certain here, but it may be that the kindly spirit which broods over these things may have displayed a little compassion on that occasion.

7818. *Professor Sayers*: Are you certain about who did the jettisoning?——"Jettisoned" is perhaps unfortunate; I am afraid it is my own word, and I apologise for it if it is wrong. In fact there was an unremitting stream of sellers, and sellers in such large quantities that they were compelled to take very much lower prices. You will be able to see from the tables we have submitted to you the extent of the falls which took place. May I remind the Committee of the sort of situation which prevailed then. As long as the 2 per cent. Bank Rate, which had stood for so long, was still there, some people came to regard the optional redemption date on 3½ per cent. War Loan as likely to become the effective redemption date. There were many people who held War Loan during the years that money was getting cheaper, when the price rose to over one hundred, who regarded it in some sense as a potential short dated security. It may have been an over-hazardous thing to do, but a lot of fairly responsible people did in fact do that very thing.

7819. Surely the big break in the price of War Loan which made people change their minds about whether it was going to be redeemed or not, came in the autumn of 1949, not after 1951?——Right up to 1951 there was still a falling of War Loan. I think that the change of Bank Rate in 1951 more or less put a seal on the changed situation.

7820. I suggest that the change in market opinion was going on for some time before that; otherwise how can you explain the continual rise in the yields on the longer gilt-edged from February, 1947 I think, right down to 1949, 1950, and 1951?——That certainly had been going on, but I think that the shift in Bank Rate gave the final warning that there was no likelihood of a return to the conditions of the previous time. I am thinking back a very considerable period, as you can appreciate, and there have been many movements; so I can only give the best answers that I can.

7821. *Chairman*: You were asked by Professor Cairncross who were the buyers of gilt-edged when there was a great volume of selling in the first part of 1952. I did not really want you to leave your answer quite in the form you made it; but if you cannot tell us anything about it, then you cannot.——I am in no position at all to say this, and I give it with the greatest reserve; but, when the market is under pressure, it is not unusual, if the pressure gets severe enough, for it to get a hand either from the Issue Department of the Bank of England or from the National Debt Commissioners.

7822. I thought it was like that; since you live in the market we would like to know what the market knows about it. Your impression is that there is official support in general?——When the pressure gets very severe. One would suppose that the authorities concerned have a special interest in the maintenance of some semblance of order in the market, and when it is a question of someone not being able to sell £5 or £10 millions of stock, there is generally speaking only one buyer with the resources and the courage needed to do that. It does occasionally happen that, when large institutional funds think the market is at the bottom, they will take a large slice of something running into many millions, but it is less usual when the trend looks as though it has set in; and then I should guess that there is occasionally a relief expedition from the authorities. But it is entirely guesswork, and I would not like it to be thought to be anything else.

7823. *Professor Sayers*: Can we distinguish here between on the one hand the market facing a continuing trend, a continuing pressure of sales in big quantities by somebody, and on the other hand a situation which is short-lived, one in which the market is demoralised and the authorities then step in and buy? Clearly they did so in October-November 1949; do they also relieve the market of appreciable amounts of stocks when there is a continuing pressure of sales such as you are talking of in paragraph 4?——I should have thought that they do not do that in ordinary circumstances. This is a long time ago, but I think some institutional funds, in the post-war years when the market was rising, had become possessed of War Loan, and even in some cases of very large holdings of 2½ per cent. Treasury Stock; when it became quite clear that the market was turning, and it became a question of devaluation and so on, there were funds which were absolutely impelled to get rid of these things; that is why I used the word "jettisoned". They were no longer suitable for their portfolios, and that was what gave the particular impetus to the fall in undated securities.

7824. Who were the buyers?——I can only guess that on this occasion, because it was rather a question of public interest, they may well have found their way int some fund under official control.

7825. You would say that of a period other th October-November 1949?——It could be, yes. I thi that all these questions, if I may say so with respe. can be answered with great accuracy by the Govern ment broker or the National Debt Commissioners; I am only guessing, and my guess is probably a very poor one.

7826. *Chairman*: For the moment we are interested in what the market thinks happens; there are other means of finding out what actually happened. It is of importance, I think, to know what is believed to happen, and that is why I am really trying to go into this in some detail with you?——I think that what is believed to happen is that, when the market get into difficulties, they may get some assistance if the difficulties are serious enough, but it will never be as much assistance as the market would like to have.

7827. How often in any one year would there be an impression in the market that there was official intervention in support of the market?——Very seldom. Occasionally, if there is a weak trend for the time being, it may be that sinking fund purchases of 4 per cent. Funding Loan and 3½ per cent. Conversion Loan appear to be used for that purpose; but I should have thought that the actual interventions to steady the thing up were not very frequent, and only exercised under the strongest pressure.

7828. You have spoken of two occasions, the autumn of 1949 and early in 1952. Are there other periods that spring to your mind?——I should not like to say; it is too difficult.

7829. *Professor Cairncross*: You would not suggest early last year?——No, I do not think so, to any very great extent. One of the things which has influenced this position a little is, I think, the fact that the National Insurance Fund has been a growing fund.

7830. In paragraph 21 you say: "The Departments, it is believed, do from time to time buy stocks other than the shortest dated." I take it that what you are putting to us at the moment is that in the first half of 1952 the intervention was not just in stocks other than short dated but in the stocks at the extreme end of the maturity range, the undated and very long dated stocks. I take it that it is your view that the peculiar feature in the first half of 1952 was the sharp drop in prices, the large sales of stock of that kind, and the intervention by the authorities in that market?——Yes. What we had in mind as much as anything else on the particular paragraph that you have just quoted is that, where the authorities have stock for sale by tap, they are believed to encourage the purchase

of their tap stocks by taking other stocks in return. As I said before they do not always fulfil the market's best expectation; the uninformed guess would be that they might only take half the stock which was offered in return for whatever was taken from them.

7831. It is your view that in the first half of 1952 the authorities were purchasing the very long dated and undated stocks?——I think that is quite possible; and I have no doubt that as an offset to that they were selling to the people who had to restore their balance sheet position some of the other stocks off the official portfolios.

7832. There had been, as Professor Sayers put to you, a considerable drop in gilt-edged prices well before 1952. Is it the distortion between different maturities that you think was peculiar at that time? You lay stress on the sales of undated stocks?——I mentioned that they were jettisoned in favour of those with medium and short maturities. I come back all the time to the fact that this is a question of adjustment of the balance sheet positions where some form of public certificate is necessary, and where the retention of those stocks would produce an embarrassing situation. I do not think that anything more is implied in paragraph 4 of the memorandum than that.

7833. Is it possible to document this, in the sense that you can show the turnover in undated stocks at that time?——No, I am afraid that is not possible. There is no statistical information. It was considered some years ago, and recommendations for statistical surveys were brought in by a committee over which I presided, but it did not meet with sufficient general approval to be carried into effect.

7834. *Chairman*: I think it follows from what you said in an answer just now, and I think also from paragraph 21, that the possibility of official intervention in support of the market when it is reasonable is not unwelcome to you at the Stock Exchange? You would like to see it on a larger scale than you think you have seen it?——Not necessarily, no. We should like to go on on our own feet as long as we can, but occasionally the pressure is large, when these lots of £10, £15, or £20 millions come along, as they do from time to time, and that is rather a large undertaking in an uncertain outlook.

7835. But, given that the occasion is special when you want intervention, I rather thought you would like to see it on a larger scale than in fact took place?——I think I said that it did not take place on the scale which the people who were loaded with stock would have liked to see. That, of course, is quite a natural wish on their part. I think generally speaking the position of the Stock Exchange in this matter would be that we are of immense value to the authorities as a sounding board, as a yardstick and as a market, and that therefore we do not feel that it is inappropriate if we get a little encouragement from the other end from time to time.

7836. Suppose that was an avowed policy (I dare say it is); you would not have to introduce anything that was upsetting to the position of the market with this possibility of official intervention?——No, Sir, I certainly would not want to do that, and I do not think anyone would wish it done, or wish to do it. In so far as anyone wants to do anything they want to preserve a liquid market.

7837. *Professor Cairncross*: The intervention that you are putting to us in the paragraph we are discussing is one in which the departments are buying and selling simultaneously. You are not suggesting that the departments should be plain buyers of stock, are you?——I think that there might be occasions on which it would be very helpful. There are many occasions on which they are sellers; one might say they are permanent sellers. I cannot see anything wildly extreme in thinking they might occasionally be buyers.

7838. *Professor Sayers*: Given the flow of maturities there has been, and the flow of maturities that is to come, and given the Government's methods of issuing stocks, must not the authorities necessarily have been and continue in the normal course to be predominantly sellers, even though they are buying at the same time?——Yes.

7839. The Government broker's operations must at times be very much the biggest operations in the market?——Yes.

7840. That is obviously true at the short end of the market; or would you question that?——I would agree, except for this qualification: I do not think that it is ever the policy of the departments to press stock on the market. I am thinking mainly of their chief function as sellers. They supply stock when it is wanted, and they do, as far as I know, encourage the demand by regulating the steps at which they raise the price of the stock they have for sale and the volume of stock which they will sell at each step; but they will not go to the market when it is a dull day, and someone has said something unpleasant in Peru, and say: "Now you have to buy £10 millions of stock from us."

7841. They cannot force people to buy?——No. The jobbers will make a price in stocks; but I should say that it is the general belief that they are not invited by the official sellers to take stocks unless they see a prospect of someone buying them. Occasionally as the taps draw near their close, the jobbers may take rather more stock from the sellers than they would otherwise do; but in the ordinary way they would not load themselves up unduly with stock, and the Government broker would not expect them to take stocks unduly if they were not in demand.

7842. You have spoken of the Government broker edging up his prices?——I do not know that I used that exact word; it might represent roughly what happens.

7843. Is that in your view an important element in the funding operations of the Government?——We have said here that the condition in which stock is most likely to be sold in large volume is on a steadily rising market. It is a funny thing, but the very knowledge that there is stock for sale, and that the price will be raised, does in fact help to achieve that end.

7844. *Chairman*: How do you know that the price will be raised?——I think it is part of the traditional technique; but occasionally the seller may encourage intending buyers by intimating that the tap price will shortly be raised, and there is not much more at a given level.

7845. Such intimations are passed down?——Yes.

7846. *Professor Sayers*: From the Government broker?——I should say so.

7847. So that you know in the market that he is operating continually in certain stocks?——I do not think there is any question about it. It would be an unusual stock which was not available from the outset.

7848. But if you know always that he is a seller, is it a fact that you do not know when he is a buyer?——Yes, I think that is so. We know that at certain times there will be sinking fund monies available for certain stocks; the best known are the 4 per cent. Funding Loan and the 3½ per cent. Conversion Loan, 1961 or after.

7849. You know at certain times he will be buying those stocks?——Yes; but one does not know what the market situation is, and whether in fact they will be ready to supply that demand from their books without having any notable effect on the prices of that stock.

7850. *Chairman*: Let us see how much you do know one way and another about new issues. It is a safe assumption that each new issue will be on tap for a time after issue?——Yes.

7851. Do you know how much of the original issue is going to be on the tap and how much has been taken up?——No.

7852. Do you know for certain when the tap runs dry?——Yes, I think we do. Sometimes there is a slightly complicated situation, because the tap officially runs dry, but one or two barrels manage to get scraped and a little more stock does in fact find its way out after the tap is said to have been closed; but generally speaking when the tap is closed we know about it.

7853. While the tap is running, do you know at all how much is still available?——No; it is a question of inspired guessing.

7854. *Professor Sayers*: When the tap is first opened, there are published guesses, which may or may not be near the truth, about how much there is to come out of the tap and how much is left with the Government departments after the lists have been closed. Would it make any difference to the behaviour of the markets if instead of having those unofficial guesses you had an official statement on how much had been taken up by the public?——I should have thought that, from the point of view of the seller, he was more likely to do well if there was not a precise knowledge of what he still had to sell.

7855. *Chairman*: Suppose that we approach it not from the point of view of the seller, but from the point of view of the health of the market, and of general confidence in this method of Government issue; do you think there is anything that is not made public already that could be made public?——I do not see how they could really make public anything more than is known already. It is largely a matter of guesswork what goes on, but there is a fairly regular pattern to these things; in the early stages of a tap it will remain on offer, probably at a relatively favourable price compared with existing securities to encourage switching. A great deal of absorption of new issues is effected by way of switching. But in the later stages the tap runs rather more by sharper steps on smaller amounts.

7856. Would it be true to say that by this method no one ever knows what the effective price of the issue has been for any of these stocks?——Nobody not among the initiated.

7857. Is that a deterrent?——No, I do not think so. One guesses a lot about these things, but there is no definite knowledge.

7858. *Professor Sayers*: When other people make issues a statement is published afterwards saying how much has been taken up by the underwriters. Do you think that makes for health in the markets?——Yes, I think it does, because the amounts involved are not very much, and then people have a measure of the task. Where you are talking in scores or hundreds of millions, the amounts are so large that they must in any case go in the first place largely to departmental funds, and I do not think that any information on that would get one anywhere. There is usually a slight indication of the extent of the outside interest in a new loan, because the amount which is allotted in full may be smaller and the residual percentage may be lower; but I do not think that it would help anyone very much to know that in fact £100 or £200 or £300 millions are left to be disposed of. I do not think that it would be any better to know the nature of that enormous task, than it is just to go plodding along, and for people to buy the stock when it looks on relatively favourable terms against other stocks.

7859. Is there not always speculation on how much is being left with the departments?——*Mr. Althaus*: There is a lot of official information people would like to have if they could, but I do not believe that it would in fact serve any very useful purpose. I do not think it would benefit us very much.—*Mr. Greenwell*: I am rather prejudiced on this matter, because I do not like open market operations, although I see they are in present conditions, or have been, necessary. I think it is better to know, as we know today, that 68 per cent. of the New Zealand loan was not taken up than not to know that; and I feel exactly the same way about Government financing. I see your point, but I do not think it would be in practice a good thing for the Government to reveal these figures that are altering from day to day and hour to hour, or that it would be practical policy. As with the exchange control it seems to me that the Government must keep these operations secret. It is not so much a question of keeping them secret; it is just is not possible to keep the home public, the foreign public or anybody else informed about day-to-day operations.

7860. I am not thinking of day to day operations; I am thinking of the result of an issue by prospectus. Take the New Zealand loan this week: £20 millions was the announced amount of issue, and public statements were made afterwards about how much was left with the underwriters. A Government prospectus appears in just the same way; the same form is gone through, except that afterwards there is a statement, which is a travesty of the truth, that the issue was over-subscribed. There are then various unofficial speculations about how much is left with the underwriters (that is, the departments), and the market does in fact know within very broad limits how much the Government has managed to sell to the public. Would there be any objection from the market's point of view to the British Government coming into line with other issuers of stocks in this way?——*Mr. Althaus*: I cannot see what objection there would be from the market; I am merely thinking of the general interest. If anyone says: "Do you want information, or would you rather not have information", of course we would say: "I would sooner have information." But I feel that there must be two sides to this thing.

7861. I am asking you about your side?——The more information we have about everything the happier we are.

7862. *Chairman*: Let me put a concrete case to you. There was an issue of 3½ per cent. Funding Stock 1999/2004 in February last year at an issue price of 80. I believe that was sold down by the Government in the course of the year to a price of 63. Was that ever officially made known?——I do not think it was officially made known, but the only source of supply would be likely to be from that quarter, and people would therefore assume in fact that that was the way of it. Once again I think this arose from the position that, as far as we know, the Government never force stock on anybody, or not in any notable quantity; when the position appeared to have changed, then buyers came along, and the Government did not withhold stock. In fact a substantial amount of stock, running into tens of millions, changed hands at prices about 63 to 65, and this could only have come from the Government.

7863. To get rid of it, as was done, in the course of the year after issue, a price as low as 63 had to be accepted?——Yes.

7864. Do you not think that there would be public advantage after the event is over in it being known what the effective price of the issue was?——That is a difficult question. For me as an individual it would be an excellent thing to know, but I am thinking of its impact on Government credit; that is why I am hesitating. It is no great advertisement for an issue that it is offered at 80 and its effective price is 60.

7865. *Professor Sayers*: The facts are in a very broad way known in relation to these things. Lord Radcliffe knows that this stock was sold at that price. Have you not already the disadvantage from the point of view of Government credit?——I think that to the extent that it would go on the record and stand for all time that they had borrowed this stock at whatever the rate was when in fact it claimed to be an entirely different rate, that would create a difficult situation. In a more stable market it might be very reasonable; but in a time of violently moving prices and interest rates it might be damaging to Government credit, even though it were known that they suffered from this fall in the market. It is a very difficult question; I do not know what the answer to it is.

Chairman: It is one in which we are naturally much interested. I think this would be a convenient moment to break, and you could think about your answer.

(*Adjourned until* 2.15 *p.m.*)

MR. F. R. ALTHAUS, MR. G. H. GREENWELL, M.C., D.L., and MR. C. D. MORLEY further examined.

7866. *Professor Sayers*: When we were talking this morning about what happens when there are big changes in the position taken by a large body of investors, one of the dates we did not mention was 1955. In the first half of 1955 the clearing banks are known to have sold something like £250m. of gilt-edged securities in a matter of a few months, and probably of two months or so. When those transactions were going through (and they were all put through the Stock Exchange, I understand) was the market feeling greatly strained?——*Mr. Althaus*: They would undoubtedly feel the strain if people were getting disinvested on anything like that scale. The actual amount of the clearing banks' investments, taking the average of the monthly figures, fell from £2,321m. in 1954 to £2,149m. in 1955 and to £1,978m. in 1956.

7867. I am thinking of the first half of 1955. The published figures show that there were about £250m. gilt-edged securities sold. Who bought those securities?——That is very difficult for me to say, but I should guess once more that a good deal of it went to various departmental funds.

7868. We know from figures submitted to us already that that was not so. Where did they go? I ask this, because for many years previously to that it had been generally said that if the banks ever had to unload at all quickly it would just break the market; in fact it all went off very smoothly. Who came in and took those stocks?——I do not think I can tell you. I have very little doubt that at the time my firm, like a number of others, was concerned in these things, but it is not very easy to go back in detail. It is not indeed very easy to know where the stock goes, because when a broker sells stock it goes into the jobber's nominees' names, and he very seldom, unless the transaction is married up which happens in a small minority of cases, knows who the buyers are. Jobbers would undoubtedly know the name unless they went into nominees' names once more; but I am afraid I cannot say where they did or did not go.

7869. Did you know at the time that these big sales were sales by the banks?——The brokers who were handling the business could hardly fail to know it.

7870. But was it generally known? Was it a matter of common knowledge in the gilt-edged market that these heavy sales by banks were taking place?——I think it would almost certainly become clear. First of all those jobbers who were doing the business would see what names the stock was coming out of; and also people would see from the clearing banks' returns.

7871. It did become apparent?——I do not think that would surprise anyone very much. There is sometimes a pattern of sales. Certain brokers might be associated with certain types of institution. In the case of my own firm we have very tight security and we pride ourselves that people do not know who the sellers or buyers are; but it can be deduced. It is not on account of anyone shouting it about that the thing becomes known; it is really a pattern more than anything else. It might follow from a study of bank advances and deposits and the like, and from returns of investments.

7872. Would the origin of big sales generally become a matter of common knowledge in the market fairly quickly?——I do not think that a consistent trend of disinvestment by a particular type of investor could go on unduly long without it being noticed; but very often a very large transaction will be done and there will be no change in the price level at all; it is a matter of complete secrecy between the client and the broker and the jobber. Individual transactions between particular institutions might well not be known at all.

7873. And the buyers would not be known in general?——They would not generally be known; but I must qualify that, because it was published within the last day or two that the clearing banks had increased their investments materially in the last month. A great deal of the business that happens is tied up with switching. Some of it is done on a study of charts, some is what we call parity switches. They go on all the time with a very small margin of profitability between closely similar stocks, and very often that may arise through the relative cheapness of something which the Government departments have on offer.

7874. If you do not know on the whole who the sellers and buyers are, do you know when the seller or the buyer is the Government broker?——In certain types of business, we might well know it. Suppose that I had heard that there had been a purchase of £10m. 5½ per. cent Funding Stock; I would know for certain that the seller must be the Government. Whether I knew who the buyer was would depend whether I was well-informed or not.

7875. That is because of the circumstances of the particular stock?——Yes. One can attribute certain types of business to certain types of operator, but not with complete certainty; only with a feeling of probability.

7876. *Chairman*: Would I be right in thinking that the Government broker does not deal exclusively with buying or selling for the Government account?——That is correct; that is another complicating factor.

7877. *Professor Sayers*: If he was selling a stock that had been dealt in by the market for a long time, you would be unlikely to know it was the Government broker who was selling?——I might very well not know. I should hope that I might not know that the Government broker had been dealing at all, because it is his business and the business of the people he deals with to be discreet. It is only the nature of certain types of business which leads you to attribute it to certain types of people.

7878. If you found that a group of Government stocks were coming out on the market very easily, at prices that seemed, in relation to previous prices, bargain prices, what would you deduce?——It might arise in various ways. The whole mechanism of selling by tap involves keeping the tap stock just that much cheaper than other stocks; tap stocks would always be a little bit below the current level in normally predictable circumstances. If another stock were offered immensely cheap, I could conclude one of two things; I might be wrong over both of them. I should think either that the business had been mishandled, or that the client had done what some clients do: spread the orders among a number of brokers who met in the middle of the market, competed with one another and ruined their business.

7879. You would not deduce anything particular about the origin of the business?——No, I do not think so.

7880. You are no doubt very much concerned when there is going to be a new Government issue at the price at which the issue is going to be made. Supposing that the authorities decided for reasons of their own that they wanted to see the gilt-edged yields rather higher in the medium or long-term market, just as they do in the short-term market now, and accordingly deliberately put the price of a new issue under the market of recent days; what would you expect to be the effect on markets?——I do not think that we very often get it that way. I am only talking for myself and, as you have probably gathered, I am not awfully good at this sort of thing; but I think that the market would be more likely to be regulated by the terms of the issue than by the specific price of the issue.

7881. You are telling me that this is a thing that the authorities are unlikely to do; I accept that. I am simply asking how, if they decided for reasons of their own to do it, markets would react?——I do not know.

7882. Let me refer to an actual incident. When in February 1957 the Bank Rate was reduced from 5½ per cent. to 5 per cent., it might have been expected that gilt-edged prices would rise. In fact the authorities let it be known that they would go on selling their stocks at the same prices as before; that is to say, they did not want prices to rise. What was the reaction of the market to that situation?——The market moves year by year one way and another, and I should be very reluctant to answer specific questions about specific movements without reference to my records.

7883. I am not thinking of what happened to market prices; they stayed as they were, the Government broker selling at those prices. What happened to other buyers and sellers. Did they in general shy off the market entirely? Was there a dead market as a result, or did people go on buying in the usual way? Was there a flood of purchases?——Without recollecting very clearly what happened in this particular instance, I would say it would depend enormously on the pressure on money, the general nature of the news at the time, and so on. In so far as we have said that a rising market tends to tempt buyers of securities that are for sale, the appreciation that the authorities were apparently determined not to have a rising market would tend to put off intending buyers to some extent. Whether they had to invest or not would depend on whether their balances were excessive or what was the nature of the alternative capital offerings at the time; the gilt-edged market is only one of the markets which claim the funds of the institutional investors who really govern these things.

7884. Why should they tend to postpone purchases?——It is probably a human feeling that people prefer to buy if they think that the market is going in the direction which will show their purchase to have been justified. That is apart from whether they want just to invest money; many people like to invest money at a good rate, but the good rate probably implies that events will justify the investment in due course and be reflected in a higher price.

7885. You think they are more encouraged by a rise in the price between the day before yesterday and yesterday than they are encouraged by a fall in price between the day before yesterday and yesterday?——In day to day business I should say that they are human, and that

is the particular response they make to that set of conditions. But when there has been a very heavy fall and they are quite certain that the thing is somewhere near the bottom, that there is a change in the economic or political outlook, or any of the things which might find reflection in an improved market, then the attempted buying at the lower level will probably be at least as large, if not as successful, as the ones who come in on a rising market. What makes these tap issues go (I must always come back to that) is the knowledge that the price is going to be raised, and that it is therefore better to buy now than to buy later. But that did not happen, of course, in the case of the "Eternity" issue to which the Chairman has referred.

7886. Is not all this on a very short view? On a long view one can say that between 1947 and 1957 the prices of gilt-edged securities were in general falling each year, nearly every year lower than the last; but people did go on buying?——Yes, to some extent.

7887. Is it not just a matter of whether they buy today or tomorrow that is affected by the day-to-day course of prices? People are not put off by the fact that prices have been falling over a period?——I should like to put it this way: if you put to a man two propositions, (1) "the market is not looking very good, and I think interest rates are going to rise; if you have some money for investment, will you buy now?", and (2) "I think interest rates are rather high, and I think the market will improve, will you buy now?", I think he would be more likely to respond to the hope that the market would improve and that rates would fall than to the uncertainty of knowing whether the market might further deteriorate. Where it is a matter of investing against contractual obligations like an insurance company, and he has got beyond a certain limit and dare not remain uninvested too long, he would probably delay buying if he thought the market was either going to stay where it was or go down.

7888. At the moment the long-term market is on more or less a $5\frac{1}{2}$ per cent. basis, and there are a good many people still holding back. If the Government made an issue now on a 6 per cent. basis, would people say: "This is an extraordinarily high rate; it is bound to go down over the next year or two?" Would they come in and buy, not necessarily on the first day but in the course of the first few weeks?——If there were this $5\frac{1}{2}$ per cent. stock on offer, and for no discernible reason suddenly the Government made a 6 per cent. issue, I think the average man would rather look the gift horse in the mouth.

7889. Supposing the action were explained and defended by the Government?——That would be a novel procedure.

7890. It would be a novel procedure; it would be different from the one of the last few years when the authorities have in fact almost doubled the rate over a period of years without ever defending their actions seriously; but people have gone on buying gilt-edged. They are not buying them as much as the Government would like them to, but they are going on buying them; is that not right?——Yes; there are always buyers for gilt-edged stock. There are two kinds of influences which improve a market. One is a host of small orders and the other is a succession of large orders. The immediate repercussion on the market of 500 orders to buy £1,000 is infinitely greater than one order to buy £½m., which will not help the market at all. Therefore one cannot really tell what is moving. The market might go up $\frac{1}{4}$ or $\frac{1}{2}$ because a lot of stock had been bought off the tap and that had advanced the tap price and everybody thought the market might advance; or it could be that the investor might be advised by his banker or broker or read in his newspaper that these rates were favourable and he might come in. Any of those things might move the market, but different factors and certainly very different amounts of stock sometimes move the market.

7891. If next Thursday the Bank Rate were put down to 5 per cent. and on the same day the Government made a further issue by prospectus of a fairly long-term stock at $5\frac{1}{2}$ per cent., what do you think would be the response, not just on the first day but during the first weeks?——I do not know. I think people would wonder what they were playing at.

7892. That would be the immediate reaction?——*Mr. Althaus*: I do not know. I would like to ask Mr. Greenwell how he would answer the question.—*Mr. Greenwell*: The hypothesis is that the Bank Rate is put down next Thursday by 1 per cent. to 5 per cent. and the Government that evening makes a further issue of short stock at $5\frac{1}{2}$ per cent.?

7893. That it makes an issue of a fairly long stock at a yield equal to that obtainable next Thursday morning; that is to say, they deliberately would not take advantage of the effect on markets of the drop in Bank Rate?——But they would be taking advantage; that is precisely what they would be doing.

7894. I am asking what advantage they would get. What response would they get?——That is a very difficult question to answer. The lowering of the Bank Rate by a half per cent. might tend to stimulate or create or maintain interest in the gilt-edged market more than if they actually brought it down by 1 per cent. One cannot tell until it happens what the collective feeling, which after all is not confined to this country, would be. The feeling might be that this was the end, and that we should stay on a 5 per cent. Bank Rate until after the autumn crisis occurs or passes or does not occur; or the feeling might be that the Government might soon see their way to come down to 4 per cent. That question I should not care to answer at all.

7895. There is no foregone conclusion?——*Mr. Greenwell*: None at all.—*Mr. Althaus*: As I said earlier, what matters is what people suppose to be the trend of the Bank Rate. 5 per cent. might mean one of several things according to what people expected to be the further trend.

7896. At present in trying to estimate the trend you have virtually nothing to go on in the way of public statements by the authorities. Might not the situation develop quite differently if the authorities did say a good deal of what they intended?——I think it might. Of course very much of a limiting factor is the extent of the demand for capital. An issue like the latest New Zealand one, of £5m. or £10m. for a municipality, according to the time it comes out and whether it is $\frac{1}{4}$ per cent. too dear or $\frac{1}{4}$ per cent. too cheap, may affect the market for the time being. If we are going to have very large loads of these things, and £40m. or £50m. for an oil company and so on, that will be a factor which will govern people a great deal in deciding whether or not they will buy gilt-edged at $5\frac{1}{2}$ per cent. or any other rate. It is a question of the availability of money. The insurance offices find it difficult to apportion even their large and growing resources suitably among the various contenders for the money.

7897. This pressure of demand for funds is of course a reason for a high yield on capital?——Quite. It was in connection with your theoretical lowering of the Bank Rate that I thought I should mention that, but it is rather hypothetical in that sense.

7898. *Professor Cairncross*: You were earlier laying a great deal of stress on Bank Rate as a factor in the movement of gilt-edged yields, and you have now drawn attention to other factors which are clearly of some importance. There was an initial period after the war when Bank Rate did not change and when the price of gilt-edged changed quite violently, and there was a later period in which Bank Rate did change and gilt-edged also moved, at some periods up but on the whole down in price. If you look back over the experience of the last ten years, do you think that Bank Rate has been one of the major factors determining the course of gilt-edged prices, or do you think other elements in the situation are more important?——I should say that the jump to 7 per cent. was certainly a major factor. I should think that the condition of the economy itself was probably much more of a factor in the previous years, except in so far as any doctrinaire view of cheaper or dearer money might come into the picture.

7899. When Bank Rate is changed is it the change in the level of Bank Rate that in your view is important in determining the reaction of the gilt-edged market, or is it some expectation about what may follow that?——I think it is the expectation of what may follow. The Bank Rate dots the "i"s and crosses the "t"s. There are occasions in which Bank Rate movements are discounted fully in advance; there are others in which they are partially discounted; and there are some in which they

are not discounted at all. According to people's expectation so will the effect of the actual declaration of the change be determined.

7900. *Chairman*: With the various forms of security in the gilt-edged market it seems that a change in Bank Rate is like a series of trucks shunting: it moves all the rates down the line. It affects the bill rate, which is a three-months rate, and then it stretches out year by year into the medium and long-term field. Do you agree?——It depends to what extent that has been discounted, and what the further expectation is. There was a recent occasion when Bank Rate followed the bill rate.

7901. *Professor Cairncross*: May I put the question to you from a different angle. Do you see any reason why short-term rates should approximate in any way to the long-term return on gilt-edged?——I think probably that would depend on the level of the market. When money is very dear the yields may frequently cross; they crossed, for example, in 1931; they crossed in some year in the 1920s; and they crossed at one time during this very hectic period. But that is really a matter of prices moving up and down a point or two with the undue effect which that has on the shorter securities as compared with the longer ones. When one has a sudden unexpected development the tendency is for the shorts to reflect the thing at once and to over-reflect it; a quarter or half a point may be knocked off or added to them because of some temporary difficulty of would-be sales or intending purchases or something. When the market settles down those things get straightened out a good deal. But I suppose at times the rates might approximate and at other times they might not. These are very difficult questions for me to answer at all satisfactorily.

7902. Do you think that a quite substantial reduction in short-term rates would in present circumstances necessarily have much effect on gilt-edged yields?——In so far as changes of rate in these different categories are reflected by rises or falls in the securities in that group, the almost inevitable result is that people who study these things find differentials which are excessive and adapt their policy accordingly. If in their judgment, which may be quite wrong, the yield on middle-dated stocks has fallen too much or, on the other hand, if it has risen too much, as happened when there were further bank sales not so long ago, then the thing does tend to adjust itself. I do not think one can lay down any rule about what does or does not happen; all one can say is that excessive movements in any direction in any particular group of investments attract attention and tend to be adjusted. That is not a very satisfactory answer, I am afraid, but it is the best I can do.

7903. *Chairman*: In paragraph 4 you call attention to something which you seem to feel ought to be avoided:—

"... and within eight months of their issue Exchequer 2 per cent. 1960 had fallen by 10 points to 90, and Funding 3 per cent. 1966-68 by 20 points to 80."

If you are going to have a flexible Bank Rate and a credit squeeze, which is part of the cause to which you attribute this, how can you avoid this kind of movement taking place? A violent adjustment shortly after the terms of issue had been selected for these two stocks was obviously highly embarrassing, but how can you avoid that?——I do not think you can avoid it. All we say in our memorandum is:—

"In fact, falls of this magnitude in newly-issued securities have at least temporarily shaken the confidence of important investors . . ."

I am not suggesting that monetary policy should be adapted to the convenience of the institutional or other investors.

7904. *Professor Sayers*: Are you not saying that monetary policy as it has been operated during the last years has in fact been very damaging to Government credit?——In the general context of what was happening to the economy.

7905. *Professor Cairncross*: Would we be right in interpreting what you say as meaning that any sudden or violent changes in long-term interest rates would be bound to react on the Government's credit with institutional and other investors?——Yes, I think that is a fair inference. Investors try to get into the background of their thoughts all the time the pattern of events, the pattern of cause and effect, and any cause which led to such dramatic effects as these is not an every-day event. Falls of 20 per cent. or more in British Government securities are after all dramatic effects. I think it is part of the pattern of what is in the mind of the investor, and therefore he probably remembers it when he comes to judge future situations.

7906. *Chairman*: Should one deduce from that that one ought to find a way of handling the thing which did not violently shake the Government's credit in that way?——Yes, but I do not see how you can. If they are going to use interest rates as part of their armoury they are bound to inflict these hurts. The fact is that these things change extremely rapidly. When Bank Rate as a weapon was not used in conjunction with a credit squeeze, and when, in the old years, £5m. or £10m. of gold went out and they put up the Bank Rate 1 per cent. and gold came in from Amsterdam, New York and Brussels the next day, the effect on the long-term rate was nothing; Consols might move a quarter of a point. The bill rate and the bond rate might change, but the long-term rate did not. Therefore in this new world, this painful world for investors in this respect, it is something of a novelty to find that a portfolio which is supposed to represent some measure of permanent security is capable of undergoing such violent changes. It is something which investors remember.

7907. Is not your comment directed to the violence of the adjustment?——Yes. We are merely trying in this preamble to paint the picture as it was, how investors were feeling, because we thought it might be helpful to the Committee. It is not implying any particular criticism about how the thing should or should not have been done, because I doubt whether stockbrokers would be very much better at doing it than anyone else.

7908. *Professor Cairncross*: Is it your view that the action of the clearing banks is of particular importance in relation to the movement of gilt-edged prices? Whatever one may think of what happened in 1955, would you say that, if the clearing banks were known to be buyers and sellers, this had a disproportionate effect on gilt-edged prices?——It would depend a great deal on what type of security was being bought. If, for example, they were buying a yearling or something like that, it would have no effect. If they were going for a ten of fifteen year bond, it might have a considerable effect. It would depend what kind of offerings there were. If, for example, they wanted Exchequer $5\frac{1}{2}$ per cent., 1966, that might be a thing which would be available, and there would be little effect. If, on the other hand, they wanted to buy £50m. of $2\frac{1}{2}$ per cent. Consols, which I do not think is very likely, the effect would be electric.

7909. The mere fact that they were net buyers in something with a life of more than five years would not of itself have any special significance?——That would certainly encourage investors, but it is always known that the banks have to buy at the most awkward moments and they have to sell at the least convenient time, and therefore the effect on an investor would not be quite so impressive as some other types of buying might be. But any buyer, whether it is a group of banks or insurance companies or pension funds, either by buying, or by selling, or by abstention from buying in certain circumstances, can influence the market. As I told you, the general body of small investors, if they suddenly come on, can have a tremendous effect.

7910. You would not single out the banks?——I would not single out the banks, although they can be very important; all those people can be of great importance.

7911. *Professor Sayers*: There has been something like a tradition in the past that Bank Rate normally goes up by 1 per cent. and down by a half per cent. If the presumption in the future were that the Bank Rate went up by 2 per cent. and down by 1 per cent., would you expect the disturbance of the gilt-edged market to be greater than it used to be?——People would probably be much more cautious before they bought. They might buy with greater enthusiasm when Bank Rate was 7 per cent., but they would be very careful about buying when it was 5 per cent. if they thought there was 7 per cent. waiting for them.

7912. *Chairman*: In paragraph 15 you refer to official operations by the authorities which you categorise in two main forms:—

"(*a*) Selling stock off the Departments' portfolios, e.g. stocks recently issued and still held by them,

(*b*) Purchase of the next maturity against sales of other stocks probably short dated."

Then you say:—

"These operations and the manner in which they are conducted, have become the predominant technical factor affecting the behaviour of the gilt-edged market."

Do you mean by that that it is the level of rates set by the current offerings of the stocks which are still in the Departments' hands which really determine the gilt-edged market's attitude towards yields generally?——In most circumstances I should say yes. But obviously where all the other conditions are unfavourable and there is no demand for the stock at all, and the economic situation deteriorates critically between the time of issue and the time of contemplated purchase, then it would not be true to say that. I must say once more that this is only a personal view; these are very difficult questions to answer.

7913. I appreciate that; on the other hand this is the Council of the Stock Exchange's memorandum and I want to be sure I understand what they are wanting to tell us?——I am quite happy about answering that question; it is just that the general range of questions is extremely difficult, and does not in all cases entirely arise from what we have written. I am answering the questions to the best of my ability; I do not pretend they are very clever answers.

7914. *Professor Cairncross*: In paragraph 20 you say: "tap stocks were sold at rising prices up to the very eve of the raising of the Bank Rate to 7 per cent."; that was last September. Is that intended to imply that anything untoward had been in progress before Bank Rate went up to 7 per cent.? Does this give expression to a grievance of the Stock Exchange?——I would not say a grievance. It is merely a perfectly straightforward observation that the taps were operating up to the eve of this dramatic change in Bank Rate. That did in fact mislead a great number of people, I have no doubt not intentionally.

7915. *Chairman*: That is consistent with what you said in your previous paragraph, that it really sets the pattern for the gilt-edged market?——Yes.

7916. *Professor Cairncross*: You feel this is inevitable in conditions in which the Government broker may have to be in the market all the time?——Of course the Government do make certain exceptions; they never for example deal on a Thursday morning.

7917. *Chairman*: That is rather a short period?——Quite, but it is just something that does not happen; it shows that they are aware there might be hazards for the people they are dealing with. I do not think anybody complains about it, because the market is there to make prices. If they have commitments in £1m., £5m. or £10m. stock and something happens, of course it is very unfortunate for them. Certainly on this occasion the market was caught very much on the wrong foot; probably if there had not been these sales right up to the last moment they might not have been caught on the wrong foot. There is no complaint about it; it is just a statement of fact.

7918. *Professor Cairncross*: Would you think it preferable that Bank Rate should be changed not at stated intervals or on specific days of the week but from time to time?——I can only guess, because it is before my time; but I imagine the present method must have lasted since 1694, and has appeared to be satisfactory in practice. To live constantly under the shadow of possible Bank Rate change would be very harmful to business. I should think myself; the devil you know is better than the devil you do not.

7919. *Professor Sayers*: In paragraph 27 you say: "The overseas investor is not at present a major factor in the gilt edged market." Is that true of the last year?——I think directly it is probably true. Of course there is no doubt that the 5½ per cent. Funding Stock has appealed to some non-resident funds; but where money is attracted from overseas as a temporary measure, it would go into the discount market. It might well spill over from that; the discount market might find they were short of bills and long of money, and they might then go and buy a bond and that once more, on the basis of this shunting which the Chairman mentioned, going from category to category, might go right through the list a little. I do not know what the operations of some of the oil sheikhs are; it may be that they are large investors from time to time. But taking it by and large, there is no evidence to show the foreign investor is keenly interested in gilt-edged stocks at present.

7920. In saying "the last year" I was deliberately taking in the last few months before 19th September. Was there no noticeable pressure of sales by the overseas investors in that period?——I do not think that there was. In so far as they were mobile I think they had already moved.

7921. In spite of Mr. Keswick's evidence before the Parker Tribunal?——Yes, I should have said so. I think that was a special case. Mr. Keswick, as I understood the evidence, applied a certain amount of personal pressure and appealed to patriotic feeling to stop people doing something which in fact they had been wanting to do for a long time, but I would not like to be at all specific about that.

7922. In the last year overseas central banks and currency boards are believed to have unloaded a certain amount of gilt-edged securities in the market. Would they be all short-dated bonds?——I should have thought as far as possible, yes. I could not say whether individual currency boards might not have got loaded up rather far ahead. Anyone who was likely to want to disinvest would probably have stayed as near to the shore as he could; but these are matters beyond my knowledge.

7923. *Chairman*: Then we come to your section 4. Do you consider that it would be feasible for nationalised industries' borrowings to be launched on their own credit?——I should have thought it was a very difficult task at present.

7924. I was not asking exactly on the situation at the moment. Is it that the amount of their borrowing would be inconvenient in general, or that the security they could offer would be unsatisfactory unless supported by government guarantee?——*Mr. Althaus*: I should say the answer to the second part is yes; and of course the amounts likely to be needed under their expansion schemes and so on would be so large that they would be beyond the resources of the ordinary issuing machinery, which can possibly take care of amounts up to £50m. or possibly £100m., but not more I should have thought.—*Mr. Greenwell*: It is quite out of the question for the nationalised industries to come to the market like an ordinary industrial company, because we have not yet got a yardstick for measuring whether they work at a profit or not. There could be such a yardstick, but it is not in existence for people to see. There is not the machinery in the nationalised industries to make them autonomous borrowers; it would have to be created. They could not borrow apart from Government permission; all sorts of questions have to be settled, as to whether they are going to get the capital or not going to get the capital, and all sorts of other questions. I should have thought that they clearly could not go to the market as autonomous borrowers at the moment. I do not think that size would necessarily militate against them coming to the market through other channels than at present. We have not had much experience of foreign government loans in the market on any big scale; but I think the size could be managed by a consortium of the issuing banks. What determines whether the size is to be big or not is the investor, and I think the investor would, like to be able to say that he had invested in railways, electricity, gas and so on again, which he cannot do today.

7925. It would restore diversity?——It would restore diversity and make allowance for people's likes and dislikes. Perhaps it would be a long business to do, but I think it is possible that if investors were given a chance to invest in this type of activity again they would like to do it. Undesirable things might happen; the credit of the railways might appear to be better than electricity, or *vice versa*; but that always was so. I think it would be possible that it could happen.

7926. *Professor Cairncross*: When the nationalised industries financed themselves in the gilt-edged market, were their issues at a price in line with that of direct Government issues?——*Mr. Greenwell*: Entirely.—*Mr Althaus*: They were Government guaranteed stocks.

7927. In the case of local authorities is there not a difference in the yield basis?——*Mr. Greenwell*: Yes; it arises partly out of sentiment and partly on grounds of marketability. Naturally, with an English borough which has a comparatively small debt, its securities are very tightly held by people who live in the borough and like the borough; so there is a narrow market and the price tends to be lower for that reason. It could be higher for that reason, but it tends to be lower because of unmarketability. Some boroughs appear better to outsiders than others; some counties appear financially more stable; but essentially it is all the same.

7928. It is not the fear of their not meeting their obligations?——*Mr. Greenwell*: No, not at all. It is sentiment and marketability.—*Mr. Althaus*: I agree. On the point of fear of default, there was a time when the West Ham Corporation took a different view about its obligations and the Ministry cracked down on them and took over at once.

7929. *Professor Sayers*: There was no default?——No, but that was their intention, as far as I recollect, and it was when the risk that something of that kind might happen arose that the Ministry intervened.

7930. *Professor Cairncross*: Recollections of that have no influence on the yields of local authority stocks?——No, none whatever.

7931. *Professor Sayers*: Would there not seem to be therefore some advantage from the point of view of public authorities and local government authorities borrowing entirely through the central Government, if there is this slight difference due to lack of marketability?——I suppose there might be from the Government's point of view, but I dare say the borrower would prefer to preserve his identity if he could. Those who have good credit will not necessarily want to cloak that by going to the central authority. It is one of these problems that arose over local loans and so on, but I do not think that any of these corporations are really keen on submerging themselves, as far as I know. They are proud of themselves; I think they run their business extraordinarily well, and they are prepared to stand up to the test of the market.

7932. *Chairman*: When you begin to deal with the question of local authorities' borrowing you say:—

"Owing to the enormous increase in their capital requirements, corporations and local authority borrowing has now become a major factor."

You do not want us to understand by that that there are currently a great many very large demands upon your market, do you?——No. They would like to if they could. There is a large queue of borrowers at the Bank of England, and from time to time, when the general condition of the market appears to warrant it, the Bank of England gives authority for an issue to be made. There is a general understanding that the terms must be agreed so that there shall be as little interference with or damage to the orderly marketing of securities as may be; it could be that in a competitive market one municipality might offer terms just a quarter or a half per cent. too dear, or five years or two years too long, and that might bring the whole gilt-edged market to a stop. Oddly enough if a municipal loan is a failure it acts as a damper; in that sense municipal borrowing has a great influence in the market.

7933. Who settles the terms for each intending corporation borrower; its own issuing house?——Yes, its own issuing house; but the issuing house is not entirely free. They must confer with the official representative, that is the Government broker, to agree the general basis and to get the Bank's authority. The Government broker is our go-between. He will say: "You can now go on Thursday week if you are ready, and if you and your people still want to; what terms are you thinking of?" Then the general basis of offering is agreed with the Government broker.

7934. The Government broker is acting on behalf of the Bank of England?——Yes.

7935. He keeps a list of intending applicants?——Yes.

7936. At that stage the actual proposed terms are not part of the list?——They are a matter for negotiation. Practically all these issues are done by brokers, hardly ever in any other way. The tentative terms are first agreed between the borrower and the broker. That will involve things which do not really affect the market, such as the spread, what expense ratio there is to be and so on, which includes the stamp duty and underwriting costs and so on. The basic proposition which will come before the public in the prospectus must be acceptable to the central authority. I would not suppose that they would say that half a point here or there was more latitude than they were prepared to grant; but the final terms agreed with the authority will be very close to the ones which are acceptable to the Bank of England.

7937. Does the time at which you get out of the queue depend on the terms you want to borrow on being more or less acceptable?——No, not at all. Place in the queue depends on a variety of factors; and there would be considerable priority for someone, for example, who had a maturing loan. There must be scores of would-be borrowers on the list; I could not say how many.

7938. *Professor Sayers*: Is not the queue generally known in the market to be very long?——Yes.

7939. Has it not been continuing for a very long time now?——Yes.

7940. Has not its existence been a "bear" factor all the time in the market?——A restraining factor rather than a "bear" factor, I should say.

7941. It has continually been a factor preventing the market from rising far?——I do not think it is entirely so, because if the trend of the market is all right then a loan probably is likely to achieve success and not to clutter the place up. It is when there is just a margin of doubt, which might arise either from the terms or from general uncertainty, such as bad news in the paper overnight or any one of a thousand things, that that just disturbs the very tiny margin between success and failure. It is only a tiny margin; the thing is either a great success or a dismal failure.

7942. But the long continuance of this great queue suggests there have not been very many times, or not very long times, when the queue could be unloaded a bit?——I think that is probably right. They are anxious for them to come as fast as they can, but then along comes £20m. New Zealand, or £50m. or £60m. for Shell; they all affect what is going to be practicable in the gilt-edged market.

7943. *Chairman*: How many local authority borrowings have been let loose in the last six months; four?——I think a little more than four, but not many; about half a dozen. I cannot quite tie it down in terms of time, but they are fairly modest in number.

7944. And one borrower can always get put back by some other kind of borrower having priority, as you say?——One of the factors restraining municipalities has been the penal rate from their point of view. They have gone to great lengths to borrow seven-day money at 7 per cent. and things like that, which is obviously not an entirely healthy state of affairs. There is always the mortgage market as an alternative. Investment there also is obviously limited; if the rate is right, the money is probably there, but the municipalities have been unwilling to commit themselves for twenty years, which is really what the lenders have wanted, at 6 per cent. or more. That is partly why everything has been gummed up, and why there has been this tremendous amount, which some people say is as much as £700m., loose in seven-day money.

7945. You say in paragraph 40: "Corporation and local authority financing is at the present time one of the most important problems affecting the gilt-edged market." One therefore wants to see what possible alternatives to putting them on the gilt-edged market there are. One possibility which you mention is the system of borrowing by tender. Who uses tender today?——Water companies; I do not think anyone else at all. The tender system was probably very appropriate for small borrowing but quite possibly not for large. In view of this difficulty we suggested that other methods might be examined. For example, the kind of thing which might happen is that the permissible discount on the issue of stock might be widened so that a municipality could issue a 3½ per cent. stock at 80, as the Government did in two instances. That might appeal to funds which assess their yield on the net basis. A large number of these municipal loans are written by insurance offices; most of the insurance funds are net funds, and they are not really keen investors in these sort of things. Or there might be a consortium of small municipalities, to get them out of the way; or we might revert to the issue of local loans. We might have all sorts of ingenious things

like rate-compounded loans. But I do not think in the end that we are going to get away from the fact that there are not enough savings to enable these people to come in in a steady stream.

7946. How do you market an issue by tender? Is it done through the broker?——Yes; I have very little experience of this technique.

7947. It works satisfactorily?——Yes, but they are rather modest amounts, and a tenderer does not know whether he is going to get invested. The borrower knows within limits that he is going to get the best possible price, because if the broker does not get him the best price possible he is not going to be used again. I doubt whether the tender method would really achieve anything. There would still be stock overhanging the market, whichever way one did it. We suggest examining these methods because they may be some help to the problem, but basically the thing is that there is not enough money for all candidates.

7948. *Professor Sayers*: You use the term "orderly marketing" in paragraph 37 in relation to the queue. That is presumably not your phrase: you are quoting something there?—Yes.

7949. When the queue is a very long queue for a very long time, it is not possible to argue that its purpose is to secure orderly marketing?——That is the claim; and I think in fact that, if one threw all these borrowers on the market they would possibly all get the money, but it might be at 10 per cent. or 15 per cent. If it is in the interests of the Government to keep rates at a certain level they will not do it by having constant offerings of fixed interest securities on the same basis. They all fail after a certain point.

7950. It is a matter of protection of the existing level of gilt-edged prices?——Yes.

7951. *Professor Cairncross*: In paragraph 43 (1) you say: "there is great difficulty in the marking of securities of companies with balance sheets totalling under £250,000." Is the figure of £250,000 intended precisely?——*Mr. Greenwell*: No; it is just that it is more difficult to market small amounts than large. It gives rise to scandals very often; one has to have an introduction, one cannot spread the thing widely enough to begin with, and if it is good not enough people get the shares.

7952. It is not just the cost you have in mind?——Not entirely; it gives rise to these positions that one sometimes gets when a share is introduced to the Stock Exchange, because it is too small to put on a prospectus to the public. One has to find some means of getting it to somebody. Whoever gets it has an immediate profit, perhaps; when they do it is considerable, and when they do not it is not. In any case it is expensive.

7953. Companies with balance sheets totalling £250,000 might be able to get private placing of their shares. You are speaking here of marketing on Stock Exchange quotations?——Yes; placing is not really our business. Our business is to deal in shares that are quoted rather than ones that are not. In fact we do deal occasionally in stocks and shares before they are quoted; for example, the capital for commercial television had to be raised privately because it was too speculative to do otherwise. But broadly speaking we do not concern ourselves until the thing is ripe for proper quotation.

7954. What would the figure have been here before the war?——Approximately the same, I should think.

7955. In money terms?——I should have thought so, yes.

7956. In that sense you are able to market securities in smaller companies now than you did before the war?——Because there is a change in the value of money, yes. In fact there was a great deal more marketing of smaller amounts than that. It was done, and led to scandal, and had to be stopped, in various periods of Stock Exchange activity; just before 1929, for instance, undoubtedly a large number of small companies, that ought not to have seen the light of day, did. Now it is made very much more difficult for those propositions to get into the form in which they are dealt with on the Stock Exchange.

7957. You have tightened up the regulations?——Very much indeed.

7958. You do not see any way round this? There is bound to be difficulty dealing in the shares of small companies?——If you have in mind the question of issuing small amounts of capital for small companies on the Stock Exchange, I would not entirely regard it as a difficulty. There is a type of security which is probably better not dealt in on the Stock Exchange from the point of view of the protection of the investor.

7959. You refer to the I.C.F.C. and you suggest there is room for expansion in this field. I am not clear what you mean by expansion; would you like to see other institutions compete with I.C.F.C., or the I.C.F.C. itself doing more business?——We feel that the principle of the I.C.F.C. is a good one; it is a protection to the public, and a help to the small business man in getting his business from a one-man business into its final stage. There is always the type of person who comes to us, and we advise him to go to I.C.F.C. as the first step; he may he somebody with £50,000 or £60,000, and wanting £100,000. We had not thought out anything very constructive when we wrote those phrases.

7960. Do the clients to whom you give that advice come back satisfied or dissatisfied?——I would say they are satisfied, although they often do not come back to thank us! I have never heard of anybody being dissatisfied with that advice. That is always a very dangerous stage for a man who has worked a business up himself, when he wants to borrow more money and he will not, or cannot, go to his bank. That is the moment when he can get into wrong hands. In a sense he has got to take a partner. He is a man who has needed to know nothing at all about finance, and he may get into difficulties.

7961. It is very important to see what can be done about these people at that stage in their business career. I had the impression that a large number of people who would have liked money and were recommended to I.C.F.C., were not successful in inducing I.C.F.C., to put up money, although they might have had reasonable prospects in present circumstances. I wondered whether that affected your belief; whether you thought that, if there were some competition and the man could go to an alternative, he might persuade one man where he failed to persuade the other?——That is a very big question. I have absolutely no doubt that there are plenty of other sources; what they are it is not my business to know, and I do not know, but I have not any doubt. People are getting loans today which they cannot get either from banks or insurance companies; an entirely new lot of people are doing loans even on house property.

7962. At very high rates of interest?——Yes, naturally. I imagine that in the same sort of way people who find they are turned down by the I.C.F.C. can and do go elsewhere.

7963. Would you agree that the people who come to you with a capital of under £250,000 are not always very knowledgeable?——Usually they are the reverse of knowledgeable.

7964. They may not know who to go to. Their banker is the first person they would approach; but if they want fixed long-term capital the banker might not be prepared to give them what they need. The I.C.F.C. would be the next institution to recommend them to. After that is there very much, apart from institutions that lend on onerous terms and might not really be designed for this purpose?——That is the position as I see it. Of course, there have been people who have managed to get over that difficulty long before there was any I.C.F.C. There was the classic instance of Lord Nuffield, who at one time made the jump from bicycles to a motor firm. He never came near the City until much later.

7965. Taxation was rather lower then; it is more difficult nowadays to indulge in self-financing?——Possibly; but I am never quite prepared to concede that point.

7966. *Chairman*: Do you think Lord Nuffield received help from the class of investor with an annual surplus income?——Yes, I think he did. I know one or two of the investors.

7967. He would find the money because he had local contacts, and he was a young man with an idea.——Yes; and he found fixed capital too, because he never lost any of his equity.

7968. Do you find with these people who come to you wanting more money that one of their great fears is that if they get more money they may lose part of their control?——Yes, very frequently. That is almost the first thing in the mind of a man who has built up his own business.

7969. If I have understood you, in the case of the small companies there is a difficulty that if you are going to put their shares round you will have trouble on the basis of allotment; and also you could not generate a free market?——That is another thing. It can lead to undesirable results in many ways.

7970. *Professor Cairncross*: In your experience, do you think the insurance companies, the investment trusts and other institutions do provide substantial sums for small firms?——Insurance companies I would say not. One of the many things governing insurance companies is they dislike intensely being in a position where they might ever have control of a company. They avoid that deliberately, as a matter of policy. I expect instances could be cited of an insurance company doing that, but I doubt if they would take the equity of a small company. Sometimes they do, if there are special reasons, but broadly speaking they prefer not to.

7971. You think it would be more normal that they would take a block of shares giving them 10 per cent. or 20 per cent. interest in the company?——Yes; they would not like a big interest.

7972. *Professor Sayers*: Is the Government broker your sole channel of communication with the monetary authorities?——*Mr. Althaus*: I think the Chairman of the Council always has access to the Governor of the Bank of England; and one of the Deputy Chairmen keeps in regular contact with the Bank of England on any material points. But if I wanted to make an issue for somebody (not only an issue for a municipality but any sort of issue), I would want to seek the approval of the authorities; and if Mr. Greenwell were handling an industrial issue he would want to be on the right side of the authorities over the time of issue. We should do that with the Government broker.—*Mr. Greenwell*: More than that, we have to have permission. We must go to the Government broker for our place in the queue. If we do an industrial issue, as we are doing at this moment, we must go to the Government broker and say: "We wish to raise £2m. or £3m. on debenture for a limited company; here is our time table, will you approve it?" It is approved for, say, today. We are not aware that New Zealand may be coming into the market for £20 million the same day; we are given our place in the queue. It is not a place in the queue in a sense, because the queue is a queue of corporation, Government and colonial borrowers, and the industrial requirements have to be fitted in on top of that. Industrial requirements sometimes are more and sometimes less important from the point of view of the Government broker.

7973. Would the contact of the Chairman and Deputy Chairman of the Council of the Stock Exchange with the Governor of the Bank of England be limited to matters of the rules of the Exchange, practice on the Exchange and so on, or would their discussions have a wider field?——*Mr. Morley*: They would be on general policy, but not monetary policy.—*Mr. Althaus*: On any matters of interest to the City.

7974. Do you mean that Stock Exchange opinion about the way the Government is conducting its business generally might be represented quite informally through this channel?——*Mr. Morley*: It might be, but I do not think any such representations have been made; I think it is more on day-to-day matters.

7975. Otherwise it is all done through the Government broker?——*Mr. Greenwell*: Yes.

7976. It is a matter of getting approval, not merely a matter of discussing?——As far as timing is concerned it is a question of the approval of the Government broker. So far as terms are concerned it is a question for the C.I.C. We have two fences to get over.

7977. *Chairman*: Is it in fact a standing condition of the C.I.C. approval that you should get the Government broker's approval of your date of issue, or is that not applied to industrial issues?——The two things are both necessary; as to which comes first, I would have thought one cleared the C.I.C. first before one wasted the time of the Government broker asking for a date.

7978. Does the C.I.C. make a standing rule when giving approval that you have to clear your date of issue with the Government broker?——I ought to know the answer to that offhand; I would have thought that was one way it happened.

7979. If there is a C.I.C. condition, what happens to you if you do not get the Government broker's approval?——That has not arisen, because this is not under our own rules; it is purely permissive. There are very few people about who like doing things that upset the Government broker; I do not think it would be good business to do it. You might be forced to do it by a particularly violent borrower.

7980. *Professor Sayers*: Had not the queue, and the business of agreeing a date with the Government broker, already come into existence before 1939 for some issues?——*Mr. Althaus*: It certainly existed in the case of municipal issues.—*Mr. Greenwell*: Not for industrial issues. I do not know about foreign loans, but I do not think it applied there.

7981. Did it not apply to foreign loans? There was the Foreign Transactions Advisory Committee, which was the forerunner of the C.I.C.?——I do not know.

Chairman: Thank you very much, gentlemen; we are very grateful to you for your memorandum and your attendance this afternoon.

(*Adjourned until Tuesday, 6th May, 1958, at 11 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-FIRST DAY

Tuesday, 6th May, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

GEORGE WOODCOCK, ESQ., C.B.E. (Questions 7982 to 8075 only)
SIR JOHN WOODS, G.C.B., M.V.O. (Questions 7982 to 8075 and 8143 to 8210 only)
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

THE VISCOUNT MACKINTOSH OF HALIFAX, D.L., J.P., President and Chairman, E. C. H. JONES, ESQ., C.B.E., Secretary, and H. G. D. GABRIEL, ESQ., representing the National Savings Committee, and SIR JOHN MAXWELL ERSKINE, G.B.E., D.L., J.P., Chairman, and A. GARROW, ESQ., O.B.E., Secretary, representing the Scottish Savings Committee, called and examined.

7982. *Chairman*: We have two memoranda in front of us, the memorandum from the National Savings Committee and the memorandum from the Scottish Savings Committee.* We have all read them, and looked at your figures and graphs, and seen what questions we would like to ask you on them. Would you like to take the two memoranda separately? That would mean separate questions about Scotland, after we had run through the National Savings Committee's memorandum.——*Lord Mackintosh*: Shall we try taking them together? We do everything together.

7983. We will not tie ourselves down, then, if any questions about Scotland arise as we go through the National Savings Committee's paper. One realises, reading through your memoranda, that the habits of different sections of the population are vital to your savings movement, and you must get a great deal of information about habits, and what people respond to, from your widespread organisation; hut have you conducted regular sample inquiries through any of these or other special agencies? You refer to the Oxford Institute of Statistics at one point?——One of our difficulties is that we have not got exact statistics, apart from the Oxford survey, and the one by the Central Statistical Office, both of which are somewhat out of date now. We should like (I think everybody would) to have a lot more statistics on personal savings. As it is, we have to feel the pulse of the people through our 200,000 groups; we get a very close idea of what the public are thinking, hut it is not statistical, and some of the conclusions we come to may not therefore be strictly accurate.

7984. You have to go by impression, but it is impression based on widespread contacts?——Yes.

7985. Do you aim to conduct any regular statistical inquiries?——Only through our own workers. For instance, when we started on television advertising for the first time, we had a number of workers form themselves into panels in different parts of the country. They go round asking the members of their groups what they think about the television advertising, and things like that. We are not as good as we should be on the statistical side. It is not our fault; we have not got the money or the organisation. We should need Treasury help to get more exact statistical information. We should like to have it very much.

7986. *Professor Sayers*: If you had Treasury help, do you think you have got the basic organisation which would enable you to expand this part of the service?——*Lord Mackintosh*: No, I do not think we have. The men and women in the street groups are not trained to it. We should have to go outside for it.—*Sir John Erskine*: I quite agree.

7987. *Chairman*: Do you both think that you would be in altogether a stronger position if you had, from time to time, statistical enquiries conducted about savings habits?——*Sir John Erskine*: I think it would be very interesting to us, hut I do not think it would be of any very great practical advantage to the movement as presently constituted. We are limited in the field in which we operate. It would certainly be exceedingly interesting to get general statistical information, but I could not see it being justified as an expenditure in our movement. —*Lord Mackintosh*: I was going to say the same thing. I think it would help us when we come before a Committee like this, and it would help the Treasury, but I do not think it would have very much practical effect on our day to day work.

7988. One of your papers outlines a number of possible new forms of national savings and ways of adjusting them to suit particular needs or motives; your inquiries into that would not materially be helped by statistical information?——No, I do not think so. Half the time we are working with the psychological factor more than the economic factor, in dealing with our total of nearly ten million members.

7989. *Professor Cairncross*: You say in paragraph 2 that "the greater part of the total [*sc.* sum outstanding in National Savings] is owned hy a small minority of the total holders." Would you say there has been any greater spread in the post-war years than in the pre-war years?——*Lord Mackintosh*: Yes, undoubtedly.

7990. You think that the holding is less concentrated now than it used to be?——*Lord Mackintosh*: Very much so.—*Sir John Erskine*: Very much so, and growing. —*Lord Mackintosh*: I should think that before the war it was confined largely to the well-to-do, and self-employed persons, such as the shopkeeper and the farmer. The great expansion has been in the factories. We always had the schools, but our expansion in factories is much wider, and there were no street group organisations before the war.

7991. When you say that "about half the adult population hold national savings in one form or another", do you not think the proportion might have been just ahout as high before the war?——*Mr. E. C. H. Jones*: We have no statistics that would help to answer that question.

7992. Would it be your impression that the proportion of the population that holds national savings in one form or another is greater now than before the war?——*Lord Mackintosh*: Very much so. During the war, we must have douhled or trebled the number of people holding National Savings.—*Sir John Erskine*: In Scotland in the coal industry some years ago we found very little organised saving. That now is steadily growing. We get quarterly statistics, and each quarter shows a grester number of savers and greater individual savings. That has never gone back since we started to keep records of it.

7993. The total of national savings, in the forms that you cover, does not appear to have shown very much of an increase in the last ten years. The change, therefore, must have taken place during the war. Have you noticed any continuing movement since the war?——*Lord Mackintosh*: It jumped up, from 1938 to March, 1946, by

* Memoranda of Evidence Part IV Nos. 7 and 8.

£4,000 million; from then to today it has only gone up £700 million. In the last ten years it has only gone up £300 million, but of course it is an entirely different thing. During the war it was easy; there was plenty of money, and the patriotic appeal was overwhelming. We only had to put the guns and the 'planes in Trafalgar Square and people could see what the money was for. Today we have to talk about the dollar gap and inflation, which is a very different story, and there is every inducement to people to spend their money. I think it is wonderful that we have made any progress at all.

7994. *Mr. W. E. Jones*: It is essential for you to work hard and go with some speed to maintain the balance of savings, because there are substantial withdrawals. You are doing reasonably well in that field; in any case you are not going back, at any rate at the moment. To what extent, in view of the fact that national savings are held to the extent of about 80 per cent. of their value by something like 20 or 25 per cent. of the holders, do you think that national savings are being secured from other branches of investment, particularly having regard to the new limits of holdings of Savings Certificates? Is there a transfer from other forms of investment to national savings?——Yes, it is going on all the time. There are three classes of savers. There is the well-to-do saver: the surtax payer who buys his quota as soon as there is a new issue, because it is very much in his interest to do so, and who would do a great deal more if there were no limits. I do not know what is the percentage in numbers of those. Then there is the self-employed man, such as the farmer and the shopkeeper. He probably owns as much as the very rich man. Those two are interest-conscious. Then by far the greater percentage in numbers, perhaps 75 per cent., are the genuine small savers. The changing about between one security and another, into building societies and then back to us, is mostly at the top end. The middle-class person does a little bit of it, and probably the small saver is not influenced very much at all.

7995. Would Sir John say the same for Scotland, that when the limit on the holding of National Saving Certificates is raised, there is a transfer of savings from one form of savings to another, to the advantage of the national savings movement?——*Sir John Erskine*: There is no doubt about that. When an opportunity arises for further investment in some of these securities with which we are dealing, there is an influx of money from the better able-to-invest class. They switch from another type of investment to this particular one. It always happens, each time there is a change in the ability to make an investment. It inflates our figures and it upsets comparisons to some extent, because a great number of small savers are not affected by that.—*Lord Mackintosh*: There is some switching between our own securities, for instance between the Trustee Savings Banks and the new Defence Bonds out this week. Some of the money comes out of our friends the Trustee Savings Banks, but they do not really mind, because that is what they are there for, to provide a place for the amounts to accumulate; then we try and get them into a more permanent form of investment where they are likely to stop for seven years. A man puts his few shillings a week into a group in a factory; then he gets £50 or £100 and he buys some certificates, and then, when he gets £500, he buys some Defence Bonds. There is something for everybody. We get competition from building societies, and in the North from local authorities; Yorkshire and Lancashire people are very fond of investing with local authorities, and quite rightly so. Their competition helps to increase savings; there is switching, but I think the end result is that there is more saving than there would be otherwise.

7996. *Chairman*: You make that general point in your third paragraph, where you say that with all the movement to and fro between different forms of savings media, particularly with the help of the group system, you think you have savings which would not have taken place at all otherwise?——Certainly.

7997. *Professor Sayers*: Leaving the switching aside, and looking at the formation of savings habits, what young people who are just beginning to earn good money are doing is something very important, from the point of view of the future of the savings movement. Is your impression that among such people the savings habit is more or less developed now, as compared with ten or twenty years ago?——*Lord Mackintosh*: I would think that it is developing, although not as fast as we would like. Before the war young folk probably had very little to save. Now so many of them get such very large salaries that between 18 and 25 they are probably as well able to save as they ever will be in their lives. We have a committee sitting now, to look into the question of encouraging and helping savings in youth, and we are interviewing all sorts of workers and youth organisations of any sort. We have not neglected them; we get them in the schools, we get them in the factories, and we get them when they go into the forces. The savings in the forces are very good; more than 50 per cent. of all service men are saving regularly. But we feel we could do a great deal more. I think it is growing, but not growing quick enough.—*Sir John Erskine*: We are conscious of the importance of the educational side, of getting into young people some idea of the use and the appropriate handling of money, and we have been helped very materially over the years by the school teacher. If one attends a gathering of savings workers in Scotland, one finds a very large proportion of both men and women teachers throughout the whole of the country. Very often in these small country schools the teachers have carried on their savings groups, and have continued to make them available to former pupils who have left school, and who continue to save through these agencies. We have appreciated very highly the help we have had from the teachers. But in fairly recent times, as a result of the dispute with the Educational Institute of Scotland on the matter of salaries and pensions, the Institute decided to advise its members to discontinue the collection of savings in schools. The argument is that the teachers have specific duties, to which this savings duty is rather disturbing. We had hoped that that ban would be withdrawn, but there was a newspaper report on the 3rd May, which read:

"Scottish teachers are to continue the ban on the collection of national savings in schools, a motion that it be rescinded having been rejected by a large majority at a meeting of the Council of the Educational Institute in Edinburgh. The movers, representing Angus local association, argued that enforcement of the ban was a serious matter in remote places, where there were no other facilities for saving. Mr. Kenneth Macdonald, Glasgow, moving the successful motion, said that the Institute's members were teachers, not bankers or money collectors, and they needed all their time for the job for which they were paid. Practically every village in Scotland was provided with a Post Office, where parents could use the facilities of the Post Office Savings Bank."

That is the up-to-date decision of the Institute, and we are sad about it, because it is not so much just the collection of the savings, but the educational aspect of the matter, which is so important. But it is fair to say that, although there is that official ban from that body, there are many teachers who are carrying on despite that. They have not all given up, by any means, particularly in country schools.—*Lord Mackintosh*: We are not as badly off in England. We had a temporary ban while the teachers had their disagreement with the Ministry of Education on pensions, and for about eight months they did suspend collection in school groups; but 80 per cent. have come back. But the educational system is in the melting pot at the moment in many ways, and we feel that one of the best ways is to take a long view and to re-educate young teachers coming in, not about the importance of the national savings movement, but the importance of young people learning how to manage their affairs. That is a national educational function. I am in communication with Philip Morris, the Chairman of the Committee of Vice-Chancellors, who has promised to help us in the universities in the country by having in our speakers and taking in our literature. The schools were our main support in the first stages of this movement; they were the mainstay of the movement and we do not want to lose them.

7998. *Chairman*: You attach great importance to your group system in the organisation of national savings. Could you enlarge a little upon what the organisation involves? Is it mainly in places of employment?——We start with the schools; there our work does not raise a lot of money, but is very important educationally. During the last 40 years many generations of school children have

passed through, the great majority of whom must for some years have been members of the savings group; it means that more than half the population of the country have been through it. We think that is most important from an educational point of view. Next come the street groups; over a million houses are visited every week by one of the voluntary workers, to collect 2s. 6d. or 5s. from the housewife. That is educational, too, because if you get Mother on your side, she has a word with the younger members of the family who are working, and with Father too. But 80 per cent. of the money comes from group savings in places of employment, where money is earned. That is obviously the psychological moment to get it. We would like more, of course; our trouble with this factor is that, while we have fairly good coverage in places of employment employing 500 or more, nearly 80 per cent. of the population works in places with under 500 employees, and they are much more difficult to organise. We do not know whether the Treasury, through pressure on the Trustee and the Post Office Savings Banks, might get them to give a little more help. The trouble with the small firms is that they have not enough spare clerical staff to do it. They have probably only a couple of girls in the office, and they cannot put anybody else on the work of collecting savings. But if we could double the number of our groups in the small places of employment, we would touch a lot more people. Then we have the groups in all sorts of clubs; women's clubs, women's institutes, townswomen's guilds, rotary clubs, and clubs and pubs generally. Then there is the savings section in the forces, of which Air Chief Marshal Sir Hugh Saunders is head. So we have eight or nine million people every week saving through our groups, with 200,000 voluntary workers. But that is only where it starts. Take my own firm, where there are 5,000 workpeople, with 84 per cent. of them in the savings group; they save £200,000 a year through deductions in pay, but they save another £200,000 privately through the local Savings Bank. If they get a little windfall or legacy, or something like that, they will put it in quietly; they do not want their pals to know that.

7999. In paragraph 5 you give a figure of £6,300 million for the total outstanding of national savings, and a figure for the average withdrawals per annum over the past five years of £1,224 million. So over the five years, just about the whole of the aggregate sum invested has been turned over. Is that not a heavy range of withdrawals? Does it surprise you? Is it heavier than earlier years?——No; we expected heavier withdrawals when the war ended, and when the goods began to come back into the shops.

8000. *Professor Cairncross*: Is not that a little misleading? Surely these are withdrawals which are counter-balanced to a large extent by deposits by the same persons. When you speak in this paragraph of new savings, you are presumably thinking of new savings by different people, but in practice there might be a good deal of depositing money with the Post Office Savings Bank or the Trustee Savings Bank, and a subsequent withdrawal in the course of the year. Are you in a position to make a distinction between the two types of withdrawals? Do you know how far seasonal withdrawals account for this large figure?——We do for the Savings Banks. This huge turnover comes because of the savings in the Post Office and the Trustee Savings Banks. It is a much smaller turnover when it comes to Savings Certificates and Defence Bonds; and Premium Bonds, strange to say, have the smallest turnover of all; it is less than 3½ per cent. per annum. The banks are becoming used more and more for semi-current account purposes. A lot is taken out for Christmas and a lot for holidays; but there is a surplus left, and an increasing surplus each year.

8001. The weight of this figure falls on the Savings Banks side?——*Lord Mackintosh*: Yes.—*Mr. Gabriel*: In the past year or two, particularly, the weight has tended to fall on the Certificates as well, because of the credit squeeze. I think we have suffered quite a lot through lagging in the variation in the rates of interest on our own securities. Previously we suffered tremendously on the Savings Bank side, particularly as a great deal of the post-war gratuities of the fighting men went into the Post Office Savings Bank, and then, when the goods came on to the market, there were very large withdrawals of those gratuities.

8002. You have not at any time attempted in the post-war years to take these two opposite tendencies apart, and see how fast some people were using up their savings, and how others were accumulating fresh savings, have you?——*Mr. E. C. H. Jones*: We could only get this type of information from social surveys; the only evidence we have to offer derives from general impressions.

8003. If you have these general impressions, would you not have expected that, once the savings, built up in war-time and unexpended, had been used in the post-war years, the residual savings would have begun to show themselves in additions to the total of actual savings, where, in fact, you have had no very spectacular increase?——*Mr. Gabriel*: I think that would have happened after the with-drawals from the Savings Banks towards the beginning of the 1950s; but then with the introduction of the policy of monetary control, raising the rate of interest and so forth, from 1951 onwards our figures have been very much affected by the variations in the rates of interest. In other words, the people who would be saving through the Savings Banks, the withdrawals having taken place, would then have started to accumulate again; but the figures were offset by the very large withdrawals which have taken place from the Defence Bonds and Certificates I have mentioned, particularly in the last year or two.

8004. You make this point in paragraph 8, and you cite the years 1952-53 in evidence; but the graphs suggest that the movement in the aggregate represented the outcome of very divergent tendencies in the constituent items. There was very little change in the trend in Trustee Savings Bank deposits in that period; Defence Bonds went down steadily; the Post Office Savings Bank deposits took a bit of a plunge which continued, and National Savings Certificates actually increased after a dip. Is it not a little accidental that the years 1952-53 should have shown a net diminution in total small savings?——*Mr. Gabriel*: I think there was also another factor which first came into the picture in 1952-53, and that was the fact that taxation on the Post Office Savings Bank interest began to take its effect on depositors. There were a lot of withdrawals, and people resented the fact that they were having to pay tax on the interest. A lot of money was withdrawn from the Post Office Savings Bank at that time in 1952-53.—*Lord Mackintosh*: During those years our rates of interest on most securities were a bit out of line. One cannot sell goods if they are not worth buying; at that time our goods were a little bit shop-soiled.

8005. *Chairman*: But if you throw the emphasis on the rates of interest being out of line with other things else-where, are you not telling us that your investors in national savings are greatly interest-conscious?——*Lord Mackintosh*: Much more than they used to be.—*Mr. E. C. H. Jones*: The figures for the Post Office Savings Bank are not the best possible guide to the movement of small savings in the post-war years, for two reasons: (1) war gratuities were paid into accounts in the Post Office Savings Bank, and that must have accounted for a good deal of money coming in and going out during the imme-diate post-war period; and (2) during the war building societies were allowed to place large sums in the Post Office Savings Bank, and withdraw those amounts over a period of years after the war. The Post Office Savings Bank figures are vitiated to some extent by that kind of thing.

8006. *Professor Cairncross*: If you take the period from 1950 onwards, in the Ordinary Departments of the Trustee Savings Banks they were paying 2½ per cent., and the Post Office Savings Bank in fact was also paying 2½ per cent. The trend is very markedly different in the two institutions; so is it not clear that the rate of interest alone does not account for the movement of the funds in the two institu-tions, which are the two largest we are discussing?——*Lord Mackintosh*: I agree; and there is the better service which the Trustee Savings Banks are able to give. That is through no fault of the Post Office officials; it is just the nature of the beast. The Post Office has a hundred and one things to do, whereas the Trustee Savings Banks have nothing to do but look after the interests of the depositors. That gives them very much the edge on the Post Office. Then, latterly, they have had the Special Investment Departments, where they have been able to give up to 4 per cent., which the Post Office have not done.

8007. You do not give us in your memorandum the rates paid in the Special Investment Departments, since 1953. Could these rates be made available to us?——Yes. Of course, different banks vary; since the Bank Rate went to 7 per cent., some of them have gone to 4 per cent. and some even to 4½ per cent.

8008. *Chairman*: Each bank is at liberty to fix its own rate in the Special Investment Department?——Yes.

8009. Since 1949 there is a continually rising line of deposits in the Special Investment Departments. Over that period there must have been varying rates of interest being paid on those deposits. You say that since September, 1957, they have reached 4 per cent. or more; is that the average of the rates paid?——No, I think that is more than the average. I was talking of the top rates. The average would still be under 4 per cent. But the Trustee Savings Banks will have more information on that.

8010. *Professor Sayers*: That accounts for the increase in the Special Investment Departments; it does not account for the rise in the Ordinary Departments, on which the 2½ per cent. rate applies, in 1949-51, at a time when the Post Office Savings Bank was still coming down very sharply?——That is the time when they were beginning their biggest period of expansion; they were opening several hundred new branches a year. For the first time they had really gone to town on new branches.

8011. *Professor Cairncross*: The proposition put to us in paragraph 8 is that a rise in interest rates was responsible for the dip in national savings in 1952-53. Does that explanation quite agree with the sharp rise from 1954 to 1957, when interest rates were again rising steeply?——*Mr. Gabriel*: It is a question of whether our rates of interest keep in line with the general level of interest rates. Sometimes our securities lag behind the rise, and if variations take place rather rapidly our securities do not follow quickly. For instance, we have only just had a change in the Defence Bond rate. It had been the same for two years, but during that time the rates of interest varied considerably, with the result that there have been repercussions on our figures.

8012. But for the years quoted, 1952-53, the rates of interest did not change very greatly, as compared with the change between 1955 and 1957. As I understand it, it would be necessary to show each of the savings media here to show the movement, and that is not very apparent?——*Mr. E. C. H. Jones*: The Trustee Savings Banks provide services to the local inhabitants; for example, they accept cheques in payment of wages into the bank, and they pay the rates of members having accounts in the bank. The amount accumulated in these banks is attracted by that kind of thing, probably more than by the rate of interest paid.

8013. *Sir John Woods*: Does not that imply that the rate of interest, at any rate so far as the Trustee Savings Banks is concerned, is not as important as all that, and that the giving of the service will outweigh it?——Except that it is significant that there is a steeper rise in the Special Investment Departments, than in the Ordinary Departments.

8014. I was not saying it had no importance; I was doubting whether it had the importance you attributed to it in this paper?——*Lord Mackintosh*: For the ordinary small saver, the worker who is saving out of earnings each week, who is really our main concern, I put the factors in this order of importance: first of all, security; they want to feel that the money is safe; secondly, they want to feel able to get it when they want it; and only third, the rate of interest. They seem more conscious of an income tax concession than of an extra ½ per cent. on the rate of interest.

8015. *Professor Cairncross*: There are four graphs in front of us; the Post Office Savings Bank and Defence Bonds show a downward trend, and the Trustee Savings Banks and Savings Certificates an upward trend. In the two that show a dip, I think it is your contention that either there is considerable interest sensitivity, or else there are other circumstances which would lead you to expect a reduction, as in the case of the Post Office Savings Bank. In the other two cases, National Savings Certificates and Trustee Savings Banks, you are dealing much more with the savings of the average working man, and in those two cases you have had a continuous rise with some reaction to interest rates, but perhaps not a very swift or marked reaction?——*Lord Mackintosh*: I would agree with that.——*Sir John Erskine*: So far as Scotland is concerned, Scottish people are very conscious of the Trustee Savings Banks, which have been established many years in Scotland. In so far as groups are concerned, and the development of groups in places of employment, and so on, a very large part of the collection there goes to the Trustee Savings Banks, and not to the Post Office.

8016. *Professor Sayers*: Is that because of a difference in service, or simply historical accident?——*Sir John Erskine*: It is rather that the Trustee Savings Banks have helped in the encouragement of groups and have done all they can to bring in the money. I suppose they do it on a competitive basis; they want the money, and they attract it by this special approach that they make to the problem. The Post Office, as Lord Mackintosh has said, is much less personal.——*Lord Mackintosh*: But it is also a historical fact that the Trustee Savings Banks have made much greater headway in Scotland during the last century. Just as the building societies at one stage in Yorkshire and Lancashire outstripped everybody else, so have the Trustee Savings Banks in Scotland. It is only in this last century that the Trustee Savings Banks have got in in England.

8017. *Professor Cairncross*: Has the increase in the number of branches, to which you refer in your memorandum, occurred largely in England, or has it been spread all over the country?——Largely in England, and particularly in the south of England where there was more scope.

8018. *Chairman*: There is one thing I want to add to your general summary of this case. The trend of deposits in the Special Investment Departments is much steeper than the trend of deposits in the Ordinary Departments. Do they both give the same service?——*Mr. Garrow*: In all respects except withdrawals. In the Ordinary Department withdrawals are on demand whatever the sum, as against the Post Office Savings Bank, where £10 is the limit on demand. In the case of the Special Investment Department, the usual rule is one month's notice for withdrawal.

8019. That would tend to tell slightly against the popularity of that?——*Lord Mackintosh*: That is the reason why they give the increased rate of interest.—*Sir John Erskine*: But the increased rate of interest has attracted deposits from the ordinary department.

8020. That is what I was coming to. They both give exactly the same facilities, with the slight detriment of the time of notice in the case of the Special Investment Department; yet the bulk of the popularity has gone to the Special Investment Department?——*Professor Sayers*: It would seem to follow from what has been said that one of the most effective ways of encouraging saving in this country is to have more and more offices of Trustee Savings Banks. Is that a fair inference?——*Lord Mackintosh*: That is true of saving. We have not said anything about the publicity side of the savings movement, which is quite an important side. It is not enough to convince people that thrift is a good idea; we have to make it easy for them. That is why we have to go to the factory. Therefore, the more branches there are the more people save. But I think there is still a great deal of room for the Trustee Savings Banks in the south of England.

8021. Do you question whether it is economic? At first sight it looks extravagant to have the second-best sites of the little towns and big villages being taken by Trustee Savings Banks offices, when there are already other banks on the best sites. Why is it that the other banks are not getting this business? What are the differences in facilities that are important to people?——I think you should ask Sir Oliver Franks that!

8022. I am not asking why the big banks have not made the effort; I am asking what are the differences between what the big banks do and what the Trustee Savings Banks do, which attract people to Trustee Savings Banks. You have been arguing that the expansion of the Trustee Savings Banks has been quite a big element in the development of savings in this country since the war, and when we ask how they have got the new deposits an important part of your answer is that their facilities are facilities that people like. What are the facilities that people like, which they get at the Trustee Savings Banks, which they do not get elsewhere?——With the Trustee Savings Banks, that is the only thing they have to do.

I should think people could get nearly as good service at any joint stock bank, but they seem to prefer a little thing on their own.

8023. The joint stock bank closes at 3.00 p.m. and much earlier on Saturdays. What time does the Trustee Savings Bank close?——*Mr. Garrow*: It varies from place to place. An important point, if I may mention it, is that the working man is against being seen going into or coming out of a joint stock bank.

8024. *Mr. Woodcock*: What about bank charges?——*Lord Mackintosh*: As Mr. Woodcock reminds us, there is no charge for operating a Trustee Savings Bank account. It is borne by the Treasury in the margin they allow. So it is cheaper. Then it is not quite so pretentious. There is generally more time. But I think that, when the time comes that they want a chequeable account, then they go to the banks. I am sure the Trustee Savings Banks are recruiting, without knowing it, for the joint stock banks. It is the beginning of savings.—*Sir John Erskine*: There is a great pride in Scotland in the Trustee Savings Banks. In so far as the joint stock banks are concerned my bank was the birthplace of not a few of the Trustee Savings Banks. They were carried on usually with the local manager (agent as we used to call him) acting in the double capacity, and it was only when they got to a certain size that they hived off. We have never felt there was anything contrary to a useful purpose in that collaboration, because if we get people used to savings the chances are that they will come to the joint stock banks. They do; whatever may be said about the working man going in to the joint stock bank, they do build up from the Trustee Savings Banks, and come and open a current account.

8025. *Mr. W. E. Jones*: Is it not true that in the community life of the working class, particularly in the North, heavy reliance is placed upon three movements, the Co-operative movement, the Building Society movement and the Trustee Savings Banks movement?——*Lord Mackintosh*: I would agree entirely.

8026. We are shown here that from March, 1949 to 1957 there has been a tumble in holdings of Defence Bonds from about £980 million to about £750 million. Are there any figures available, which would show us what part of that Defence Bonds holding has been redeemed on the basis of the bonds coming to maturity, and what proportion of it has been subject to six months notice?——*Mr. Gabriel*: We have the figures here of those that were redeemed before maturity, and those that were redeemed on maturity, since 1954. In 1954 £47½ million was redeemed before maturity and £31½ million on maturity; in 1955 £53 million before maturity and £43½ million on maturity; in 1956 £117 million before maturity and £48 million on maturity; and in 1957 £88 million before maturity and £20 million on maturity.

8027. *Mr. Woodcock*: You expect that to shift now that you have the new Defence Bond?——*Lord Mackintosh*: Now that we have a new Defence Bond. As those figures show, in the last two years it has been out of line.

8028. *Mr. W. E. Jones*: It has been affected by the rate of interest?——Yes.

8029. *Mr. Woodcock*: And it is this class of saving which is subject to your comment that it is affected by the rate of interest?——*Lord Mackintosh*: Yes.—*Mr. Gabriel*: And it is not only with the recent issue, but with earlier issues held by people.

8030. *Chairman*: Do you regard the Defence Bond as being directly in competition with the ordinary Government short or medium term bond?——*Lord Mackintosh*: Not entirely, because it has some other advantages which a small family trust likes very much; but generally speaking, yes.

8031. *Mr. Woodcock*: And in competition with building societies, too?——Yes. There is no doubt that, generally speaking, Defence Bonds are affected by the rate of interest more than any other of our securities.

8032. *Professor Cairncross*: It would seem from the figures for the Post Office Savings Bank, which may be different from the other savings channels here, that withdrawals form a higher proportion of the outstanding balance now than before the war. Would you think that this was true in the aggregate as well? Would the ratio, which is 1 to 5 since the war, look very different before the war?——*Mr. E. C. H. Jones*: Again we have no figures that would help us very much, but the general impression is no. The post-war gains have been very much affected by the factors I mentioned earlier of the post-war gratuities and the building society amounts. It is very difficult to arrive at any firm decisions concerning the flow of money in and out of the Post Office. One can say in general that it has followed the pattern which Lord Mackintosh has mentioned in national savings as a whole, that as a result of the last war national savings in the post-war period are more widespread than they were before. There is more money coming in, in both the Post Office and other forms, and more going out.

8033. Is the turnover of deposits with the Trustee Savings Banks more rapid than before the war?——*Lord Mackintosh*: I should say it was. The habit of using the Savings Bank account as a semi-current account is quite a recent development. Before the war it was used purely to save for the longer term. Now a lot of salaries are actually paid into the Trustee Savings Bank and taken out through the rest of the month. I would say the turnover is two or three times more.—*Sir John Erskine*: In Scotland there are a great many cases where firms pay in the salaries of their staffs and employees direct to the Savings Bank at the end of every month, and of course the employees draw on these amounts at frequent intervals; that creates a bigger turnover.

8034. In those cases is there a limit to the proportion of a man's wage paid in, or are there cases in which the whole of the wage is paid in to the Trustee Savings Bank?——*Mr. E. C. H. Jones*: The whole of the wages or monthly salary cheque is paid in to the Trustee Savings Bank. This is a practice which is growing, but I would not like to say that it constitutes a big part of the deposits in the Trustee Savings Banks.—*Lord Mackintosh*: No, but it is growing. It is often done, of course, with the joint stock banks; but it is something new to be happening in the Trustee Savings Bank.

8035. *Mr. Woodcock*: You have your direct transfer schemes, when a man determines what part should be paid in?——Yes, we have three million people in industry who are doing most of their saving through the Trustee Savings Bank through deductions from pay of 5s. or 10s. a week. The people in my own firm average 25s. a week; I do not know how they do it. It is deducted from their pay each week and paid in at the end of each week to the Trustee Savings Bank. That is our main method of collecting savings from places of employment, and I would like to see it extended even further.

8036. Are they more liquid than other forms of savings? Do they come out more?——Not as much as the salaries. They are hoping to save that amount mostly for short term, for holidays or Christmas, and after three or four or six months some of it comes out.

8037. *Chairman*: Would you care to say anything more about your general policy with regard to competition between savings? You are running a movement in which there are these various media, which to some extent obviously compete among themselves; but you also can have competing sources outside. You say in your evidence that you have no direct working association with other agencies, that is to say, building societies. How do you actually decide how far it is to be active competition?——The Treasury, of course, has the last word. During the war the building societies had a representative on the National Savings Committee, and so had the insurance companies, but we are friendly competitors now. I should like to see some unofficial get-together of, say, the life insurance people, the building societies, the co-operative societies and ourselves; we might meet twice a year with no fixed agenda, just to get to know each other better. At least we might decide on methods of getting more statistical information than we have now. I do not know if I am talking out of turn here, but since last September, when Bank Rate went up to 7 per cent., the Treasury have called together once a month representatives of the building societies and myself and the Treasury; we have compared notes every month, and have both promised that neither side would steal a march on the other. The result is that building societies have not put their rates up, and we did not, until the danger was over and the Bank Rate was coming down. We found it very useful to talk over these problems, because I have been a building society man longer than a savings man.

8038. That is interesting. It has started, from what you know, in the last six months?——Just with the building societies; we might enlarge it.

8039. Do you think it is likely to be permanent?——We would welcome it if the Treasury gave their blessing to it. I would like to see it tried out.

8040. *Professor Sayers*: Do you think the existence of these meetings has anything to do with the comparative slowness with which the rates of your movement were adjusted, and the lack of any response in building societies' interest rates to the movement in other interest rates in September?——I think it is almost entirely due to that monthly meeting. Both of us would have jumped our fences before we did, if we had not had this friendly talk.

8041. And in looking forward to a continuance of these friendly talks, would it be in your mind that you might moderate the competitive movement of interest rates?——Yes, I think it would have that effect. It would stop us from getting cross with each other and doing silly things. It would undoubtedly help.

8042. You do not think it would stop you from doing sensible things?——It could work both ways.

8043. *Mr. Woodcock*: But your competition is really with spending. You do not care a great deal where they save as long as they do save?——No, we are friendly rivals. We are like members of a test team; we like to look at our own averages for the club. The great thing is to get people to save; it is only secondary where they put it.

8044. *Mr. W. E. Jones*: In paragraph 9 you say: "There has been evidence, although it cannot be measured, that individuals failing to secure accommodation from their bankers have had resort to the encashment of national savings." Suppose that there had been no restriction in bank credit to creditworthy customers, but that there had been a high Bank Rate, would you have expected a much lower encashment of national savings?——Undoubtedly. I think we lost many millions, especially during the last twelve months, through the credit squeeze. Take a man used to working on an overdraft of £1,000; it came to Christmas time, and: "I am sorry," said the bank manager, "I cannot do it." What does he do? He looks around at what he has got, and Savings Certificates are the first thing he gets his bank manager to encash. It has been accentuated by the fact that the Rent Restriction Act has made more people want to buy houses, and they have then found the building societies want a higher deposit. Again, they go to the bank manager and he says: "I am sorry." Then out again comes another batch of Savings Certificates. We must have lost hundreds of millions in the last eighteen months.

8045. *Mr. Woodcock*: Suppose that the bank manager had been able to say: "Yes, but at 10 per cent., not 7"; have you any impression that 10 per cent. would have made them think? At 7 or 7½ per cent. would they not still have borrowed from the banks?——*Lord Mackintosh*: Yes, though that would be regarded as a high rate.—*Sir John Erskine*: Although National Savings Certificates could not be assigned officially, it was quite common practice for customers who wanted temporary facilities to deposit certificates with a repayment form signed. I would not have thought that the rate of interest for a very short period would have been a serious factor. I think the manager would simply say that he could not do it, and then the man would encash National Savings Certificates.

8046. *Mr. Jones*: But in no case would you have a situation where the bank which was refusing credit on the normal basis of restriction would advance £600 or £700 more because there was £600 or £700 worth of National Savings Certificates or Defence Bonds. That would not make any difference, surely; the man would have to encash?——*Lord Mackintosh*: That is correct. That is what we have suffered from. That is why our figures have been so bad—partly the rate of interest and partly the credit squeeze.

8047. *Chairman*: You spoke of 7½ per cent. as something which would be regarded as a high rate. I think probably you had in mind for temporary accommodation?——Yes, for temporary accommodation. I think a man would rather pay that than sacrifice some hard-earned savings; he would hope it would not be for long.

8048. Have you in mind any rate of interest which would be regarded as the dividing line between the high rate and something less?——The good old 5 per cent. I think anybody is suspicious of anything over 5 per cent., and rather pleased with anything less.

8049. Would you say that is true all over the country?——*Lord Mackintosh*: Yes.—*Sir John Erskine*: I would say so.

8050. I gather from the end of paragraph 15 that opinion as represented by conferences and local representatives does represent the saver as being interest conscious?——*Lord Mackintosh*: The people who come to these conferences are the key workers; they are not the ordinary workers that run the little groups. There is also a sprinkling of bank managers and stockbrokers, people of consequence and thoughtful people. It does not mean to say that they represent entirely the view of the ordinary man. They would be more likely to be conscious of this than the rank and file of our workers. But our key workers are very conscious indeed, more so probably than they need be sometimes.

8051. In paragraph 16 you say that you are frequently urged to adopt new media by your voluntary workers, and you outline three possible lines: to attract the middle-aged, to attract the young, and an organisational arrangement with unit trusts. Evidently it is your view that the range of possible media for stimulating savings is not closed?——Certainly not. It must be apparent to you that I am no economist or expert in these things, not as much as my friend Sir John Erskine here. I look upon the facts. As Mr. Macmillan put it, when he was Chancellor, in my first interview with him: "You are the sales department of the Treasury", and he asked if we were good salesmen. We did not happen to be at that moment; so I said "Let us have a look at the goods. If the goods are not right you cannot sell them." I look upon myself as the sales department. The Treasury and the Post Office are the manufacturing side of the business. They make the goods; we sell them. In business there is always a tug-of-war between the factory side, who want to have things streamlined, as few lines as possible, as few difficulties, no difference in packs and weights, and the salesmen, who always want something new, something tailor-made, as it were. Business constitutes a tug-of-war in deciding between those two. Now, the manufacturing side, the Post Office and the Treasury, are inclined to over-estimate and exaggerate difficulties, just as a salesman is apt to under-estimate the difficulties. So when we come to our conferences we suggest to the Treasury this sort of new investment and the other. This may often not be practical, but it is our job to tell them what we think will sell, and these three here are always coming up. The Savings Certificate itself when it was introduced was a very novel thing. Look what it has done: nearly £2,000 million now. Premium Bonds are the best bait at the moment. So we should not close our eyes to anything new; I realise there may be great difficulties, but I think we should be always searching for something. These are some suggestions.

8052. On (*a*) and (*b*), the middle-aged and the young people, have you in mind fiscal concessions?——With regard to the pension one, I think we would not get away with anything unless there was some income tax concession, as there is with life insurance. We have little schemes now (there are thousands of them going in the country) where a worker in a small office or a small firm can buy Savings Certificates under a scheme which buys them an annuity when they mature. But we are handicapped because we cannot offer them any taxation concessions. I do not say it is possible, but we would like it looked into. The one for youth is new. Several countries on the Continent have given special facilities for youth in the rate of interest, especially for when they are getting married and things like that. It is a bit early for us to say about that; when we have our committees worked through on youth we may have some suggestions to make. But we frequently ask the Treasury and Post Office for something to help pensions, and we have never got anywhere yet. On the unit trust idea, I like the general idea of encouraging the man-in-the-street to invest in carefully selected and managed shares, but I see the practical and political dangers of doing this through the savings movement, which after all is active on behalf of the Government. Nevertheless, I think some form of voluntary movement which attracts unpaid service, like our voluntary workers, would seem to be needed to put

these plans over without hampering them with great overhead costs. How can you harness those two? I do not know whether something like the I.C.F.C. could be set up, who would manage the units. The savings movement, with all its experience, could help by doing their publicity for them. Some of our voluntary workers might offer them, and people could take them up or not as they wished, as they do now with Premium Bonds (we never compel any worker, because some people object to Premium Bonds on principle; it is just up to them whether they push them or sell them or mention them). And if there was some Government institution that would vet the unit trusts so that they were perfectly safe, we could perhaps leave it to the voluntary efforts of those workers who like to do something about it. I think the principle is good, but I see dangers in the Government having anything to do with it.

8053. *Sir John Woods*: In the experience of your groups, with your voluntary workers, have you come across any signs of reluctance to save by the various media which you use on the grounds that the value of money is depreciating all the time?——Yes; that is undoubtedly our chief handicap.

8054. It is noticeable?——Yes, and I wonder why we have got on as well as we have the last ten years; it is extraordinary.

8055. That is one reason behind the suggestion of this unit trust?——Yes.

8056. *Professor Sayers*: When would you say that it first became a substantial factor, this fear that the savings would lose their value?——*Mr. E. C. H. Jones*: Within the last two years.—*Sir John Erskine*: I would say within the last four years.

8057. *Sir Oliver Franks*: There is a great deal of difference between the answer "in the last two years" and the answer "in the last four years". In the first half of 1957 in a number of parts of the community for the first time the citizen of this country distrusted his currency, and it became sufficiently widespread to attract notice abroad. It became one of the main factors affecting the economy; it was a new thing for Britain. Now, it may well be that in the groups of people who save through the different arms of the savings movement this does not apply in the same way; that it is not a matter of two years, but of four years, that it was building up a little under the surface before this more overt state of mind manifested itself in the first half of 1957. Would you say four and not two?——*Sir John Erskine*: I would rather think four.—*Mr. Garrow*: Yes.—*Lord Mackintosh*: I can scarcely remember when it was not an issue since the war; I would say quite five years.

8058. We are not talking about the rate of inflation; we are talking about the effect of that rate of inflation having sunk into people's minds and become a motive for distrusting the money that they use?——*Lord Mackintosh*: They have been told that the £1 is now worth only 14s. 6d., and so on, and the advice they get is: "Spend the brass; what a fool you are to save it." We hear a lot about it. Personally, I do not think it has as much effect on saving as you would expect it to have.—*Mr. E. C. H. Jones*: I think the effect has been accelerating in the last two years. It has been a factor over a period of perhaps five years; I think it was slow to develop, but certainly in the last two years we have heard a great deal more about it.

8059. And you think it has affected people's actions?——*Mr. E. C. H. Jones*: Yes.—*Sir John Erskine*: I have been faced on several occasions with people saying to me: "How can you reconcile with your conscience taking money from people when the indications are that it is going to have a lower purchasing power when they get it back?"—*Lord Mackintosh*: I have had all sorts of abusive letters calling me robber, thief and pirate.—*Sir John Erskine*: I have, too.

8060. *Chairman*: Are you able to give convincing answers to that question?——*Lord Mackintosh*: I think so. I say: "What would you do with the money if you did not put in in national savings? There is only property and equities, and look what equities have done. With property unless you have a lot of money you cannot start. Even if money buys 5s. less in five years' time, it is better to save it than to find yourself with two wireless sets, both of them out of date. It is no good buying for the sake of buying; you had better have 15s. and have it safe."—*Chairman*: I think that is very forceful.

8061. *Mr. Woodcock*: Is not the surprising thing that despite the vocal comment and criticisms national savings have not suffered as much as you might have expected from this?——It is quite remarkable.

8062. There is a difference between what people say and what they do?——*Lord Mackintosh*: We have to get nearly £1,400 million in before we start to score a plus at all. If we can only hold the reservoir, that is an achievement.—*Sir John Erskine*: It is important to hear in mind this enormous figure of potential spending power. If I am faced with the argument: "Why not withdraw it and spend it?", I come back with "Are you encouraging withdrawing this very large sum and spending it, because then you will have inflation doubly confounded?" It works with certain people. I think it is quite marvellous that all these voluntary people throughout the country assist the Government in maintaining this very large reservoir. What could he put in place of that I really could not tell, because it requires the stimulus of constant prompting to keep it filled up.

8063. *Professor Cairncross*: When was the unit trust idea first drawn to your attention? Is this an idea which goes back many years, or is it a recent one?——*Lord Mackintosh*: I do not think I ever heard it mentioned until four or five years ago. Then it began to be talked about and we got letters, and members of both Houses of Parliament have been to see me about it. But I do not think this demand has come from our workers at all; it comes from the economists and politicians. I think it is a facility that would be in the interests of the country and everyone else if there is a practical way of doing it, but I do not want you to think that the ordinary worker is crying out for this.

8064. But you say that it is an idea that commends itself to many voluntary workers?——Yes, we have had resolutions at conferences. But they are all people who have come right to the top of the movement; they are intelligent, the readers, the thinkers. Of the eight or nine million people who are saving regularly through us I do not think one in a thousand has ever thought of it.

8065. *Lord Harcourt*: Is the accent always on the unit trust? Has no one given consideration to the managed trust?——It is just the word which came first to my mind. It is a chance for the ordinary man to have a well-managed mixed bag.

8066. *Professor Cairncross*: Are the Trustee Savings Banks prohibited from handling unit trust certificates? Do they sell them over the counter?——*Mr. E. C. H. Jones*: Yes, they do.—*Lord Mackintosh*: I do not think so.—*Sir John Erskine*: The joint stock banks do in Scotland. I have never heard in Scotland the idea of unit trusts being linked up to the savings movement. I have heard people talk of the advantages which might accrue in bringing the working man into the purchase of unit trust certificates. When the promoters of a particular unit decided to ask the joint stock banks to sell, they spoke to me about it and asked if I would come along and purchase the first unit. Feeling that it was all towards thrift, I saw nothing incompatible with my position as chairman of the Scottish Savings Committee in going to the joint stock bank with the officials and buying some of the units for my grandchildren. I am in favour of the idea; but I have great difficulty in seeing how it can be linked up with a savings movement the pattern of which is to collect money directly for the State.

8067. *Professor Sayers*: Have the other suggestions for pensions and young people come from below?——*Lord Mackintosh*: Yes, frequently. We never have a conference without them, especially the pensions idea, coming up.

8068. *Chairman*: Are there any special points in the Scottish memorandum that anyone would like to raise? We have covered a great deal of it in our questions. —*Professor Cairncross*: In the table in paragraph 3 no figures are given for Trustee Savings Banks Special Investment Departments before 1954. Does this mean that the balance outstanding for Scotland is not available for that

year?——*Sir John Erskine*: Until that date the accumulated balance of the Special Investment Departments was not included in the national figures at all.

8069. *Chairman*: You mean they were not treated as a branch of national savings?——No, the argument being that the proceeds of these deposits do not necessarily go directly to the Treasury.

8070. *Mr. W. E. Jones*: Are these figures additional to the £6,300 million, or are they part of it?——*Sir John Erskine*: Part of it.—*Lord Mackintosh*: Our figures include Scotland and Northern Ireland.

8071. *Professor Cairncross*: Special Investment Department figures are available, and have been submitted to us, for Great Britain before 1954. Presumably you have them for Scotland in that case?——*Sir John Erskine*: We should have to get them from the Trustee Savings Bank; we do not have them*.

8072. *Chairman*: Would it short circuit it if we asked them direct? We are seeing them this afternoon.——*Sir John Erskine*: Yes; we should only have to ask them.—*Lord Mackintosh*: We work very closely with the Trustee Savings Bank. We are very happy together.—*Mr. E. C. H. Jones*: The Special Investment Departments of the Trustee Savings Banks were closed during the war; they did not offer that facility. It was re-opened at some period after the war.—*Lord Mackintosh*: During the war the banks could not invest with corporations, because they were all borrowing temporarily.

8073. In paragraph 6 you distinguish between the attitude of the different classes of saver and the different media they go for.—*Mr. W. E. Jones*: Do you have a spurt when there is a new issue, or an extension of the limit on the maximum number of Savings Certificates, as recently it has gone up from 600 to 1,000 units?——*Lord Mackintosh*: Yes.—*Mr. Gabriel*: The weekly rates would go up about three times the normal sales, and that would continue for about a month.

8074. Would that be the outcome of switching of deposits and investments?——*Mr. Gabriel*: To some extent.—*Sir John Erskine*: I have some very well-off friends who say: "I have taken up the full quota for myself, my wife and my family." That is not in a proper sense new small savings. They have drawn it from some other source and put it in to take advantage of it for their own particular purposes.—*Lord Mackintosh*: Sometimes people criticise, but nothing succeeds like success. If national savings figures are good and doing well, then the ordinary man-in-the-street thinks it is a good thing to do. If our figures week after week, month after month, are depressing, then the idea gets about: "What is wrong with national savings?" We have to have a shot in the arm now and again.

8075. To what extent do you think the value of investing in national savings is known, and to what extent has the knowledge of the value of them increased in consequence of these extensions from time to time? Would you expect new savings in National Savings Certificates apart from the extension to holders in consequence of this?——Yes, all the time. And something entirely new, like Premium Bonds, no doubt brings millions of people in; in fact Premium Bonds were baited for the people to whom the difference between $3\frac{1}{2}$ per cent. and $3\frac{3}{4}$ per cent. does not mean a thing. Millions of pounds go on pools every week and they were not playing their part in the contribution at all; so we tempted the bait for them. It was meant just for those people, not for the regular saver. I remember speaking with the Archbishop of Canterbury at their introduction. He was against them, and I followed him at a public meeting. I said I knew the church's job was to save sinners; I did not know it was their job to stop sinners saving. It was something new, and it has brought in millions who were not in the movement before.

Chairman: That would make a very good slogan! I think that completes our questions; thank you very much, Lord Mackintosh and Sir John.

(*The witnesses withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

The following witnesses, representing the Trustee Savings Banks Association, called and examined:—

SIR KENNETH STEWART, G.B.E., J.P., Chairman, T.S.B.A., and Chairman, Manchester and Salford Trustee Savings Bank, A. HARRISON, ESQ., C.B.E., Deputy Chairman, T.S.B.A., and a Trustee, Edinburgh Savings Bank, A. THOMSON, ESQ., O.B.E., J.P., Hon. Secretary, T.S.B.A., and General Manager, Savings Bank of Glasgow, and C. L. LAWTON, ESQ., O.B.E., LL.D., Chief Actuary, York County Savings Bank.

8076. *Chairman*: You have been kind enough to send us a memorandum;† we should like to run through it with you. First you describe the general history and organisation of the Trustee Savings Banks, and you give us a figure for the funds of the banks. Are we to think of the funds in paragraph 3 covering deposits in the Special Investment Departments, the Ordinary Departments, in the Stock Departments, and the surpluses?——*Sir Kenneth Stewart*. Yes; and that has increased by just under £50 million in 1957, to £1,298,600,000.

8077. In your description of the Ordinary Department you refer to the National Debt Office. I should like to be clear as to the relationship between the Trustee Savings Banks on the one side and the National Debt Office on the other. You turn in all the money that comes in to you to the National Debt Office?——In the Ordinary Department, yes, except what we retain for our till money.

8078. They then handle the investment of those funds in Government securities without reference to you?——Without any reference whatsoever. I think it was Gladstone who once said that, as far as the Trustee Savings Banks were concerned, if the Government chose to chuck the money into the sea it would not make the slightest difference; the deposits were guaranteed by the Consolidated Fund of Great Britain to the trustees, and how the National Debt Commissioners invested the money was their business.

8079. And the guarantee is a guarantee from the Government to the trustees of pound for pound of the sums turned in to them, plus a rate of interest which the Treasury fixes?——Which the Treasury fixes. The rate has been £2 17s. 6d. per cent., that is £2 10s. paid to our depositors and 7s. 6d. for running the show, and the Treasury have increased that to £3 per cent. from the 21st May, which is the beginning of our half year.

8080. Then the surplus of income which you are referring to in paragraph 9 is a surplus which arises from the investments which the National Debt Office make with your funds and which is not needed to cover the fixed interest they pay to you?——That is right.

8081. Quite large sums seem to be involved; nearly £7 million for the six years 1950-56. Why should not the Trustee Savings Banks get the benefit of that surplus?——Because it is none of our business whatsoever; what the Treasury choose to do with the money they receive from us is entirely their business. They guarantee that they will look after the money that we hand over to them; how they invest it and what they do with it is their own business.

8082. *Professor Sayers*: You invest it with the Treasury compulsorily?——Compulsorily.

8083. At a fixed rate?——At a fixed rate.

8084. And that is the cost to the Treasury of this part of the national debt?——That is right.

8085. *Chairman*: Does it cost them much to put the money into the Government securities which they buy? Surely they have nothing to do except invest it?——That is perfectly true. At one time many years ago they made a loss on their investments, but for very many years they have made an actual profit on the difference between the fixed rate they paid us and what they were able to invest it for.

8086. Somewhere at the back of my mind I have the date of 1910-11 as the last time when there was a deficiency?——*Dr. Lawton*: It was 1909.

* See Qn. 8142.
† Memoranda of Evidence Part VI No. 19.

8087. *Professor Sayers*: Is not that deficiency entirely internal to the Exchequer?——*Sir Kenneth Stewart*: Yes.

8088. *Chairman*: But the cost of running the Trustee Savings Bank organisation falls upon the rate of interest which is paid to you?——Yes; the 7s. 6d. per cent. paid to us over and above the amount we have to pay to our depositors was the rate which we have had to keep within, somehow or another.

8089. Out of that you have to meet the costs of running the movement, including buying or renting premises?——Yes.

8090. *Lord Harcourt*: What happens if one of the banks exceeds the differential?——They do often. When the Post Office Savings Bank was opened in the sixties, most of the Trustee Savings Banks in the south of England shut up and handed everything to the Post Office. We have been recovering that in the last ten years or so, with the result that the southern banks have opened a very great number of offices. It takes something like an average of £750,000 per office to cover the cost. It takes many years to come up to that amount, and in the meantime a great many of these offices are running not at 7s. 6d. per cent. but at, say, 12s. 6d. or 13s. 6d. per cent. We have a mutual assistance scheme, by which banks who have a surplus over and above the amounts they require for running their banks pay it into a central pool, which is divided out to help the banks who at present are still on the wrong side. This mutual assistance scheme between all the banks was formed in 1948, in order that development might be enabled to go ahead, and that those banks who have no resources of their own should be helped by the resources of rich banks, such as Glasgow, who contribute something like £50,000 a year into this pool.

8091. Is that the contribution scheme to which you refer in paragraph 12?——Yes.

8092. *Professor Cairncross*: If Glasgow did not contribute £50,000 a year in this way, what would happen to that money?——It would simply go into their surplus and be paid in with the rest of their funds into the National Debt Office, and would be invested by them, just the same as the deposits from every other kind of money that comes in.

8093. *Chairman*: It would be interest-bearing at the same rate?——Exactly.

8094. *Professor Cairncross*: And would remain to the credit of the Glasgow bank?——It would remain to the credit of the particular bank concerned.

8095. What is to prevent a large number of additional Trustee Savings Banks setting themselves up, if they can rely on this guarantee that if they are unable to cover their costs they can draw on the pool?——We have an association in which we all work together in these things. No bank can set up without being supplied with some sort of capital which has to come from this mutual assistance fund, or some such thing, or from the National Debt Office in certain individual cases; therefore the whole thing is under pretty complete control in that way. No new Trustee Savings Bank can set up without the backing and help of the Association, or without the permission of the National Debt Office.

8096. How would a new Trustee Savings Bank set itself up?——I can give you an example. Some years ago we were asked to set up a new Trustee Savings Bank in Bristol. £40,000 was advanced by a good many banks in order to supply the necessary capital to set up a new bank, to build a new building for the head office, and to finance the opening of some branches. A couple of branches were handed over by another bank that was already established in Bristol. So the Bristol Trustee Savings Bank was set up, and the trustees find themselves today running their concern still at a very heavy loss, because it takes some years to set up a bank; last year they made a loss of £18,000 on four or five offices. That was met by the mutual assistance fund. In the course of time that £18,000 a year loss will gradually diminish; we will look after it with the mutual assistance fund in the meantime. In the course of time they can put a certain amount every year towards paying back that £40,000. The mutual assistance fund, if it has the money to spare, will help to pay that off also; if it has not, in the course of the next twenty or thirty years the trustees will perhaps be able to pay off that debt. Loans between banks are always free of interest.

8097. Do you ever wind up a bank?——No, but we sometimes amalgamate banks. If some bank is in a bit of a difficulty, or anything of that sort, a neighbouring bank usually amalgamates with it and takes it over; some richer bank helps it out in that way.

8098. Who takes the initiative in these matters, for instance in an amalgamation or in founding a new bank?——In the founding of the new bank at Bristol the initiative came originally from Sir Stafford Cripps. He was the Member of Parliament for one of the Bristol constituencies, if you remember, and he was asked whether a Trustee Savings Bank could not be established in Bristol. He referred the matter to the Association; I, as chairman of the Association, called together a meeting to decide how we could do that, and by a series of arrangements we gradually set it up. The National Debt Office had a very great deal to do with it; they advanced the money from the Closed Bank Fund to a certain extent. When banks gave up in the sixties, there was a certain amount of money left over, which all went into the National Debt Office and was retained in a fund called the Closed Bank Fund. That has been lying there and gradually accumulating interest. That was used to a certain extent; and the Manchester, Liverpool, and Glasgow Banks and a whole lot of other people helped to advance money.

8099. *Chairman*: When the rate of interest allowed on your balances by the National Debt Office is fixed by the Treasury, do the Trustee Savings Banks have any say in the matter?——A very great deal indeed. In fact there has been a very tough negotiation for the last three months, in which a good many of us have had to spend a good deal of time. We have been negotiating with the Treasury and the National Debt Office as to what we ought to have, and we have had to put up all the arguments we can to show what we require. In the end we came to an agreement on £3 0s. 0d. per cent.

8100. *Mr. Jones*: Having regard to the substantial amount of deposits you handle, would you say that the staff you employ are small, medium or substantial?——*Dr. Lawton*: I think we have rather more than 4,000 staff in total. I work to a standard, which I think is probably much the same with other banks, of 10,000 transactions per year per member of the staff.—*Sir Kenneth Stewart*: I cannot give you the total number of transactions, I am afraid; but it is pretty large. I suppose our staff is between 4,000 and 5,000 for running this concern.

8101. That is over the 82 banks?——Yes.

8102. *Chairman*: Is the accumulation of surpluses by the National Debt Office year by year since 1909 regarded as a relevant consideration in fixing the rate of interest today?——No. The rate of interest payable to the depositors has been £2 10s. per cent. for a very great number of years. The rate paid to us has varied; for many years it was £2 17s. 6d. per cent.; for three years, from 1951 to 1954, it was £2 16s. per cent., and then it was restored in 1954 or 1955 to £2 17s. 6d. per cent. From the 21st May next it is to be £3 0s. 0d. per cent., that is £2 10s. 0d. per cent. for interest to depositors and 10s. 0d. per cent. for management expenses.

8103. I had in mind that, if you were allowed a higher rate of interest by the Treasury, you might be able to allow a higher rate of interest to your depositors?——There you get to a very vexed question indeed. When, during the time of Dr. Dalton the rates of interest were $2\frac{1}{2}$ per cent. generally, there was naturally a great deal of controversy on the subject of whether the rates paid by the Post Office and the Trustee Savings Banks to their depositors should be allowed to remain at $2\frac{1}{2}$ per cent. or should be reduced. After a great deal of discussion it was pointed out that this had been a rate which had gone on for a very great number of years and that it would be undesirable to alter it. Our feeling generally is that we are quite content to allow that historic rate to remain. The fact of the matter is that both in the case of the Post Office and the Trustee Savings Banks Ordinary Departments a very great number of people begin their savings in that particular way. In our particular case for many years there has been a gradual increase of 300,000 accounts a year; it does not matter very much to them in the initial stages whether they get $2\frac{1}{2}$ per cent. or $3\frac{1}{2}$ per cent. or 4 per cent. I do not believe it would make very much difference to the number of people who started their savings in that particular way. The effect of it is a

little different. What happens is this: when outside rates of interest are very low the average deposit per depositor is a good deal higher than under present circumstances when outside rates of interest are high. Last year we had about 7,600,000 active depositors in the Ordinary Departments with an average deposit per head in the region of £100; ten years ago we had a good deal fewer depositors but their average deposit per head was more like £150.

8104. But over the last few years has not the Special Investment Department, which has paid increasingly higher rates of interest, shown a much bigger increase than the Ordinary Department?——A very much bigger increase; but the two departments have, I think I may say, a completely different function. The Ordinary Department is the department in which it is extremely convenient for all those who want to begin saving to put their money. They begin saving through that. The Special Investment Department, which is in competition with every kind of building society and everything else, is where people who have accumulated £100 or £200 go when they want to get the best rate of interest they can. We offer them the facilities of the Special Investment Department; they may transfer to that, or they may transfer to National Savings Certificates or to Defence Bonds or any other type of more permanent saving that gives them the best rates possible.

8105. *Mr. Jones*: It is necessary for a person depositing in the Special Investment Department to have at least £50 in the Ordinary Department?——That is right.

8106. To what extent do they transfer, when the deposit reaches a figure of over £50, from the Ordinary Department to the Special Investment Department? Is there a substantial amount of movement these days?——A very substantial amount of movement.

8107. Has that been recent or is it something which is operating over a long process of years?——If you go back to 1935 or 1936, there was a larger amount of deposit in the Special Investment Department than there was in the Ordinary Department, because 33 per cent. of our depositors in the Ordinary Department had money in the Special Investment Department as well. That really meant that as a general rule, when they had got over the £50 which they needed to have in the Ordinary Department, they put it into the Special Investment Department. From 1939 until 1951 or 1952 the rate we could offer in the Special Investment Department was no larger than in the Ordinary Department. Since then the rates of interest that we have been able to offer in the Special Investment Department have steadily risen up to something like 4 per cent. In a very few cases it has gone up to 4½ per cent., but the average is somewhere around 4 per cent. A larger and larger proportion of our depositors, although it is only up even now to the extent of about 20 per cent. as compared with 33 per cent. before the war, are inclined to transfer to the Special Investment Department once they have got their £50 in the Ordinary Department.

8108. Why do you require £50 in the Ordinary Department to qualify for deposit in the Special Investment Department?——The original theory, and I think it was quite a sound one, was that a person needed to have £50 in his current account to draw on; that he should not put it all into the Special Investment Department, which was intended as a permanent thing for him to keep it in. A depositor is always drawing bits out and putting bits in, and it would be highly unsatisfactory if he were doing that in the Special Investment Department. We think it is extremely desirable that he should have accumulated £50 in the Ordinary Department to allow for that kind of thing.

8109. *Professor Cairncross*: Was the £50 figure fixed before the war?——*Dr. Lawton*: It was fixed in 1891; at that time it was just about the limit of the amount that could be held in the Ordinary Department. At that time the Special Investment Department was a very much looser sort of thing, practically unqualified by regulations (there was simply a single section, section 16 of the 1863 Act). It might quite well have been that one of the reasons for fixing that sum at £50 was that the authorities did not want what was regarded as the legitimate business of Trustee Savings Banks spilling over entirely into this very free and imperfectly defined supplementary business. That figure of £50 has stood unchanged for 66 years.

8110. In that case it must be much easier to become a depositor in the Special Investment Department than it used to be?——*Sir Kenneth Stewart*: Yes.

8111. But none the less the proportion of the depositors with the Special Investment Department is considerably less now than it was before the war?——Yes, because it has not had time to grow. The high rates of interest started in 1913 or 1914 and went on until 1933; the Special Investment Departments had twenty years to grow. So far they have only had a short time to grow, but they are growing all the time.

8112. What would be the pre-war differential between the return on the two forms of deposit?——*Dr. Lawton*: I am not sure what was the rate allowed in the Special Investment Department in 1910, 1911 and 1912; I am told it was 2½ per cent. It went as high as 4 per cent. in the immediate post-war inflationary period, about 1920, and then gradually came down, and was running at about 2½ per cent. after the time of the War Loan conversion in 1932.

8113. But by 1938-9 had it risen again?——*Sir Kenneth Stewart*: No, after that it gradually went down, because we were gradually cut off from investments in mortgages and that sort of thing. In the war the Government took the whole thing under control, and we were not able or allowed to pay more than 2½ per cent. in the Special Investment Department. We could not have afforded to, in any case; we could not invest it in anything.

8114. Was it chiefly through local authority mortgages that you were able to obtain a better return?——*Dr. Lawton*: That did happen. The policies of different banks in the percentage of local authority mortgages that they would have in their portfolio probably varied quite a lot. Under the 1918 Act one was so very restricted in investment, and when the short term rate became more or less nominal, as it did after 1932, one was driven either to take a longer term security or else to go into a local authority loan. The restrictions imposed in 1918 were very much lightened by an Act of 1934. By then it was really difficult to get enough money to allow depositors a rate somewhat in excess of the rate payable in the Ordinary Department. I believe in my own bank we had from 75 to 80 per cent. in mortgage loans at that time; I do not know whether that was typical.

8115. Is the main reason for the differences in return obtainable in different Trustee Savings Banks on Special Investment Department funds the degree to which investment took place in local authority mortgages?——*Sir Kenneth Stewart*: No, I do not think that is the case. The position today is rather interesting in that particular respect. Generally speaking the average throughout is that about 70 per cent. of the Special Investment Department money is in corporation mortgages, graduated over the years rather carefully; the remaining 30 per cent. is in Government securities, 20 per cent. of it fairly short-term. We are having a good deal of discussion with the Treasury at the present as to what that proportion should be. Their view, which is also the view of quite a number of our own people, is that the proportion of 70 per cent. of corporation mortgages compared to 30 per cent. of Government securities is not a very good proportion, and that it ought to be a higher percentage in Government securities, which are saleable after all, even if there may be a loss on them.

8116. The proportion presumably differs pretty widely between one bank and another?——*Sir Kenneth Stewart*: I think it does, but not quite so widely as one would think. —*Dr. Lawton*: A bank which goes in for a rather high percentage of mortgage loans will probably try to correct things by having a rather higher proportion of very liquid assets like Treasury Bills. A bank whose proportion of mortgages is a little lower may extend its portfolio to rather later years. But those kinds of internal variations are within the limits of the sanctioning powers of the Nation Debt Commissioners; the Commissioners must sanction every mortgage, every change of interest, every investment.

8117. You mean that even in the Special Investment Department the Trustees cannot make any investment without the sanction of the National Debt Office?——*Dr. Lawton*: That is so; since 1919 they have had to have that sanction.—*Sir Kenneth Stewart*: That does not raise any difficulties at all.

8118. You say in your memorandum that there was at one time a seven year limitation on investment in mortgages which has since been removed. Was that limitation imposed by the National Debt Commissioners or by the local authorities themselves?——*Mr. Thomson*: I do not think there was a limit imposed on mortgages; there was a limit, strange as it may seem, of 50 per cent. on marketable securities. That is why, as Sir Kenneth has just said, many of the banks had a larger portfolio of mortgage loans than some of the others. Their main interest was to give the biggest possible flat yield to the depositor; not being commercial institutions they were not concerned about making a profit on the sale of marketable securities but they were anxious to get a fairly constant yield that they could pass on to the depositors. In that sense the mortgages offered an advantage.—*Dr. Lawton*: The seven year minimum was imposed by order under the Local Authorities Loans Act, 1945. I do not know that that applied to Scotland. That meant that we could not make a loan repayable sooner than at seven years, even by means of a break clause. The only thing that was provided for in the order was something that was more or less equivalent to the Savings Bank stress clause which we have to have, which is only used in the case of emergency.

8119. Over what period did this last?——Up to 1954 or 1955. The only way of getting out of it was to go in for an instalment repayment loan, where we could get so much of our principal coming back year by year.

8120. *Lord Harcourt*: How is the investment policy of a Special Investment Department formulated and controlled?——*Sir Kenneth Stewart*: The manager and the trustees of a bank take counsel together as to what investments they should make, and everything they do has to have the consent of the National Debt Office. The National Debt Office to a certain extent controls the directions in which we are allowed to go or ought to go. For instance in the Manchester bank, when things are going well, perhaps we may get £100,000 in a week; we then find out from various brokers as to what investment suits us best. We like to have a fairly even amount of money becoming due each year; for example, if we found that we had rather a smaller amount than we should have coming due in the year 1976, we should try to get some sort of security that was likely to become due about that year, so as to keep our portfolio in a fairly even state. We also have to be very careful to see that we have a sufficient amount of money liquid so that we can immediately lay our hands on it. A depositor in the Special Investment Department has to give us a month's notice before withdrawing; we have to see that we have a really sufficient amount of money liquid in a month, and we have to have other money that is liquid at a rather later date. That is continually being laid down for us, after discussion with the National Debt Office, so that the liquidity position is always pretty well under control. Lately we have been discussing that very liquidity position again with the Treasury, so as to be sure that we are in a sufficiently liquid position to meet any emergency that we can imagine arising.

8121. The actual proposal originates from the manager and the trustees of each individual bank?——Yes.

8122. And that proposal is forwarded to the National Debt Commissioners, who approve it?——Yes. In the ordinary everyday transaction there is no doubt about the approval: it is only when somebody gets a bit out of step that the National Debt Office check on them and say: "You must think again on this."

8123. With dated mortgages you try and spread the maturities over various years so that you have a certain amount coming in each year?——Yes.

8124. You may be holding gilt-edged securities which you bought twenty years ago; when those become short-dated Government securities do you normally allow them to mature or do you then switch to longer-dated maturities?——*Sir Kenneth Stewart*: Every case is rather different in that respect. In our own case we have switched just lately. Mr. Thomson can say what they do as a rule in Glasgow.—*Mr. Thomson*: We exercise prudence in that, always having in mind a degree of liquidity; for instance we sold £350,000 of 3 per cent. Savings Bonds 1960-70 and applied the proceeds to the purchase of 4½ per cent. Conversion Stock maturing in 1963; over the course of the years since we first bought those Savings Bonds we have written them down to a book value which I am glad to say is below present day market value, so we make a profit in that and we are getting a better return. We exercise some foresight and prudence in what we do in the way of switching, always taking care that we do not lose in the transaction, unless the loss sustained at the time of the switch is more than likely to be made up by the return we get on the new investment. These things are under review very constantly in the case of our own bank.—*Mr. Harrison*: I think I may say that the tendency has been to increase our liquidity.

8125. Where do you look for the recruitment of your trustees?——*Sir Kenneth Stewart*: In the provincial cities of this country we look amongst the principal business people in the place. Perhaps Mr. Thomson could give a list of the Glasgow trustees.—*Mr. Thomson*: Generally speaking they are taken from people belonging to the professions who are likely to be of use to the bank in the exercise of their knowledge of one kind or another. We have solicitors and stockbrokers, chartered accountants, as well as warehousemen and ex-Lord Provosts, so that we have the business community, and the community at large, pretty well represented. The Lord Provost, with his knowledge of municipal affairs, can very often give us advice when we want to build an office in a feu that belongs to the Corporation. There is a wise discretion used in the appointment of our trustees, but they are all voluntary, as you know; they give their services gratuitously, and they are all very attentive to their duties.

8126. *Chairman*: And all these gentlemen cannot switch out of one security and make another investment without the consent of the National Debt Office?——That is so.

8127. *Professor Sayers*: What kind of investment do the National Debt Office object to?——*Sir Kenneth Stewart*: I can give you a simple example of that. If a bank whose liquidity is not sufficiently up to the standard laid down by the National Debt Office as desirable seeks consent to invest £50,000 in some long-dated security, the National Debt Office will write back and say: "We would think that you would be better advised to cancel that and invest in something that is more liquid". That continually happens, because sometimes banks get a very tempting offer of a long-dated stock, when the National Debt Office consider they should take something more liquid. It is just a general check; it does not happen very often.

8128. *Chairman*: And who represents the active direction of the National Debt Office?——The Comptroller General, Mr. Kirwan, and his Assistant Comptroller, Mr. Mileman. They take the very deepest interest in everything that is done in the Trustee Savings Banks; they travel all over the country looking at the Trustee Savings Banks and visiting all the head offices and finding out from them what they think about things. They are most active and most interested; it is nothing like a dead hand, I can assure you.

8129. *Professor Sayers*: And is their veto on investments absolute?——*Sir Kenneth Stewart*: Their control on investments is absolute if they choose to use it.—*Mr. Harrison*: I cannot remember any occasion on which they have objected to any investment that Edinburgh has proposed.—*Sir Kenneth Stewart*: No, but there are smaller banks than Edinburgh!

8130. *Chairman*: And this is all within the range of the permitted securities; within that range they can object to any particular transaction?——They can.

8131. *Sir Oliver Franks*: And the surplus of any particular bank must be invested in the same way as the depositors' money?——Exactly the same way.

8132. *Chairman*: In paragraph 38 there is a reference to the payment of salary credits; what exactly is the salary credit?——*Sir Kenneth Stewart*: A firm paying its clerks, and so on, will often ask each clerk which bank he would like his salary paid through, and they then send the salary cheque straight to the bank. A great many clerks choose the Trustee Savings Bank; their salary cheques are then paid through the Trustee Savings Bank, and the clerk comes and visits the Trustee Savings Bank when it is

convenient to him and draws out what he wants. It is current account business, we cannot get over that; but it brings the right kind of depositor, our type of depositor, into our offices, and gets them used to using our offices. We consider it of value within limitations. We do put a limit on it; if we find that it is overwhelming our offices, we just say that we are sorry but we cannot take it.—*Mr. Thomson*: In Glasgow the salary credit scheme is becoming an embarrassment to us, and a service that is provided with little or no profit at all. In Scotland, as Professor Cairncross knows, we suffer from what I would venture to suggest is a monopoly on the part of the joint stock banks. They have a common charge which they make for their services, and it falls very heavily in my view on the Trustee Savings Banks. The joint stock banks say to us: "Every £100 you put into any of our banks will cost you 9d.", and when we get a composite cheque from Rolls Royce or some big firm which pay their salaries through our agency, we have to pay 9d. per cent. for the privilege of putting that into our current account. We get nothing at all by way of allowance for the large current balances which are always held, amounting every week to no less than £700,000. Last year we paid £6,000 to the joint stock banks for putting our money into the bank. They have raised it to 9d. this year and it will probably cost us between £9,000 and £10,000. Moreover, because they have raised their charges to their own current account customers, we are getting a lot of people from the joint stock banks who formerly held current accounts there for wages and salary purposes, coming to us, where they get the service for nothing. We are beginning to find now that it is not only difficult to give them the quick attention they expect on the first of the month or the end of the month, but it is an embarrassment to us because it is a service given free at a cost to ourselves. I would say broadly speaking, although there are exceptions, that the salary credit scheme is not for us a profitable business.—*Sir Kenneth Stewart*: It does vary in different places. We do not find it any particular difficulty in Manchester, as a matter of fact; these serious crises have not arisen with us yet. If they do, we shall have to cut it down.

8133. *Mr. Jones*: Do you make any charge for this service?——No, we do not.

8134. *Lord Harcourt*: If there is a large growth in this system throughout the country, would it be the intention of the Trustee Savings Banks to make a charge for it, or would you go back to the Treasury and ask for a larger differential?——*Mr. Thomson*: We have salary credits paid into our banks in different ways. In my bank, if we have a composite cheque which comes from a firm representing perhaps 200 employees, we say to the employer that we will perform this service (which saves him a certain amount of administration expenses) if he will pay us ninepence for each item which we have to advise to our various branches in respect of his employees. He sends us a cheque centrally and we have to send to perhaps thirty other offices an advice of the amount of salary contained in this composite cheque. That costs us postage and work. Some of them are very happy to give us ninepence for that service. They save twopence on each cheque which might otherwise have been involved, as well as other things that you know better than I do. But there are many other employees who get a salary cheque and who come in as individuals: we do not say: "Is this a salary cheque?"; we take it as a cheque payable to him as payee. There are many hundreds of those. When we can identify the source of the cheque and the employer is getting some advantage we feel justified in charging, but we have no justification, nor are we allowed, to make a charge on our depositors for a service of that kind in the Ordinary Department. That is the difficulty with which we are faced.

8135. So that in fact you already are charging for your salary transfer service?——*We* do. I do not know whether that is peculiar to our own bank. We do it also in the case of miners who are removed from the pit where they should be paid. The National Coal Board say to us: "We are going to send you a cheque every week for thirty or forty miners and they will come into your office and lift the pay". We cannot just hand them their pay; we have to make a deposit entry, and they are in fact depositors. They come in on Friday night and lift out the deposit that was made the day before. This all takes time and we have to exercise care, and so we make a charge for that service.

8136. *Chairman*: To the Coal Board?——Yes.

8137. *Professor Cairncross*: The figures in Appendix A, showing salary credits and withdrawals during one quarter in 1957, show an excess of credits over withdrawals during that quarter of about £1m. I take it that would not be typical; you are not constantly in surplus on salary credits and adding to your credits each quarter at the rate of about £1m. in consequence of the service you perform?——*Dr. Lawton*: No doubt there will be variations, but I was very much surprised at one of our offices on Tees-side to find that in their salary accounts there was an average balance of £200. That is really very good, and that was growing. Even so, the arithmetic of it is rather devastating; £200 means £1 for management expenses; if we have a monthly cheque and a monthly withdrawal that is 24 transactions; if we have 24 transactions each costing 1s. to 1s. 6d. we are out of pocket. We do not make a charge, but we say that we will not accept a bulk salary credit from a firm without inquiry of the local branch manager as to whether he can absorb that in his business. We do not very much like the idea of charging; it might be the only possible way of control, but we should prefer, if we found that we really could not burden a particular office with any more fairly substantial firm credits, to say: "We are sorry; we cannot take on this additional one."

8138. I take it you would not have the balances standing to the credit of those covered by the schemes listed in Appendix A?——Not here. I am bank "R", which was a sample because we have not got those accounts segregated.

8139. *Professor Sayers*: Sir Kenneth Stewart said that the depositor comes when it is convenient to him; do you arrange the hours of opening in such a way as to facilitate these visits?——*Sir Kenneth Stewart*: Yes, I think we do. We are normally open from 10 a.m. to 3 p.m.; anything extra varies with various banks according to their circumstances. In the Manchester bank we are open from 10 a.m. to 5 p.m. on Mondays, and on Fridays in all the banks outside the centre of the city we shut at 3 p.m. and open again from 5 p.m. until 7 p.m., so as to suit the particular customs of the people in various places.

8140. *Chairman*: At the end of your memorandum you make some remarks about new opportunities for the Trustee Savings Banks in the future, "if they are enabled to take advantage of them with, as in the early days, the encouragement of the State." I follow that the salary credit and all that goes with it may be too expensive for the Trustee Savings Bank to handle if it is developed; but where are the new opportunities going to lie?——Simply in development. In 1946 we had 770 offices; if I remember aright, we have 1,333 today, and we find that it is bringing us in at the rate of 300,000 or 400,000 new depositors a year in the Ordinary Departments. Wherever we put up a new office a great number of people come in to invest. Of course, the putting up of new offices is a very expensive matter, and we have to keep it within such bounds as are necessary. For instance, if I may take the London Bank as an example, the London Bank of course suffered most when the Post Office was opened; practically speaking all the London Trustee Savings Banks shut down. In the last ten years fifty or sixty new branches have been opened in London; they are steadily increasing their deposits, almost all in the Ordinary Department, at a rate of £50,000 per office per annum. It takes fifteen years, and perhaps a little longer in London because expenses are a bit higher in London than in the provinces, for a bank to reach a point at which it covers its cost. For this reason offices can only be opened as we can afford to open them. That is where the mutual assistance scheme comes in, in helping to open these offices, because any surplus that there is over goes towards development and paying back debts that one bank makes to another, and that sort of thing. We were discussing this morning whether, if you asked us such a question, we should suggest that there were any fresh facilities we wanted, and there are none. We are carrying on very nicely and steadily on the way we are going; all we want is to have enough money to pay our expenses. We do not want an extravagant amount paid us for running the show, but, if we can carry on as we are doing and expenses do not increase too much and inflation does not become too bad, with the help of the surplus we are able to make

from our pretty steady increase in funds every year, we are hoping that we will be able to carry out a pretty steady line of development.

8141. What then lies behind your words in paragraph 53 about the new opportunities? What are you looking for in that prospect?——When I wrote this I was looking very much at the problem that we were running up against at the time, inasmuch as we were getting 7s. 6d. per cent., and we were not able to run our show at 7s. 6d. per cent. The statutory limit on what the Government were allowed to pay us was 7s. 6d. per cent. Under the new Act that was passed this year the limit that the Government can pay us has been put up to 12s. 6d. per cent. and, by negotiation with the Government, we have received what is to us at present an entirely satisfactory rate of 10s. per cent. On that we hope we will be able to make a sufficient measure to enable us to carry on. If we had got less than 10s. per cent. we would have been very unhappy because it would have cramped our style badly.

8142. *Professor Cairncross*: I have one rather special question to put to you. We have been given some figures for the Special Investment Department of the Scottish Trustee Savings Banks over the past three years but not for earlier years. Would it be possible for us to have figures of the deposits in, withdrawals from and balance outstanding in the Special Investment Departments of the Scottish Trustee Savings Banks for each year from 1946 to 1953?——*Mr. Harrison*: We will certainly get those figures out and send them to you, if we may*.

Chairman: I think that completes our questions, Sir Kenneth. We are much obliged to you and your colleagues for your help.

(*The witnesses withdrew.*)

The following witnesses, representing the Multiple Shops Federation, called and examined:—

W. CRAWT, ESQ., Managing Director, Tyler and Co. Ltd., O. H. FROST, ESQ., M.B.E., M.C., Chairman, New Day Furnishing Stores Ltd., W. G. MCCLELLAND, ESQ., Managing Director, Law's Stores Ltd., J. C. BUTLER, ESQ., M.B.E., Director, Multiple Shops Federation.

8143. *Chairman*: We are much obliged to you for sending us this memorandum,† which I note you have collected from a number of sources with which you are in contact. Perhaps you would have it in front of you and see if there are any questions we want to follow up. You say:

"The Committee has asked the Federation for evidence of the effects upon members of the authorities' use of monetary measures since 1951, and of the effects of these measures upon consumer spending. . . ."

If I follow the purport of your memorandum, your general answer is really almost unqualified, that the effects have been very small in those fields?——*Mr. Butler*: That is the burden of the evidence which various members supplied to me. I think it is possible that some of the gentlemen here might want to qualify it rather more than I have done in the statement.

8144. Perhaps that would be a good way to start, because the impression I had, reading the memorandum as a whole, was that so far as planning developments or extensions is concerned, and spending money for that purpose, the effect of the monetary measures taken had been very small, though occasional instances cropped up of somebody who had been influenced; and that with regard to consumer spending the effect again was very small, at any rate up to September, 1957; and that even since September last year the observable influence, at the time this information was collected at any rate, was very small. What qualifications would you like to make upon that as a general statement of what you have been able to observe?——*Mr. McClelland*: As far as I am concerned I would say that we have seen no perceptible influence of the measures on consumer spending; and certainly they have had no effect on our own carrying of stocks of commodities, which is determined by other factors whose importance is very much greater than that of the cost of finance.

8145. Would you just outline those other factors?——First of all we have to avoid being out of stock both in our branches for our customers and in our warehouse for our branches. We regard that as of primary importance; indeed we think that if we tend to become out of stock in our warehouse then our branch managers tend to carry higher stocks because of the uncertainty of getting prompt delivery. So what you might call buffer stocks are set so as to be adequate. So far as replenishment stocks are concerned, we try to balance the cost of getting a lot of consignments and the cost of holding stocks. We turn over our stocks very rapidly; we only hold in the whole business about five to six weeks' stock, so that any change in interest rates per annum is very small as a proportion of turnover. In addition, there is the risk of goods becoming unsaleable and the cost of storage and so forth. Those are the main other factors and, when we have looked at all those, interest plays a very small part.

8146. I suppose that in the grocery business the stock-holding is almost inflexible; there is not much that can make you vary the volume of stock you hold?——We could order a smaller quantity at a time and more frequently. That would increase the work in certain departments, and if we were forced to reduce our commitments temporarily we would certainly incur that extra cost.

8147. *Professor Cairncross*: You have not been influenced by lack of finance? You have always been free to choose the level of stocks you have wanted?——Yes. It has so happened that we have always looked too pessimistically at our requirements for finance, and we had made arrangements with our bank in advance of restrictions coming in several times; those arrangements were maintained. So far as fixed capital is concerned, we have felt a very strong effect since 19th September on the property market. We have been trying to dispose of various small shops to independent retailers, because we do not think they are an economic proposition with us, and since 19th September the market for that type of property has flopped completely. At the same time there have been one or two cases where we have been interested in acquiring branches which were in good sites run by independent retailers and not run economically, efficiently and profitably. In some cases the vendor has been prepared to take out a debenture from us and finance the transaction that way, but in one other case the amount has been large, and we have been deterred from continuing negotiations because of the amount being so large. So far as that is concerned it would be true to say that our present overdraft limit and the difficulty, which we have not pressed very far, of raising finance in other ways have deterred us.

8148. *Sir John Woods*: Was that the cost of the finance or the non-availability of it?——The non-availability.

8149. *Chairman*: Has Mr. Frost any qualifications to make to your general line?——*Mr. Butler*: I should explain that for certain reasons Mr. Frost did not contribute written information at the time we were collecting it, but we had the opportunity of asking him to come today and I am glad he was able to accept the invitation. Mr. Frost will be able to put a point of view which is certainly not in this written statement.——*Mr. Frost*: The members of this Federation have only one thing in common: we all own a large number of shops individually. Apart from that our interests are very divergent and diverse; if the points of view that we put to you may seem at variance one with the other, it is for that reason. I am here today as a representative of a hire purchase furniture firm and therefore my problems are very different from those that have been outlined by Mr. McClelland. In our case we not only have the general monetary limitations which the Government have imposed but we have also the arbitrary and discriminatory legislation which has been directed against hire purchase trading in general. Whereas I think that the general run of retail traders have not suffered materially in regard to these points which have already

† Memoranda of Evidence Part VII No. 12.

* *Note*: The witness subsequently informed the Committee that the figures asked for were not available.

been touched upon, the hire purchase furniture trade, indeed any hire purchase trade, is in a very different position. With the recent measures since September we have suffered very much indeed in that, as our business has to be financed on a long-term basis and therefore we are dependent on borrowing large sums of money in relation to our business, the effect of a material increase in Bank Rate does come very much into our planning for the present and for the future.

8150. Do your stores carry their own hire purchase?——They find the finance for it themselves?——We find the finance; we have done so for some years for all our own contracts.

8151. *Lord Harcourt*: Do you ever make use of the block discount facility?——We have not done so for the last three years since I have been chairman of the company. Before that it was done in a certain measure.

8152. *Professor Sayers*: It is the rate at which you have to pay for finance that you feel has changed heavily against you since last September? You are not thinking of any other changes?——Just that particular change in regard to the monetary system. I do not know how far the Committee is concerned with the other measures which were introduced which were not of a monetary nature, that have affected the nature and operation of the business.

8153. *Chairman*: We should like to hear from you about them, but we want to follow it point by point as we go. Do you normally get your finance from the bank?——From the banks, yes. With hire purchase contracts that have to be financed on average for about 2½ years the volume of finance we require is very material in relation to our turnover. The other changes to which Professor Sayers has referred are matters which largely concern the public and the reaction to the purchase of our goods. If limitations or restrictions are imposed on the methods of trading they have a bad effect on the public. By and large, however, my own view is that these special and discriminatory measures which are taken against particular trades do not really serve a useful purpose in the interests of the community as a whole, because by damming up the pressure of inflation in one hole they merely cause it to flow with greater strength through another. That is what has been happening in the last three years to hire purchase business.

8154. *Professor Sayers*: But this is something that was not changed last September?——No. I am looking over a longer period. I am saying in regard to last September that, contrary to what the general run of the members of the Federation have said, which was that these things have not materially affected their business, I think they have affected hire purchase business materially.

8155. *Chairman*: What did you not do after the change last September that you had been doing before, or what did you do that you had not been doing before?——We had to take very careful acount of every item of both revenue and capital expenditure. The expense of finance was so heavy, and so heavily increased, that it made a material difference to our planning both for present and future needs. We just had to cut our suit according to our cloth.

8156. Do you mean you took in less stock?——No, I do not think it would be true to say that we took in less stock; but we were very careful about what we bought, and we also tried to extend our arrangements with manufacturers and other suppliers in regard to deliveries. In other words, whereas before it would have paid us to take in large quantities to our warehouses and carry them on our own account, we now have to plan carefully for all our purchases to come in at what we think are the right times in regard to the sales we anticipate. We have had to do a very much greater managerial job in our business than we had to do before. I am not saying that in many ways that is not a great advantage; it puts people on their toes.

8157. How do the manufacturers from whom you take your stock regard your new and more selective form of ordering?——They have been ready to meet us because they have suffered in their turn at the change in our business. It has been a co-operative effort between suppliers and retailers.

8158. *Professor Sayers*: Even if you have not taken a decision to reduce stocks, your more selective ordering must have had the effect of reducing the amount you have on hand at any time?——In a small measure; but with a group of multiple stores (we have some 130) a minimum stock has to be maintained in each store, and below that we cannot go if we wish to maintain our business. We have to multiply everything by 130, so that the movement between minimum and maximum is really very small.

8159. How else can you save money, except by reducing the amount you had outstanding?——We do not achieve very material reductions.

8160. Then what is the point of the exercise?——To reduce whatever you can reduce, because we are having to pay so much more for our finance.

8161. Even a little saving is quite a lot of trouble?——Our final net profit does not leave so much over that we can afford to throw away money we could otherwise save with a little careful planning.

8162. *Chairman*: I got the impression from what you said that you went for the more certain-selling lines of stock and took no chances about things you might have to hold on to for a period?——I am sorry if I conveyed that impression; I did not wish to do so. I was trying to say that we have to maintain in each of our many branches a minimum stock, which has to be a fairly representative collection of all the goods we normally sell. Among those goods we would naturally have certain articles which were not selling as readily as others.

8163. There is no margin for play in that aspect of it?——No.

8164. *Professor Cairncross*: If I understood you aright, you are also using your power to call forward supplies at a time when you think they will be readily saleable. If that is so, that would seem to cast on to your suppliers more of the burden of carrying what would normally be stocked on your own premises?——That is so.

8165. In that sense you would also be economising in finance but partly at the expense of your suppliers. Thera the question put to you earlier is pertinent: do your suppliers resent the additional finance they are then called upon to put up, and are they able to carry the burden?——So far as our experience goes they have been able to carry the hurden. We have had no complaint from that source.

8166. Does it mean also that you have tended to order in smaller lots than before?——We have endeavoured to get manufacturers to spread deliveries; we have not actually ordered in smaller lots. We have given them the production runs which they require in order to get the best prices, but we have persuaded them to phase their deliveries over longer periods.

8167. In effect they have the option of either carrying more stocks themselves or chopping up the order and raising the purchase price?——Yes.

8168. *Lord Harcourt*: Are all your sales on hire purchase terms?——No, they are not. I have jotted down the figures of my company's trading from the year 1954, which was the year before the restrictions were introduced in February, 1955. At that time the hire purchase element in our business was 94 per cent. and the cash element was 5·66 per cent. In 1955, there were roughly three months only of restrictions; the hire purchase element was only 90 per cent. In 1956 it dropped to 53 per cent.; in 1957 it was 29 per cent., and in this year to date, which covers nine months of our financial year, it is 28 per cent. As against that the credit sales were negligible in 1954, ½ per cent.; and they have progressively increased in 1955 to 2 per cent., in 1956 to 32 per cent., and in 1957 to 58 per cent., at which figure they remained this current year. The cash figures have varied from 5 per cent. in 1954, to 7 per cent. in 1955, 14 per cent. in 1956, 12 per cent. in 1957, and 14 per cent. this year. So although the restrictions have had the effect of curtailing the hire purchase business on a long-term basis they have diverted that business into the credit sale business. That is a concrete example of my point that by damming up inflation in one direction it is merely diverted in another.

8169. The credit sale has a maximum of nine months?——Yes.

8170. What has happened to the total volume of business?——The total volume of business today is 70 per cent. of what it was in 1954, before the restrictions were introduced.

8171. *Professor Sayers*: Did the September changes have any effect on your capital plans?——Yes, they did, in that we were compelled to restrict planning operations in regard to redecoration and refurnishing of our shops. It is usually done on a fairly long-term plan and, in view of the expense of money, we felt that we had to postpone a great deal of that work.

8172. You said "in view of the expense of money"; was it the expense rather than the non-availability that checked you?——Both in our case.

8173. But the rate of interest did enter into it?——The rate of interest was the main factor because at the time you are referring to we had ample funds. In a hire purchase business one is always collecting money for 2½ years after a transaction has been made. The position we are now in is that 1958 is the crucial year and the critical year for the hire purchase business as a result of the restrictions imposed in 1955.

8174. *Chairman*: Critical in what sense?——That we have exhausted all the money that was coming in to us as a result of collections on transactions made in 1955.

8175. You said that it was the high cost of money that made you defer this programme of redecoration and alteration. Is it inherent in that that your view was that the cost of money would be less high in the reasonably near future?——I think it is, yes.

8176. *Professor Sayers*: You say that the rate of interest mattered a great deal from September onwards; had this rising trend since 1951 mattered at all? Were the rates that were payable in 1955, for instance, a deterrent?——Not the rates in themselves. One has to take two things in conjunction in considering the effect of these things. If the hire purchase trade had been allowed to continue without restrictions, without hindrance of a serious nature which the Government imposed, it would not have mattered so much about the rate of interest or the availability of money.

8177. You are talking now about before September, 1957?——Yes.

8178. But you think the rise to 7 per cent. did make the rate of interest begin to matter?——I think it did, combined with the other restrictions on hire purchase.

8179. Suppose that there had not been any restrictions on, say, hire purchase in September, 1957, that Bank Rate had been put up, and that there had been no other change special to your trade at all; would you have become more selective in your purchasing and have postponed this redecoration of shops and so on?——*Mr. Frost*: I think we should have, yes.—*Mr. McClelland*: Could I come in on this question of redecoration and so on? Earlier I mentioned one case where the extra difficulty in raising money probably had a marginal effect on our decision to drop negotiations for a business, but that is only an isolated case; in general we have been spending a good deal on our existing premises. In distinction to my colleague here I would like to say that in most of these cases we have thought when the time comes that the need will brook no delay. A district may be expanding and developing; other districts may be going downhill and be subject to slum clearance; some shops therefore may need to be enlarged while others may have to be closed. At the same time we are in the middle of a technical revolution (conversion to self-service and things like that) in the grocery trade. There are a lot of personal factors, management factors and the possibility of neighbouring buildings becoming available and things like that which in our concern have made it in many cases essential to go ahead with redecoration. It may not be just redecoration; it may be reconstruction, it may be anything. In fact we have stepped up our programme since credit became tighter.

8180. *Mr. Jones*: Does that arise from having reserves available for this sort of development and for the maintenance of decoration, or does it mean that you are prepared to borrow the money and pay the higher rate of interest?——We have been working on a bank overdraft. We have been well within the facility allowed, but we have been incurring a liability for interest over the whole time of which I am speaking.

8181. Then without reserves you would go on?——Yes, without reserves, except in the shape of extra and unused overdraft facilities.

8182. *Chairman*: Has Mr. Crawt any comments to make?——*Mr. Crawt*: I am concerned with the wine and spirit trade; our biggest problem today is the effect of the spreading of the spending power of the public. We now find that the Christmas trading takes up a larger percentage of the year's business than ever before. Our present experience is that we do in December probably one-fifth or one-sixth of the total year's trade, so that the financing of stock in front of Christmas is a very real problem, by reason of the very high level of duty which is paid. We have had to look very closely at our level of stocks at branches; it is so easy to have money lying idle in unused stocks, but bearing in mind the high rate of duty we have had to give it very much closer attention than we ever did before. Then many of us have been leaning on the distillers rather more than we ever did before. Instead of buying under bond and financing the duty as we cleared we have been buying duty paid and taking the thirty days' credit.

8183. This is since September?——Yes, and it has been growing a bit lately. Of course since September none of us has yet shipped a full vintage of claret or burgundy; none of us has shipped a full vintage of claret or hurgundy since the 1955 vintage, and none of us knows whether we are going to ship a 1957 vintage because we do not know the quality of the wine yet, although some may have financed forward; but if we do, the financing forward is going to be an immense problem, particularly keeping in mind that space restricts bottling in under bond stores and bottling in duty paid stores requires financing of duty. So we have to consider the financing of duty and the laying down of stocks, which is for a long period of years, and the tendency is that, if we are not careful, we shall find ourselves losing the quality level of wine by reason of the problems of financing and the laying down of stocks. Many of us have the view that that might seriously interfere with the tourist trade in this country by reason of the fact that the quality level of wine may not be available to the extent that it should be. We have found, too, that there has been a growth in the day-to-day purchasing of repetitive lines. I am dealing now with the cash purchases of the public. Instead of buying their week's requirements they are more and more buying on their day-to-day level, because of not wishing to finance it forward even for a week for themselves. We also find with credit transactions that a growing percentage of our customers finance from month to month, and if we miss the first weekend of a month in the delivery of the statement of account for the previous month's supplies we miss the settlement, and have to wait until the next month. We have the feeling that more and more of the people who live on a monthly income take their monthly bills the first weekend of the month and deal with the bills which are to hand; having dealt with those they have expended their resources, and any that come in after that have to wait until the following month. That is a very bad thing from our point of view psychologically because in the second month the account looks large and the customer's immediate reaction is: "We must cut down on this because we are spending too much in this direction." That is a bad thing as far as we are concerned.

8184. The big unknown problem is the standard of the 1957 vintage?——That may well be.

8185. *Professor Sayers*: Is it your overdraft limits that are bothering you there?——Yes. If one had had overdraft arrangements prior to September of last year over the Christmas period, I am told that it has not been difficult to have those overdraft arrangements continued over last Christmas, with some understanding about future Christmases; but if one did not have overdraft arrangements in the past it is very difficult if not impossible to get those arrangements made for the future.

8186. There is no basic ration of credit?——That is true.

8187. Two among you have referred to the overdraft limits as being the effective limits rather than any difficulty of getting an increased overdraft or an increased use of overdraft facilities. The agreed limits with the banks appear to be the effective limit from your point of view on the credit available. Is that right, Mr. McClelland?——*Mr. McClelland*: In our case it is.

8188. You were not worried about increasing your overdraft; you had plenty of room below the limits?——*Mr. McClelland*: That is correct. We had previously increased our overdraft to the limit they were prepared to grant us.—*Mr. Crawt*: I am always worried at overdrafts on the present rates, because the room for manoeuvre in the price structure of a spirit which suffers a very heavy duty is very small indeed and does not permit of high financing rates.

8189. That is another point; it is the agreed limit with the bank that is bothering you in the first instance?——*Mr. Crawt*: Yes. With expansion of business one must have a higher limit. The wine and spirit trade is mostly concerned with that limit in front of Christmas.—*Mr. Frost*: In our case, we are given to understand the banks had special instructions to treat the hire purchase firms rather more severely than other customers.

8190. *Chairman*: Let me mention one or two other general impressions I have formed from your memorandum, and see how far you would regard them as correct and how far any of you would qualify them. I was struck by the number of members who answered your questionnaire who seem regularly to finance their development out of retained profits. Do you think that is a representative pattern? All of you here today have spoken rather of the bank overdraft as being the source of development finance? ——*Mr. Butler*: As I said at the beginning, I could not say that the group of members who supplied information were a good cross-section of the multiple retailing trade; but certainly of those who did reply to me it was a very common fact that they relied very largely if not exclusively on their own resouces in the form of retained profits. —*Mr. Crawt*: It depends very much on whether expansion in the way of new branches and so on is by freehold or leasehold. Many multiple groups do their expansion under leasehold arrangements, but a firm expanding by way of freehold cannot finance it out of its own resources except on a very limited scale. Big expansion must be financed by leasehold interest, and that is contrary to the policy of many companies.—*Mr. McClelland*: It also depends on the rate of expansion. For a number of years we were expanding at a rate which was determined by the fact that a new generation of executives were still finding their feet. During that period we could finance our expansion out of profits and a relatively modest increase in our overdraft. Since one does not always replace equipment in the same form, we usually include depreciation in the funds available for new expenditure on fixed capital; but there comes a time, I suppose, in many businesses where for one reason or another circumstances seem favourable to taking the bull by the horns, and it is in those circumstances I think one tends to rely more and needs to rely more on outside finance. That has been our case.

8191. It seems that certainly up to September last many of your members had found alternative finance fairly abundant; they found places they could turn to when the banks were not able to help them further. What is your impression about this?——In our case, Mr. Chairman, I think that was so; finance was freely available.

8192. I think, Mr. McClelland, you said you had not looked very far on this question of raising alternative finance rather than deferring development?——We had not looked very far, partly because we had a lot of other commitments on hand which were going to be covered by our overdraft facilities. We happen to be in a very strong position with a great amount of freehold in our own possession, and we thought that at any time if pressed we could have turned that freehold into liquid capital.

8193. *Lord Harcourt*: Have you in fact sold and leased back any properties in the last four years?——*Mr. McClelland*: No.—*Mr. Crawt*: We have not, but we are having to give serious consideration to it now. We have reached the limit of our own resources for expansion in freehold properties, but not the expansion in leasehold premises. Mr. McClelland mentioned the rather novel form of finance by purchasing a property and taking out a debenture for it. That is out of the ordinary so far as raising money from banks or other orthodox sources is concerned.—*Mr. McClelland*: Purchasing a going concern it is sometimes possible, depending on the motive of the vendor.

8194. *Professor Cairncross*: May I ask you something about the replies you received on trade credit? I have formed the impression from some of the answers given today that many of the big multiples have been able to obtain additional credit from their suppliers, and have at the same time been under pressure to give additional credit to their customers. When that happens are the terms on which the credit is received or given altered? Is a higher rate of discount offered to customers and a higher rate of discount required by the supplier?——*Mr. Crawt*: In the wine trade the answer is no in both cases.

8195. There is no change?——No change. No discount is given to the customer, and the terms of purchase from suppliers are related in the majority of cases to quantity rather than to times of payment.

8196. You said, as I understood you, that you had drawn more on the credit that distillers offer?——That is so.

8197. But they do not alter the terms of payment?—— No, because their terms are related to quantities of purchaso; it is a question of buying power, not of length of credit. But whereas six to seven months ago they would have been quite easy if one had gone beyond the thirty days' credit that they gave, and got into forty or forty-five days, now if one is one day beyond the thirty days one has a telephone call to remind one that the account has not been paid.

8198. There is no suggestion of an interest charge?—— No.

8199. And no discount for prompt settlement?——*Mr. Crawt*: No.—*Mr. Frost*: In the case of the furniture trade the position is the other way round. In normal circumstance the retailer gets the best possible discount for payment by cash, and the amount of discount varies on a sliding scale, which differs with different suppliers as to what the shortfall of that discount will be for particular lengths of extended credit terms, and there is an overall discount availahle on quantity purchases; so as ono extends one's credit one sacrifices one's discounts and rebates.

8200. Have the terms changed? Have the rates implicit in that changed?——No, they have been fairly constant in the furniture trade and allied trades for a longish period.

8201. In spite of a movement of the Bank Rate from 2 to 7 per cent?——By and large there has been very little change. Furniture manufacturers have been under a good deal of pressure through slackness of business and are anxious to get business on any terms.

8202. Is this also true in the grocery trade?——*Mr. McClelland*: In the grocery trade there is a clear distinction between quantity discounts and settlement discounts. Invoices are either for a settlement discount or net; some, usually for provisions which have a quick turnover and large volume, are marked "net seven days". Incidentally, we have begun to pay after fourteen days instead of seven, with only one objection out of 30 suppliers. Other net invoices we pay after four weeks. The settlement discounts are either 2d. in the pound or $1\frac{1}{4}$ or $2\frac{1}{2}$ per cent., and the length of credit is so relatively short that it always pays us to take advantage of those discounts.

8203. Again there is no change in the rate of discount in these settlements?——There has been none.

8204. In the memorandum there are some references to this, and it does seem that suppliers have not objected greatly to more advantage being taken of the credit they offer?——*Mr. Crawt*: I would subscribe to that view as it obtained at the time of the memorandum, but there has been a considerable tightening up since. I would not subscribe to that view today.

8205. There seemed to be different views as to the relative cost of trade credit and bank credit. In paragraph 16 there is a reference to circumstances in which "it was actually cheaper to use trade credit . . . . than it was to borrow from the banks", but in paragraph 8 another member seems to imply that trade credit was certainly more costly. Is this something on which there are wide differences?——*Mr. Butler*: The reference in paragraph 16 is not to any of the companies represented here. A very large company in the food trade gave us

that information. I do not think the two references necessarily conflict; this company particularly says "in one or two cases".

8206. I formed the impression that the memorandum laid more stress on the effects of higher interest rates and the credit squeeze generally on capital expansion and replacement than on the effects on the holding of stocks. I am therefore a little surprised to find that at least two of the replies we have had today imply that stock-holding either has been affected or is likely to be affected by the difficulty of finance?——*Mr. Butler*: There was no doubt about the statements which came to me; in so far as people said they had been affected by the monetary measures they mostly quoted examples of effects on their capital expenditure. The effects on stock-holding vary according to the rate of stock turn. If the stocks turn over very quickly, then a higher interest rate is not likely to have such an effect as if the stocks turn over slowly.—*Mr. Crawt*: I think that is a point of paramount importance, the question of the turnover of stock and the value of gross profit in the stock sold. If a firm is trading in whisky and gin where the margins of profit to the retailer are 15 per cent. gross, and if over the Christmas period it has to hold those by reason of the physical problem of getting them into the shops in front of Christmas for ten weeks or so, then it does become a vitally important matter; but if one is talking of financing bourgeois wines on which the margins of gross profit may be around 30 per cent., then it is a very different proposition.

8207. I was impressed by the fact that you and Mr. Frost have laid some stress on the effect on stock-holding of difficulties of obtaining adequate finance. I appreciate that you have a very slow turnover compared with others. ——*Mr. Butler*: The rate of stock turn may be the explanation of that. There was one other point, in case it has not sufficiently come to the surface, that was made by several members, about the somewhat arbitrary incidence of quantitative restrictions. It seems in quite a number of cases to mean the loss of an opportunity which does not necessarily recur. People have cited the loss of an opportunity to invest in particular kinds of plant and machinery; Mr. McClelland referred to the opportunity of acquiring a particular site, which is a non-recurring opportunity perhaps, and even such personal factors as having one's executive team at the right pitch; that team is not necessarily together when the finance becomes available again.

8208. *Lord Harcourt*: What is the total membership of your Federation?——For what it is worth, we have 500 members. There are probably 1,100 or 1,200 multiple companies in the country, but this is not a case where numbers indicate size; our members probably account for two-thirds or even three-quarters of the trade done by multiple retailers.

8209. *Professor Cairncross*: How many of your members replied to the questionnaire you sent out?——Twenty.

8210. So that when you mention say one, two or even three of your members giving similar replies, that is a fairly large fraction of the total?——Yes, but with such small numbers, of course, it is difficult to say that it is ten per cent. or fifteen per cent.

Chairman: Thank you. We are very grateful to you, gentlemen, for coming this afternoon.

(*Adjourned until Wednesday*, 14*th May*, 1958, *at* 11 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-SECOND DAY

Wednesday, 14th May, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 8306 to 8616 only)
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The following witnesses, representing the Association of Municipal Corporations, called and examined:

J. W. F. HILL, ESQ., C.B.E., Chairman, General Purposes Committee, A.M.C., Alderman, Lincoln City Council;
E. SWALE, ESQ., D.F.C., J.P., Alderman, Chesterfield Borough Council;
C. H. POLLARD, ESQ., C.B.E., City Treasurer, Kingston upon Hull;
F. SMITH, ESQ., M.B.E., City Treasurer, Peterborough;
SIR HAROLD BANWELL, Secretary, A.M.C.

8211. *Chairman*: We are much obliged to you for the paper* which you sent in to us, which has been most helpful. We should like to ask you some questions arising out of it. As you know, we are seeing the County Councils Association later in the day, so that we must distinguish in our questions between those things which are more your special concern and those which are their concern. You represent all county boroughs and non-county boroughs in England and Wales, and all but one of the metropolitan boroughs?——*Alderman Hill*: Yes.

8212. You have given us in Table C an analysis of your borrowing for two recent years. It would appear that much the largest single part of your borrowing is concerned with your housing obligations; next to that would come your responsibilities for education; then sewerage and water supplies; and then highways. Would this roughly be the pattern over the years?——Yes.

8213. In paragraph 3 you give us an analysis of the purposes for which finance is sought otherwise than from rates and from the Exchequer. Would it be possible to give us some rough idea of the proportion of your capital expenditure in a year that is carried by Exchequer grant?——*Mr. Pollard*: I do not think we can give you that figure.

8214. *Professor Cairncross*: Is it of the order of 50 per cent.?——A table published by the Institute of Municipal Treasurers giving the summary of debt outstanding shows that housing represents no less than £2,305 million, education £381 million, and other services £365 million. Education is the one which is mainly concerned with a specific grant. The housing grant is granted on a unit basis, and a large proportion of the housing debt is met from the rents of the houses as distinct from Government grants or local authority payments. I would not think that as much as 50 per cent. of our total capital expenditure was met by the Government.

8215. Are you able to tell us how far you finance your capital expenditure out of revenue?——Again we have no statistics available in print, but we could very well provide that information for the Committee very quickly.†

8216. *Chairman*: Perhaps you would send the Secretary what you have on this. If you finance capital expenditure out of revenue do you get into any difficulties with your grants from the central Government?——No, because where we are dealing with a grant earning service we arrange in advance with the department concerned to ensure that they will accept the expenditure for grant purposes. In many cases we have a general kind of approval for amounts not exceeding a certain sum for charging in the year of account.

* Memoranda of Evidence Part IX No. 1.
† See Appendix to Minutes of Evidence.

8217. *Professor Cairncross*: Have you been under any pressure to increase the resort to ordinary revenue to meet capital expenditure?——No.

8218. Has the increase in capital charges had that effect to any extent?——There is no doubt that the local authorities have decided to meet capital expenditure, within limitations, from revenue, in a number of cases, rather than borrow, because of increased rates of interest; but what they can do is very limited. I am speaking of the large bulk of authorities; for the larger authorities, where the product of a 1d. rate is £50,000 to £60,000 or more, it is a very different proposition when dealing with expenditure from revenue.

8219. *Professor Sayers*: Has this tendency to meet capital expenditure out of revenue because of the high interest rates come only since last September, or was there already a change in that direction before September?——Local authorities have increasingly been trying to meet capital expenditure from revenue rather than borrow for it. I only wanted to indicate that I thought there may have been some impetus to that by reason of the rates of interest.

8220. Would you put any period to that?——No; it has been going on for a very long time.

8221. A matter of some years?——Indeed, yes.

8222. *Sir Oliver Franks*: Can anything be said about the period of the additional impetus? Did that only come since last September, or did it go back a bit further in time?——It is difficult to answer that question in a definite way. Local authorities, over the past few years in particular, have been tending more towards this method of financing capital expenditure, again within limitations; when I use the word "impetus" in relation to the period from last September I think it is relatively small even then.

8223. The point of the question is to find out, if possible, what in fact in the experience of the people who may or may not have been affected by the higher cost of money has been the influence upon them: whether it has been substantial, or real but small, or none. If the impetus to meeting capital expenditure out of revenue has really grown in this period in which the cost of money has been dearer, we should have direct empirical evidence on one part of the field. That is why the question is an important one for us to ask, and why it is important for us to know if we can be told?——*Mr. Pollard*: The only answer I would feel able to give would be that it is not substantial; it is relatively small

because the period is so short. Without further information direct from authorities I could not be more definite than that.—*Mr. Smith*: I would agree that it is quite small, but the smaller authorities in particular have, I think, been inclined to look more carefully at the possibility of financing capital expenditure out of revenue in the last nine months or so, than possibly they were previously.—*Mr. Pollard*: This does not refer only to impetus springing from the local authorities. In many cases Government departments have probably withheld loan sanction; it may be that some authorities, if they have had loan sanction withheld and the amount has been within their compass, have decided to meet the cost from revenue.

8224. *Professor Sayers*: That is to say that the withholding of loan sanction on central Government grounds has not succeeded fully in holding down capital expenditure?——In these small cases that I am trying to refer to, I would say that that is a fair summing up of the situation.

8225. This would relate to small capital schemes?——Yes.

8226. *Chairman*: You have several times used the phrase "within limitations" when speaking of what they could do in the way of raising capital expenditure out of revenue. What had you in mind there; the impossibility, for the large monies involved in a scheme, of raising it out of rates?——Yes. If a scheme is going to cost, say, £100,000 and the product of a 1d. rate is £2,500 it is just impossible for a local authority to put it on to the rates in one year.

8227. *Professor Cairncross*: So far as one can judge from the figures there were two periods in which the revenue surplus rose rather sharply, first in 1952-53 and second in 1956-57. This is not just for municipal corporations but for all local authorities. These two periods happened to coincide with periods in which local authorities were under considerable difficulty in borrowing or had to pay higher rates. Would it be within your recollection that these would be two periods of marked change in resorting to revenue surpluses?——No.

8228. Are there any specific items of capital expenditure which you would normally expect to finance out of revenue?——Some kinds of recurring expenditure that might many years ago have been the subject of loan sanctions and loans. The construction of new roads, for example, may be financed by a number of authorities directly from revenue because that is an item that recurs every year. It is rather difficult to give you other illustrations; but in schools, for example, there are cases where extensions are made from time to time, and they are regular in their incidence. These cases are increasingly being met from revenue instead of by borrowing. One instance occurs to me from the past, in order to try to illustrate the kind of thing I mean; in my young days it was the practice of electricity authorities owned by local authorities to borrow for providing electricity meters. It came to be recognised in the 1920s that this was ridiculous, because it got to the stage where we were spending more on loan charges than we needed to spend on meters in the year; and the system was changed. It applies only in a minor degree in connection with water undertakings because meters for water is not a very big thing. It is that kind of thing, recurring expenditure of that nature that can be met from revenue in the year in which it is incurred.

8229. There are no items you can think of that would, more readily than others, be transferred from the category where you would borrow the finance for capital expenditure to the category where you would rely on revenue?——*Mr. Pollard*: Offhand I cannot think of any particular items. I think we have all tended to judge this by amount rather than by purpose.—*Mr. Smith*: Most non-county boroughs limit it by amount; in other words, if the cost of a capital project is going to be under or just about £2,000, we think it is wrong to borrow because of the long spread of interest and the ultimate penal cost. Most of the non-county boroughs would not borrow for anything under £2,000, and that would not necessarily apply only to recurring items. I have in mind, for instance, a better mess room for the police, improvements to public conveniences and such small items; if they are under £2,000, we should generally not go to the market, but finance them out of revenue, spreading the expenditure over two years if necessary.—*Mr. Pollard*: One of the more modern developments, although it has been going on for some time, is the development of financing capital expenditure through capital funds, which is mentioned later in the memorandum.

8230. *Chairman*: In paragraph 5, you say:

"Loans from the Public Works Commissioners may be obtained by most smaller corporations, but are available only to a limited extent to the larger corporations."

I think I know what you have in mind in drawing that distinction, but what is it based on? Is it based on the view that the larger corporation has access to other means of borrowing which are not open to the smaller corporation?——Perhaps that is putting it too definitely. The Public Works Loan Board scrutinises applications from larger local authorities much more closely than applications from smaller authorities. We know that that must be so, because the smaller authorities in the aggregate have obtained the vast majority of their requirements from the Public Works Loan Board, whereas the larger authorities find it very difficult to get advances from the Public Works Loan Board at all.

8231. You would accept as the justification for that difficulty that they regard the larger authorities as having access to other means of borrowing?——I am not arguing the point, if I may say so, but merely stating it. The case that is made is that the larger authority has much better access to the open market than the smaller authority is believed to have.

8232. In paragraph 6 you say:—

"As regards lending on mortgage by the general public, this is usually in relatively small individual sums, but this method was very highly developed in many localities before the war and has been renewed on an increasing scale in the past few years. This especially applies in the north-west of England, but is being increasingly used in other parts of the country."

I would like to know what you can tell us about this particular form of borrowing? Would the sources tapped by the municipal corporations for this purpose be mainly local to themselves?——In general it is the local money that is brought in by the local authorities, but it is by no means confined to money from local people. In my own particular instance I have received loans from much wider areas than my immediate locality, and I think that would be the experience of most of my colleagues.

8233. When you say the general public locally, would they be institutions working in your area who would find this money?——Some of them; but when we say general public we are rather thinking in terms of individual loans. For instance, people may have £100 and want to lend it. If they have any knowledge of this kind of thing, they are following advertisements; in many cases they merely come in and inquire, they may lend £100 or £1,000. The local institutional lenders, like trusts and so on, also come into this picture.

8234. What about the Trustee Savings Banks?——*Mr. Pollard*: I look on the Trustee Savings Banks as the institutional type of lender. The Trustee Savings Banks lend all over the country. If there is a local Trustee Savings Bank it may very well be that the local Treasurer and the Actuary of the Savings Bank, through their respective committees, have a close liaison and a good deal of the money is lent locally; but, on the other hand, a great deal of the money is lent elsewhere.—*Mr. Smith*: It may be of interest on that point to give an example: about two years ago we decided that we would launch a local campaign by advertising in our local press and that brought in about £650,000 from about 1,000 different people. We think we skimmed the local money; we tried again eighteen months later and the result was £150,000. It is interesting from my point of view, as besides being the City Treasurer I am also the local Secretary of the Savings Committee; during that period when we were advertising I know that the receipts of local savings tended to fall; in other words, we were skimming it off for the corporation and it was coming from somewhere else.—*Alderman Hill*: The Trustee Savings Banks suffer in the

same way.—*Mr. Pollard*: There is a great deal of interest in this, if I may say so. I am also a Trustee of our Savings Bank and, like Mr. Smith, I am closely associated with our Savings Committee as its Chairman. From the local authority's angle it is very much easier administratively to borrow £100,000 through the Savings Banks than to borrow 100 separate loans of £1,000 each; and the Savings Bank keep their facilities for withdrawal and so on available for their depositors. I do not give that as the sole reason for the arrangements, but one has to try and balance these factors in borrowing procedure.

8235. Do you regard yourselves, as municipal corporations, as competing with each other for the resources of the general public on these loans?——We are competing with each other.

8236. Because you advertise outside your own area?——Yes, indeed; you will find advertisements in the national daily press, the weekly press and the Sunday press, and you will find too that local authorities from quite distant parts of the country are advertising in newspapers in other distant parts of the country.

8237. *Professor Cairncross*: What is the period of these loans?——It depends on the time; at the present time the general period probably varies from about two to five years for the type of borrowing that we are discussing now.

8238. Is there complete freedom as to the period?——As far as the authority is concerned, yes; we choose our own periods. The only thing that those of us who borrow in this way cannot do now that we used to do before the war is to take a loan for, say, five years and then let it run at six months' notice.

8239. *Chairman*: Are you not promised a better future with regard to that?——The Treasury have promised us that as soon as the current period of restriction is eased they are in favour of allowing this.

8240. *Professor Sayers*: You mentioned that, when your mortgages were being pushed locally and a large amount was obtained, the local national savings and the Trustee Savings Bank suffered. Would you say that most of the money obtained on mortgage was money that would otherwise have been going into Trustee Savings Banks, building societies and various national savings?——*Mr. Smith*: Yes. I think the people who lent money to us would normally, if we had not been advertising, have put it into a building society, national savings or the Trustee Savings Banks. I think it is the same money.

8241. They are, on the whole, people who are very much alive to the possibilities of investing money in these other ways?——Yes, indeed. Perhaps it is not too indiscreet to say that in my case a lot of the money that comes in is farming money. I am thinking particularly of the Fen district, which is an extremely profitable farming area; that money came into us in large amounts, but, if we had not been advertising, they are the type of people who would certainly have put their money into gilt-edged or trustee securities of some other sort.

8242. *Sir Oliver Franks*: We have been told in evidence before this Committee that the general public pays very little attention to interest rates, and evidence has been offered to show that the volume of short term personal savings remains much the same through the years; but what you have just been saying rather suggests to me that quite large sections of the public are in fact conscious of interest rates and, given that they are saving anyhow, are quite prepared to exercise their judgment about where to put their savings, putting them where the interest rates are high. Now, is that so? Would you say that in your part of the country a lot of people with £100 or £500 or £1,000 to put away somewhere to earn interest compare what they can get here and there, or would you say that on the whole they do not?——*Mr. Smith*: I would say that they do, chiefly for this reason: that most of these small investors go to their bank manager for advice in the first place. If it is a question of £100, £300 or £400, I think his first answer would be to put it into national savings, which is tax free; if they have their quota of savings, or if it is over £1,000 the bank manager would obviously advise them to go where they can get the highest rate of interest. The bank manager must do that.—*Mr. Pollard*: I think there is something to be said for the point of view that the general public have a sense of interest rates. The Trustee Savings Bank in my area found that they lost quite a lot of their deposits when the terms on Savings Certificates were improved. I think that is a case in point. It is now being found in the savings bank world that they are having to compete with these higher rates of interest in order not only to get deposits but to retain what they have. There is always, clearly, inertia in a certain amount of the savings; that is proved by the mass of savings certificates that still remain of earlier issues that could be altered by the people who own them if they wanted to, and by the amount of money in savings banks, where savings banks have provided two or three-tier rates of interest in their Special Investment Departments and yet quite substantial amounts remain at the lowest rates of interest. There is one other point that I would like to make here: it is not always rates of interest that induce the local person to invest his money with his local authority. There is still an element, particularly in the north-west where I come from originally, of local patriotism, or even of knowing that " the money is in the Town Hall."—*Alderman Hill*: I would agree with that. Speaking as a solicitor, I think many small business people who have, say, £500 lying idle in the bank and seeing an appeal from the Chairman of the Finance Committee would be moved partly by self-interest and partly by local feeling, and would put their money into this.

8243. *Chairman*: I rather gather from what you say that you do not think that there is any means of tapping these additional resources here; that in effect there is a good deal of competition and what can be got is being got?——*Mr. Pollard*: I would think that is so.—*Mr. Smith*: So would I.

8244. *Lord Harcourt*: By and large what is being got by one borrower is a diversion from other forms of saving?——*Mr. Pollard*: I do not think there is much of the " money in the stocking " business. I think even amongst the community where that used to apply they have got out of that habit, with the strong publicity of National Savings.—*Sir Harold Banwell*: Particularly in the north-west there is strong feeling about this; our own people think that they can get a certain amount of money into the Town Hall which no one else can get.

8245. *Chairman*: They can draw money which nobody else can draw?——*Alderman Swale*: Yes, particularly from the smaller borrowers; their local feeling is quite intense.—*Sir Harold Banwell*: That is where we come back to the six months' notice which we like so much. They like to have the feeling that they can get it out quite quickly. In fact, as I understand it, they very rarely do want it quickly. That also was an aspect of our loans which appealed to those peculiar people who seemed only to come to the Town Hall.—*Mr. Pollard*: There is a wide experience of loans that have been put in at, say, three years and then left at six months' notice, which have remained for years and years and have not been touched at all, unless the local authority decides that the rate of interest is too high.

8246. *Professor Sayers*: Is the local authority free to fix its own rates of interest?——Absolutely.

8247. No Treasury restriction?——None whatsoever.

8248. *Chairman*: It is part of your paper that you ought to be given freer access to the Public Works Loan Board for your loans, because there are other means of controlling your expenditure. But suppose that some sort of principle was introduced that you could have accommodation with the P.W.L.B. in proportion to the amount you raised outside by the local means; would that be a workable principle?——Yes.

8249. Do you think there would be any value in it? If you do tap some resources which would not be available otherwise is it not very desirable that they should have their opportunity of lending maintained?——I think there would be a value in it, but I think it varies considerably up and down the country. The smaller authorities who are getting 85 to 90 per cent. of their requirements would not want that to be reduced by some fixed proportion that they could obtain from the Public Works Loan Board. I think I must add that most local authorities would like to see the Public Works Loan Board arrangements a good deal more flexible, a good deal less rigid.

8250. *Sir Oliver Franks*: What is the interpretation of "flexible" in that context?——One has a lot of procedure to go through before ever a loan is advanced. There is still a tendency for the Public Works Loan Board to require to tie a loan to a loan sanction. No modern local authority of any size does that now; they must have loan sanction cover for the loan but they never tie a loan to a loan sanction.

8251. *Chairman*: Do you mean that they want to tie the money you borrow to the actual expenditure that is concerned and not let you have a general fund of money you can advance for different purposes?——They require to see a loan sanction against which they are ostensibly advancing the loan. But when a loan gets into the hands of a local authority that keeps a consolidated loans fund, for example, it loses its identity immediately.

8252. Is the consolidated loans fund spreading very much?——Yes, and the Government in the current Local Government Bill are providing that any local authority over a certain size can, if it wishes, operate a consolidated loans fund, and any below that size may do so with the approval of the Minister of Housing and Local Government.

8253. So they are favouring it and supporting it?——Yes, indeed. Up to now it has always been a case of having to obtain the power in a local Act.

8254. *Professor Cairncross*: When you consider borrowing, is the rate of interest that is in your mind in raising the money the average that will be charged from the consolidated fund to the particular service that is being financed?——There is no doubt that in operating the consolidated loans fund we work on an average rate of interest, so that when we are dealing with repayments that cover a long term, say 30 years, we use the average rate of interest; but I think it should always be in the minds of the members of a finance committee of a local authority that, when actually borrowing the money, they are not necessarily paying the average rate of interest; they may be paying 2 per cent. more than the average.

8255. The particular departments of a local authority when submitting schemes for approval by the authority know that they will be debited by the average rate?——Yes.

8256. In their thinking on the subject they are bound to be influenced by the average rather than the current rate?——That may be, but then it has to come to the finance committee, and they have the whole of the facts before them in making recommendations to the council as to whether or not the scheme shall be approved.

8257. *Chairman*: The spending departments work on the average rather than the current rate?——It is so; but, of course, if money is to be borrowed at 6 or 7 per cent., even though the average rate may be 4 or 5 per cent., it is clear that that 6 or 7 per cent. has to be paid, and paid by somebody.

8258. And those responsible for borrowing have the current rate of interest and the average rate of interest in their minds?——*Mr. Pollard*: Yes.—*Sir Harold Banwell*: I have just asked Alderman Swale and Mr. Pollard which figure they tell their council, the rate at which they are borrowing or the average rate; and I have had a different answer from different sides! Mr. Pollard says that in the case of his council he tells them the consolidated rate, while Alderman Swale tells me that in his non-county borough they work on the actual rate at which they will borrow, and the consolidated rate is not disclosed to the committee at that stage.—*Alderman Swale*: I do not think any member outside the chairman of the finance committee knows the average rate!—*Mr. Pollard*: In my finance committee, it is on the basis of the consolidated rate. As I indicated a few moments ago it is that rate that really applies over the period of the loan. The immediate rate of 6 per cent. or whatever it may be will be (we hope, perhaps wrongly) a relatively short term affair, though it affects the average rate and so we have to keep that average rate. But the whole of my finance committee, and not only the chairman, know the rates of interest that are being paid on loans reported at any meeting.

8259. *Professor Cairncross*: But the accounting that is done subsequently for each department must be on the basis of the consolidated rate, whether for housing or any other service, so that whether it shows a profit or loss will be governed by the consolidated and not the current rate?——That is so.

8260. In that case the current project, whatever it is, once launched, is not debited for the full cost to the authority but only with the average of past borrowings?——Yes, and the other services have a counterbalance, in the increased average rate which they are charged.

8261. You do not regard it as a subsidy?——No, because the local authority is one person.

8262. You offer the consumer many services, and it does matter to the consumer which group of services he is offered and on what terms. If he is being offered housing at a rent, for instance, which is lower than would be in keeping with the loan charges currently incurred, then housing is being subsidised?——*Alderman Hill*: It is an internal subsidy.

8263. *Chairman*: With a consolidated loan fund, over the period of years the average rate which the corporation is going to pay for its borrowing is evened out internally.——*Professor Sayers*: But that is a different average. Apart from the subsidy point I am trying to think how important this choice of interest rates is. Whichever rate is discussed when the project is being discussed, does it affect the decision whether to build the school, or bridge, or the block of houses, or whatever it is?——*Alderman Hill*: It does not necessarily affect the expenditure. If the expenditure is dictated by actual need, for instance by public policy for education or housing, it does not affect it at all.—*Mr. Pollard*: Alderman Hill is right in the broad general point, but there must be cases, for example in the case of beginning a new water scheme, where an authority might decide to defer the beginning of a scheme if interest rates are high in the hope that the interest rates will become more favourable and not involve the local authority in long term high interest rates which might only mean a transfer of the charge on to the water consumers. That might happen; indeed, I know it has happened. However, there are certain schemes, like new drainage schemes, or an expansion of the sewerage scheme, that just cannot wait.

8264. So the view of what is absolutely necessary and must be started this year is perhaps not at all elastic for some things but is a little elastic for other things?——Yes, I think that is fair.

8265. Has this tendency to defer schemes because of the high interest rates been at all noticeable since September?——*Mr. Pollard*: I do not know of a lot of instances. One reads of civic offices, or new public baths, having been deferred until times are more opportune; that refers, by implication at least, to the current high interest rates.—*Alderman Hill*: Where you have a bridge scheme, as in my city, that has to go through, the consequential street improvements and so on can quite well wait for a time.

8266. *Professor Cairncross*: Do you think the high interest rates have had any effect on housing programmes drawn up by corporations?——*Alderman Swale*: I do not know if it is general all over the country, but I would say yes. We found on an examination of our reservoirs that one of the banks needed attention, and we had to go for a loan sanction last October for a £100,000 job. That has just got to be done, whether the interest rate is 5, 10 or 20 per cent. We have to do that, and we could not do it out of revenue. So far as housing is concerned, we cut it down to slum clearance only until the interest rate eased; it has eased, and now we have started again. I thought at the time that it would probably last six months or so, but actually it has come down a little sooner than even I expected; and we have started a smaller programme of housing other than slum clearance. That is how we have tackled it, and I think that is a reasonable approach which has been adopted by other authorities.

8267. *Professor Sayers*: What about education?——*Alderman Swale*: That has to go on.—*Mr. Pollard*: Our development programme is more or less arranged with the Ministry of Education.

8268. And the elaboration of schools (if that is the proper word) is not affected by the rate of interest?——*Alderman Hill*: By and large I should think not.—*Mr. Pollard*: Not by the rate of interest, although there have been alterations in the plans of schools by the Ministry of Education.

8269. *Sir Oliver Franks*: That is administrative action?——Yes, from the centre.

8270. *Professor Cairncross*: And goes back a long way to the late 1940s?——Yes.

8271. *Sir Oliver Franks*: The spending policy of the Government as expressed in the education programme so far as your authorities are concerned just goes ahead?——Indeed it does.

8272. The interest rate is not relevant to it; you just pay?——Yes.

8273. *Lord Harcourt*: Am I right in thinking that in educational improvements the local authorities receive the bulk of their finance by way of grant?——No. We provide the whole of the capital, and the grant is paid on the basis of loan charges.

8274. The central Government services the loan?——Yes; the Government pays a grant towards the service charges, of 60 per cent. in the case of education and 50 per cent. in the case of health.

8275. *Chairman*: This is including whatever is needed for the sinking fund?——Yes, it covers interest and capital repayment charges.

8276. *Sir Reginald Verdon Smith*: Alderman Swale told us about his own housing programme; was the decision on the housing programme related solely and exclusively to the question of interest charges, or to any general considerations of Government policy about capital expenditure, or more broadly?——*Alderman Swale*: Purely to interest charges, because it would have led to such a problem as regards rents; if it were to have gone on for any length of time we just could not have faced the interest rates.

8277. *Sir Oliver Franks*: You have said that these decisions about the housing programme were taken last September in the belief that the period of really high rates would be for six months or a year; in fact it turned out to be a little less. Am I right in inferring from that that the rate begins to bite at 7 per cent. but short of that you feel that you need not worry?——Not quite, no. That has some bearing on it; but I related that to the question of rents and looking at the capacity to pay of the people for whom we provided the houses. Some of us were getting worried about that, and felt that if there was a depression, it might be really difficult.

8278. Are you not putting in proper language and in its proper context what I put rather crudely, namely, that the 7 per cent. rate in that context did bite, whereas up to that point you had not felt in the same way that the interest rate did bite?——That is right.

8279. Would that be general?——*Mr. Pollard*: What has happened in Chesterfield has not necessarily happened elsewhere. My own authority has not, as far as I can see, put any brake on housing at all. They have taken the view that housing in our area must go on.—*Alderman Hill*: I think that would be the more general experience; we took that view also.—*Mr. Pollard*: I know there may be an influence on rents; the difference may be that some authorities may allow rents to be influenced by the increased rates of interest, and others would say that rents must not be influenced by that and the charge must fall on the rates.—*Sir Harold Banwell*: It is a difficult question; motives may have been mixed. In some cases it stopped because the general subsidy for houses had ceased; there were other cases, clearly, that we know of, where it was done on interest grounds, but I would agree with Mr. Pollard that the number of them would not be very great.

8280. *Professor Sayers*: May I ask Alderman Swale another question? You said that when you took this decision you did it in the belief that the high interest rates might last six months or a year. Suppose that you had taken the view that these high interest rates had come to stay for a long time, five years or perhaps longer; would your decision have been the same?——*Alderman Swale*: I do not think it would.

8281. Would you then have gone ahead with your housing programme?——I think we should have had to, yes. I am afraid it was a purely personal policy that I managed to put across with my colleagues. It was my own summing-up of the situation at that time.

8282. To you the important point was that loans were temporarily extraordinarily dear?——Yes.

8283. *Chairman*: You mention in paragraph 9 a market in short term loans; where do you go?——*Mr. Pollard*: We go to a variety of sources. To give examples from my own particular experience, I have quite a large amount from local companies. A company with some project in view may have money available for that project, but may want to make the best use of it they can in the meantime. They can get more money by lending it to the local authority on short term in this way than they would if they either put it on deposit with their bankers or put it into Treasury Bills; so they bring it to the local authority. There is a certain amount of money in areas of that kind. Other money comes from quite different sources; through brokers in the City of London, for instance.

8284. You go to the City for part of your money then?——Yes.

8285. Would that be true of the smaller corporations?——*Mr. Smith*: Yes. Most of the smaller corporations go direct to brokers in the City for their requirements over and above the proportion they can get from the Public Works Loan Board.

8286. *Professor Sayers*: When you say brokers in the City, just what kind of firm are you thinking of?——*Mr. Smith*: They call themselves mortgage brokers.—*Mr. Pollard*: For example two firms do a great deal of this: the Short Loan and Mortgage Company, and Long, Till and Colvin; there are others who do not do quite so much perhaps but, nevertheless, do quite a large amount.

8287. *Chairman*: They are specialists in this field?——Yes, they specialise in this kind of business. They know we have to try and get these short loans, and their clients are apparently people who do not want to tie up their money for any length of time but are willing to lend it on terms of seven days' notice or one month's notice.

8288. *Professor Cairncross*: And this is again for periods up to sixty days?——It may last much longer than that. There is a market in short term loans for three months and then at one month's or seven days' notice. It may go up to eleven months or twelve months, as the case may be, but if it runs over we should come into the stamp duty range.

8289. *Chairman*: So if one goes out the brokers will bring others in?——*Mr. Pollard*: Yes.—*Mr. Smith*: We have had a lot of seven day money, and we have had it for several months.

8290. *Professor Cairncross*: Would you raise that on the market?——*Mr. Pollard*: Yes; they do quite a lot of this seven-day-money business now.

8291. *Sir Reginald Verdon Smith*: Are you making a distinction between lending on mortgage and these loans so far as the form of security or the type of lending is concerned?——It is quite different in the form of security. Where we borrow on mortgage we issue a mortgage deed containing the full clauses of charges on the rates, and so on, but when we get one of these short term loans we simply do it on receipt.

8292. Without security?——Without the security of a mortgage deed.

8293. *Chairman*: One of your recommendations is that you should have power to issue local bills. What does that mean?——Power for a local authority to issue bills charged on its own revenue.

8294. And it would expect them to be taken up anywhere?——Yes, indeed; they are usually done through the City.

8295. *Professor Cairncross*: You do not issue bills?——Some local authorities have power to issue bills, but there is an embargo at the present time.

8296. Has it always required an Act of Parliament?——Yes. My authority has power to issue bills only to order and now they are not acceptable in the market; we have not done it for a long time.

8297. *Professor Sayers*: Whose embargo is it?——The Treasury's.

8298. *Professor Cairncross*: Would local authorities like to be free?——Yes.

8299. *Lord Harcourt*: How long has this embargo been in operation?——Since the beginning of the war, and it has never been restored to us.

8300. *Professor Sayers*: Have you asked for it to be restored?——Yes.

8301. Persistently?——We have persisted in all things that have gradually led us to the position we are in now since the war. I cannot remember the last time this was actually discussed; I think it was within the last eighteen months.

8302. *Sir Oliver Franks*: Do the Treasury go into the matter of policy when discussing it, and explain not what their attitude is only but what are the reasons which lead them to their attitude? In other words, do they treat you as rational beings?——Yes, they are very good. We have a standing committee with Treasury officers who go into the details of all these things and tell us why we cannot do them, even though we do not necessarily accept the reasons.

8303. *Chairman*: What are the reasons?——They have not given us a reason why we should not issue bills; they have merely said that Treasury policy is not to allow us to do it at the present time.

8304. *Professor Sayers*: They do not ever say why it is not Treasury policy?——*Mr. Pollard*: I cannot recall that they have ever given us a reason for it, other than the need to control the general borrowing of local authorities.—*Sir Harold Banwell*: It is difficult to carry all these things in one's mind. We have been to the Ministry, and we saw the present Minister of Housing and Local Government when he was Financial Secretary to the Treasury. They made a statement to us, in which they went to some lengths to explain why they could not allow us to do certain things we had asked for. I should not like to call on my memory to give you that information, in case it would be unfair, but I can see no reason why we should not provide that document.—*Chairman*: We should like to see it, if you will let us have a copy.*

8305. *Professor Cairncross*: Has there been an increased resort to the short term market, particularly to the mortgage brokers, in recent years?——*Mr. Smith*: Yes, without question, particularly among the smaller authorities.

8306. Have you any estimate of the figures of short-term finance of this kind?——No.

8307. Presumably it would come under the heading of "Other Loans" in Table A; would you expect it to form the bulk of "Other Loans"?——*Mr. Pollard*: I think it would form the bulk of these figures.

8308. If you take the longer-term mortgages that you referred to earlier, have you any view about the proportion in which the mortgages are provided by members of the public and by institutions—is the public the chief supplier, or is it the institutions?——I have not the information before me. We could get some idea of that if the Committee would like to have it.

8309. You are incurring debt and are likely to go on doing so; at the moment you are left to depend on your own resources to borrow locally what you can. You tell us that you do not think there is much more that the general public can contribute in the form of mortgages; you are therefore relying implicitly either on short-term finance or on the institutional supply of long-term finance. It would make some difference to our attitude to hear the relative importance to you of the private person and the institutions.——*Mr. Pollard*: We can get this information quite readily.—*Alderman Hill*: We could get either a sample for you or full particulars.—*Professor Cairncross*: All we need is a rough indication, not precise particulars.—*Chairman*: Perhaps you would send us something in due course.†

8310. *Sir Oliver Franks*: Have you ever taken it up with the Treasury that, when general Government policy has seemed to be to compress credit and to fund the national debt where possible, the effect of what they were doing in regard to the smaller local authorities in depriving them of access to the P.W.L.B. and therefore making them borrow short, was making them go liquid when the general aim of policy was to make people go long?——*Mr. Pollard*: Only in the course of our discussions with the Treasury officers. At our regular meetings of the standing committee we have pointed out the difficulties that have been caused to local authorities, and especially the smaller ones, in any withdrawal of P.W.L.B. facilities; and we have discussed this question of short loans and its effect upon general borrowing policy.

8311. But have you argued that it was, so to speak, weakening the general policy of the Government?——I do not remember that that point has actually been put in that way.

8312. *Chairman*: We should like to ask you about your position on the capital market. The denial of access to the P.W.L.B., at any rate for the larger corporations, involves the view that you should be able to meet your borrowing needs on the capital market by issues of stock. That does not work, I gather, under present conditions; you cannot get to the market?——It is very difficult. I must not say too much about it, as I have just been there, but that was only because my local authority was on the list that is kept of local authorities wishing to come to the market, and our turn came.

8313. What do you do to get on the list? How does this work?——So far as we are concerned, we act always through the Bank of England and the Government broker; we just ask that our name be placed on the list, through the Bank of England in our particular case. I take it that any other authority will do it either in that way or else perhaps through their own bankers and through brokers in London, who will then get the name put on the list.

8314. To get your name qualified for the list you have not to go to the Capital Issues Committee?——No. Before we can issue stock we must have loan sanctions, and before we can effect the actual issue we must have both Treasury consent and the consent of the Minister of Housing and Local Government, unless we have a private Act, which replaces the Minister.

8315. Having got those in your hand, you can then go to the Bank of England and say: "Put me on the list"; is that how it works?——No; we do not usually get these consents until the Bank of England say: "Your turn has come." We have to make it clear in our prospectus and to the Ministry and to the Treasury that we have sufficient loan sanctions to cover the amount for which we are asking on the market. The Bank of England, in my case (and I rather assume in most cases), will get in touch with the borrower who wishes to go on the market and say: "We think your turn may be getting very near" (that is as far as we usually get in the first stage) "and you had better get the necessary approvals." The approvals are quite easy to get, provided that all the preliminaries have been complied with, which they usually have; in my particular case it was merely a letter by return of post from both the Treasury and the Ministry. Then the Bank of England see representatives of the authority, and the process is gone through of deciding upon the terms and dates, always subject to the market being right at the proposed date of the issue.

8316. You say that terms are decided. Who fixes the actual rate of interest and the terms of issue that you want?——My experience over a long time is that the Bank of England indicate to us the kind of terms that they think will be acceptable to the market, and it is then for us to decide whether those terms are acceptable or not or whether to ask the Bank if they can alter them slightly. When rates of interest are high, one tends to want to contract the period of the stock; when they are lower we might like to take it a bit longer, and so on; but, apart from the period and the final decision of the price of issue, the rate of interest, I find in my experience, is mostly a foregone conclusion. We take it, and the rest of the terms flow from that.

8317. *Mr. Jones*: How often, when stock is being raised in the local government market, do you have an issue of stock of more than one local authority? For instance, when the Kingston upon Hull issue was raised, there was

* The witness later informed the Committee that the document in question did not deal with the matter of issues of bills by local authorities.

† See Appendix to Minutes of Evidence.

one coincidentally on the same terms for Swansea. Is that the usual procedure?——No; I think that was the first since 1921. The question of stock issues has been dealt with hitherto on the basis of one authority only going into the market for an issue, but on this occasion the Bank of England thought that these two authorities might very well go to the market together. I do not know what really decided that.

8318. *Chairman*: The Bank was the marriage broker, so to speak?——Yes, entirely.

8319. *Professor Sayers*: You said that the Bank of England tells you eventually that your turn is about to come. Do you believe that it is just a matter of turn, that you are on a list and when all the people above you on the list have been crossed off it is you next?——We accept the *bona fides* of the Bank of England in this matter. I have no doubts that they deal with this quite fairly.

8320. Yes, but is it purely a matter of the time of getting on the list?——It is. Of course, when the time comes for some authorities, they may not want to go on those terms, and so they withdraw; but then the next one comes up in turn.

8321. How long had you been on the list before you had your recent issue?——Quite a long time; several years. Hull should have gone into the market eighteen months before we did go, on a private placing; we were more or less all fixed for a private placing of £1m. when the Stock Exchange said: "No more."

8322. *Mr. Jones*: You could not go on to the market for less than £3m.?——We could have done so on a private placing. Up to that time, when we were just about to go and were then told that they had stopped altogether, there had been many authorities with the right to go on to the market for £1m. placed privately; not publicly advertised, and that sort of thing. That is what we were doing; it was a stock issue for £1m. Now, as you say, the £3m. minimum has been put on.

8323. Who would find the money in a private placing: the insurance companies and superannuation funds and the rest?——I do not know where the brokers went to. I can only assume they went to places like insurance companies.

8324. *Professor Sayers*: Was there a queue for private placings as well as other issues?——There used to be, until these were ruled out.

8325. *Sir Oliver Franks*: Who used to manage that queue?——So far as I know, the Bank of England and the market.

8326. *Professor Sayers*: Did you put your name down on the list for that?——We put our names down on the list for a stock issue, and we were then told, in about October, 1956, that if we were interested there was the possibility of a private placing. We were interested, but nobody else was when it came to the point; so we had to wait for our turn to come for a public issue.

8327. You were told by the Bank of England?——Yes.

8328. *Chairman*: Was it envisaged that the takers of private placings would later put the stock on the market?——Yes; a Stock Exchange quotation was taken.

8329. It was merely a way of getting it out?——Yes.

8330. *Sir Oliver Franks*: In your description of the process of raising money in this way, you spoke at first of the Bank of England and the Government broker, but I think the description which you gave was that it was all Bank of England. Where does the Government broker come into it in your experience? Is he in the room when you discuss the issue with the Bank? What does he do, not as a matter of policy but simply as a matter of historical fact?——I should make it clear that I am talking only of my own experience. Hull have always been with the Bank of England, because they used to be our bankers in the old days when they had an agency in Hull, but they no longer have one. On previous occasions we have, on more than one occasion, had the presence of the broker employed by the Bank; I suppose Mr. Mullens or somebody has been there, and if there has been any question to answer he has joined in the discussion, but usually not unless invited to do so by the representatives of the Bank. The Deputy Governor, and on one or two occasions the Governor himself, has chaired the meeting, which comprised representatives of my authority, representatives of the Bank and the broker. But I cannot recall that there was any representative of the broker present on this last occasion.

8331. What would the differences be in the case of a comparable local authority which did not happen to have this historical link with the Bank of England?——*Mr. Pollard*: I do not think I can answer that. Swansea came with us to the Bank; I do not know whether or not they have historical connections with the Bank of England. I have assumed, because this list is with the Bank of England, that they deal with it in the final circumstances, but I am afraid I cannot be definite about that.—*Sir Harold Banwell*: I have always assumed that other authorities have dealt with the Bank of England; but I do not know. I can find out quite easily.*—*Mr. Pollard*: Other brokers than the ones I have mentioned are employed in many issues. The corporations go through the head offices of their banks; but at what point they then get in contact with or meet the Bank of England, I do not know.

8332. *Chairman*: In paragraph 26 of your memorandum you say that several corporations have been waiting for some time. We have heard about the length of time that Kingston upon Hull were waiting; can you give us anything more precise in the way of time?——*Alderman Hill*: I do not think I can.

8333. But we are to think of it in terms of years and not months?——Yes.

8334. *Professor Sayers*: Can you remember any time since the war when there was not a queue?——*Mr. Pollard*: No, I cannot.

8335. *Professor Cairncross*: When you are waiting for a period of, say, two years, are you able to proceed with the project, or is it held up?——We have to go on borrowing from other sources.

8336. You go ahead on the basis of the loan sanction and raise the money?——Having got loan sanctions when we put our name on the list two years ago, we may have used them up in the meantime, and we have got others.

8337. *Professor Sayers*: So this queuing up cannot influence capital spending, except to the extent that you are being pushed on to other means of borrowing, which may force you to terms which are so unfavourable that there are hesitations such as Alderman Hill suggested?——That could be.

8338. *Professor Cairncross*: Suppose that a local authority is not adding progressively to its debt but temporarily borrowing; would it be in any way inhibited from proceeding with a capital issue because it could not foresee further loan sanctions?——When the time of its stock issue comes, it has to have sufficient loan sanctions or debt that it is paying off. It may be paying off mortgages and replacing them with stock.

8339. Is it quite clear that an authority, once it has loan sanction, will go ahead with capital expenditure and not be deterred by the fact that it cannot make a public issue there and then?——No, it will not be deterred; it will borrow its money from other sources. It may even happen that, knowing its name is on the list, it will go on borrowing in this short-term way for quite a time, just to finance itself temporarily.

8340 Suppose that the period extended not to one year but to three years, or seemed likely to be longer, would this still not inhibit local authorities?——I do not think so. Stock issues are only one method of financing their capital expenditure, and if they have financed it in some other way by the time their turn comes, they have to give up their turn for a stock issue.

8341. Is there no limit to the amount of short-term debt that a local authority is willing to incur?——*Mr. Pollard*: Any Treasurer must keep his authority advised as to the extent of the monies borrowed on this short-term basis, and it must at any time be a relatively small proportion of the total capital debt of the authority.—*Alderman Hill*: There is a limit of discretion.

8342. Suppose that the capital market became much tighter, and the local authority had to look forward to a delay of five years; would it still regard five years as easy

* See Appendix to Minutes of Evidence.

to bridge?——*Mr. Pollard*: If there is capital expenditure to be incurred, the local authority will just have to raise the money from other sources, if it can. Up to now, local authorities have found the only real difficulty the high rates of interest.

8343. *Professor Sayers*: You suggested a minute ago that a City Treasurer, if he saw the short-term debt of his authority mounting, might well feel that he had to advise his committee that this amount of short-term liability was becoming very large in relation to the authority's resources. Were you then stating merely a theoretical possibility, or were you thinking of somebody's experience?——No, I was not thinking of anybody's experience.

8344. It is a theoretical possibility?——It is a point that a Treasurer must bear in mind.

8345. Is it a point that, to your knowledge, has ever caused a Treasurer to put this consideration before his committee?——I cannot tell you of an individual Treasurer who has done that; but, as far as I personally am concerned, I always watch it, and I do not allow more than I think is wise.

8346. Is there not a possibility of conflict between that statement and the statement that, if the money has to be spent, it has to be raised and will be raised?——No; when a local authority has reached a point where it has a certain proportion of its debt in this short-term form, it ought to be looking into the longer-term and more fixed money rather than allowing too great a proportion of its borrowing to be short-term money.

8347. *Chairman*: So the capital expenditure of your local authorities falls mainly on housing, education and drainage services; but the expenditure which has taken place under those heads up to now has not been materially held up either by the lack of access to the P.W.L.B. or to the capital market?——No, I do not think so.

8348. By one means or another, by strictly short-term borrowing, or access to the mortgage market, or from institutional sources, you have been able to get the money?——Yes.

8349. Therefore the effect of this lack of relationship with the P.W.L.B. or with the capital market is that the costs have been heavier on what you have done?——Yes.

8350. *Mr. Jones*: Whatever credit you have required you have been able to get, but the burden you are complaining about is the price at which you have been able to secure it?——Yes.

8351. *Professor Cairncross*: What interest rates have you been paying?——When the Bank Rate was 7 per cent. we were paying 7 per cent. and more; some people paid as much as 7½ per cent. There was unfortunately a case of somebody who paid 8 per cent., and it was made rather a fuss about, to the regret of many of us; but rates of 7½ per cent. were asked for and paid, and rates of 7 per cent. have been paid over the period since the Bank Rate was 7 per cent., especially for the short-term money.

8352. *Mr. Jones*: Was there a substantial amount of money raised temporarily on short-term at 8 per cent.?——No; the only information I have is that one small local authority on the south coast paid 8 per cent. for some money which it borrowed. It was not a large sum.

8353. What proportion of borrowing would you say had been undertaken by local authorities on short-term at 7 per cent. or 7½ per cent.?——I cannot answer the question in terms of money; I can only say that we were having to pay that for all our short-term money while the Bank Rate was 7 per cent.

8354. Was there a good deal of borrowing at that rate by local authorities?——Yes.

8355. Was it at seven days' notice?——The majority was probably at seven days', but there was quite a lot borrowed at 2, 3 and 4 years' notice.

8356. Are there substantial local government loans outstanding of 2 to 3 years' duration at 7 per cent. to 7½ per cent. at the moment?——There may be at 7 per cent. That is, of course, substantial in relation to the amount required in the period we are referring to; not substantial in relation to the total debt.

8357. *Professor Cairncross*: Are you putting to us that the rate of interest paid by local authorities has risen more over the past years than the rate of interest paid by the central Government?——We were not putting that to you in any way; we have not taken that line in our comment, and I had not intended to take that line in anything that I have said.

8358. Do you think that the rates paid by local authorities have risen more than the rates that the central Government has paid?——I do not think that they have risen more than the rates that the Government have had to pay. I think that the lines have been going up together more or less in parallel.

8359. *Professor Sayers*: From February to September of last year the Bank Rate was 5 per cent. During that period at what rate were you borrowing the bulk of the money that was being borrowed at that time?——Around 5 per cent. and 5¼ per cent.

8360. *Professor Cairncross*: I would have thought that you were suggesting that the exclusion from the facilities which the Public Works Loan Board previously offered did have a penal effect on you, and that you were now paying rates that were higher than you would have paid if you had access to the Public Works Loan Board. Have you not felt that you were being penalised twice, once by the rise in interest rates and once by the exclusion from access to the capital market on the terms that you had previously enjoyed?——We have said in this memorandum that we think that, if the facilities of the Public Works Loan Board had been available to us, interest rates in the market outside the Public Works Loan Board might very well have been more favourable to us. The ground for that is the fact that, if the market knows we cannot get it from anywhere else, it is an automatic reaction that they should obtain the best price they can for their money. We feel that, if the Public Works Loan Board had been available, perhaps they would have been a little more lenient in the rates of interest, because they would have known then that they had a competitor who could provide us with money at their standard rates of interest. We also think that the Public Works Loan Board was mistaken in putting the rates of interest up when they did, at the outset in September, to the high rates that they chose. They have reduced them now, and they are more in line with what we think the market is at present; but we think that their putting them up as they did caused the market rates to move against us to a greater extent than they might have done.

8361. *Chairman*: In paragraph 28 (*b*) you say: "The Public Works Loan Commissioners should be free at all times to lend to municipal corporations, provided their advances are made at current rates of interest." What do you cover by current rates of interest?——Rates in the gilt-edged market; municipal loans have always had a high status.

8362. They have paid a little higher than Government loans?——Yes, as a general rule.

8363. Would you think it fair to perpetuate that difference on the ground that the marketability of municipal loans is less?——I do not see why the difference should be perpetuated at all. We pay the operating expenses of the Public Works Loan Board by what they charge us over and above the rate of interest, and I do not see why we should pay more.

8364. But you always have done?——Tradition may be a good thing in certain directions, but we do not think that this is one of them.

8365. *Lord Harcourt*: Marketability has a certain bearing on it?——I would have thought there was always a high demand for local authority stocks.

8366. But not quite in the same volume?——There is not the same volume as of Government stock, but I would have thought there was always a good demand.

8367. *Professor Sayers*: Going back to paragraph 28 (*a*), do you know of any reason for this minimum of £3 million on the size of a stock issue?——We were just told that the £3 million was regarded as the minimum amount for which stock issues should be made now, in view of the fact that there were so many people waiting for stock issues.

8368. *Lord Harcourt*: The minimum of £3 million only applies to public issues?——*Mr. Pollard*: We cannot have anything other than public issues now, because private

placings have been stopped.—*Mr. Smith*: I think the minimum was put at £3 million to shorten the queue. Eighteen months ago there were so many people waiting that they said: "We will shorten the queue by putting a minimum of £3 million on the size of issues.—*Mr. Pollard*: A local authority with 100,000 to 150,000 people has in the past gone on to the stock market for a loan of £1 million or £1½ million. There were a lot of these people, we gather, in the queue; it was thought desirable to shorten the queue, and the way chosen to shorten it was to put that minimum on. That has meant that those people have had to go into the mortgage market and compete there, and get their money in the best way they could; and they have not been given, according to the information we have heard from time to time, the facilities of the Public Works Loan Board to the extent that would have helped them out of the difficulty they were placed in, if they wanted to go there.

8369. Have they protested against this procedure?——They have protested against the minimum of £3 million.

8370. And have they been given any explanation?——None, other than we have said.

8371. *Professor Sayers*: Nobody has suggested that the amount of money to be raised has been reduced by this procedure?——No; it is just a difference in the method. We have suggested that, if the minimum of £3 million is to continue, two authorities should be allowed to go together for £1½ million each, or one for £1 million, and the other for £2 million, which would still be an issue of £3 million.

8372. And this has been refused?——Yes.

8373. Have you been given a reason?——No.

8374. *Mr. Jones*: Could it in some circumstances be sounder finance, in your experience, to seek to raise an issue of stock, say, of £2 million rather than £3 million?——I do not see any point of sound finance in the difference between the two figures, so long as the money is covered by the appropriate loan sanction and the need for capital expenditure. If the local authority has to spend £3 million there is no sounder finance in having £2 million rather than £3 million, if it has to get the balance in another way.

8375. *Professor Cairncross*: Is the suggestion that the smaller authorities have more difficulty in getting finance in other ways than the large borrowers, that the larger borrowers have more access to the mortgage market?——They are the people who go for the £3 million as well. It is the intermediate authority that seems to have had the most trouble, the one with a population of 100,000 to 150,000. Such an authority may find it difficult to digest a £3 million stock issue at once. They have been used to borrowing regularly from the mortgage market and having a stock issue periodically for £1 million or £1½ million.

8376. *Mr. Jones*: Would it not be more convenient for many of the larger authorities that have raised money, say by mortgage arrangements, to go for an issue of £2 million rather than £3 million, and would they not prefer to do it?——It depends on the circumstances and the time. I cannot say to you that it is more convenient to go for £2 million than £3 million. It might be more convenient to go for £5 million than for £3 million; it depends on the authority's commitments.

8377. *Chairman*: To take out everybody under £3 million was a way of cutting down the list of people who wanted to reach the capital market through this means; but surely you do not improve it from that point of view by letting two smaller operators come on the same day, because you merely add to the amount of pressure on that particular capital market?——I think it must be accepted that it adds to the pressure, but we think the local authorities ought to have the facilities.

8378. *Professor Cairncross*: Do you seriously expect a big increase in the amount of capital you are able to raise through stock issues? The figures in table A do not suggest that in the last five years there has been any increase.——That is because local authorities have not been allowed on the market; there have been plenty of them waiting. I imagine that at the moment the largest of the English local authorities is waiting to go on to the stock market at the present time, judging by press reports of resolutions passed by that particular council; as a rule, when resolutions of this kind are passed, it means that the issue is imminent, and these resolutions must have been passed two or three weeks ago now.

8379. *Professor Sayers*: On what ground do you expect there to be more issues in the next five years?——It is a hope rather than a view. Freedom of access to the capital market was only restored to us four or five years ago, except for conversion of stock.

8380. *Sir Reginald Verdon Smith*: Would you expect the waiting list to have twenty names or fifty names on it?——I do not know, but I would expect much more than twenty.

8381. *Chairman*: Your point seems to be that you should be relieved of your dependence on the mortgage market, rather than that you should have two authorities making up the £3 million minimum?——I agree; this is only a suggestion, if we cannot have that.

8382. *Professor Cairncross*: On paragraph 28 (*f*), we should like to know a little more about the extent to which the local authorities were able to take advantage of national savings raised locally before the war?——A local authority had the right to go to the P.W.L.B. for up to half the amount of money invested in national savings in its area, and the Board could not say it nay.

8383. *Professor Sayers*: Was that at any special rate of interest?——No, at the current rates of the Public Works Loan Board.

8384. *Chairman*: The idea being that if you gave your support locally to the national savings campaign, you should get something back?——It was a kind of reward for the amount of work put into national savings locally.

8385. *Lord Harcourt*: On paragraph 28 (*c*), what are the advantages which the Association thinks lie in "maturity" loans rather than loans repayable by instalments?——For an authority operating a consolidated loans fund it is more satisfactory to have loans for fixed periods than to be repaying them year by year. When it is repaying loans by instalments, it only means that it has to find other loans to replace them as its operations proceed, whereas when it has a loan for a fixed period it does not repay it to the lender until the end of the fixed period, but the provision it makes in its revenue account for repayment goes into the consolidated loan fund and is used over and over again. Therefore instead of repaying on maturity and borrowing again, a lot of us have for many years been repaying to the Public Works Loan Board every half-year and borrowing that back from them during the year as well as other monies. Maturity loans would be advantageous both from the point of view of financial method and from the point of view of administrative costs; to put it quite frankly, the majority of authorities prefer maturity loans to instalment loans.

8386. Is it not really a question of where the sinking fund lies, in other words, of whether you have the use of it or whether you genuinely redeem the loan?——Most of us do not operate sinking funds nowadays.

8387. No, but you said that you make provision in your revenue account every year; is not that in fact a sinking fund?——Yes, but what happens is that today we do not create a sinking fund; we treat the surplus as redeemed and repay this to the consolidated loan fund. I am sorry if I am getting a little complicated, but it is a very simple process in actual operation.

8388. *Professor Cairncross*: Do the local authorities lend to one another?——There is a certain amount of lending between authorities; not to any extent, I would say, on a permanent basis, except perhaps in so far as superannuation fund monies are concerned, but there is quite a bit of lending on a temporary basis. One local authority might have a surplus and lend it to another authority for a month or six weeks whilst the surplus is there.

8389. This is done informally?——*Mr. Smith*: Just between the two Treasurers—*Mr. Pollard*: One issues a receipt to the other. It is quite informal, from that point of view.

8390. *Mr. Jones*: Would you describe the operations that are summarised in paragraph 32 (2)? It says: "The Government already have the means of restricting, the

capital investment of local authorities by refusing to issue a loan sanction." That means that they can say whether or not the money can be raised and the project can be got on with. You go on to say that this could be more effective than creating the necessity for local authorities to pay penal rates of interest. Could you tell us how that operates, as you see it in the present circumstances, and how it would operate if your proposal were carried into operation, and you had a direct control rather than a rate of interest burden?——We are not asking for a control; I would like to make that quite clear to start with. We are trying to say that if, in the national interest, the Government believe it necessary to reduce capital expenditure by local authorities, they have the means at their disposal to limit that capital expenditure through the loan sanction procedure. If they refuse sanction, the local authority cannot borrow the money to meet the expenditure.

8391. *Chairman*: And that applies to short-term as much as to long-term?——Yes. We only have a limited power to borrow short-term for meeting our temporary requirements in revenue matters. Capital expenditure must be covered by loan sanctions or by private Act of Parliament.

8392. *Professor Cairncross*: The loan sanctions you require cover all capital expenditure?——All that for which we have to borrow.

8393. It is not each item of capital expenditure which must be approved?——No. If we meet it from revenue or from a capital fund, which every authority has power to set up now, then we do not need loan sanction, because we do not come into the market. The loan sanction is only to authorise us borrowing the money.

8394. Was there any system of this kind before the war?——There was.

8395. Any form of local authority borrowing, even on mortgage, has always required central Government approval?——*Mr. Pollard*: Anything we borrow must either be covered by authority of a private Act of Parliament or by loan sanction, issued by an appropriate Minister.—*Sir Harold Banwell*: Waterloo Bridge is the classic example of this. The L.C.C. built that bridge originally without obtaining a loan sanction; the Government of the day would not give them the sanction because they could not make up their mind what to do about the re-building of Charing Cross. I think they subsequently repented and let them borrow the money.

8396. *Mr. Jones*: Is there much capital expenditure going on out of resources and balances of local authorities?——*Mr. Pollard*: I think there is quite a useful amount. I cannot say how high a proportion, because I have not got any figures.

8397. Are rates being levied at the moment by local authorities for the purpose of meeting capital expenditure in this situation?——I understand that some authorities levy a specific amount in their rate budget to cover capital expenditure to be met out of revenue.

8398. *Professor Cairncross*: When you seek loan sanction nowadays, presumably the central Government wants to satisfy itself about the purpose for which the loan is raised, and therefore does, almost by implication, vet the capital expenditure?——Yes, that is so.

8399. Was that true before the war?——Yes, in the sense that the local authority had to make a case to the particular Ministry for the loan sanction, and so they had to send particulars of the expenditure. Occasionally, rather more often since the war, the Ministry would go into the scheme and satisfy themselves about it. If I might give an example, quite recently my authority were building some houses in connection with a water scheme. They were building these houses at the head works, and they were very costly; and the Ministry, examining the proposal, felt that the houses were really too costly, even bearing in mind the particular situation of building and so on. By arrangement my authority have agreed to reduce the amount of their request for a loan. That is an instance of the kind of collaboration that goes on.

8400. You still have the right, presumably, to propose the capital expenditure that you want to incur?——Yes.

8401. You would like also some freedom of expression in deciding what capital expenditure to incur, just as any company or industry has?——Yes, we like to feel that we have our freedom.

8402. Just how much freedom do you have?——There is no restriction upon any scheme that we can put forward. Our discretion is absolute in what we can put forward.

8403. If you say that the central Government has the means of restricting capital investment, do you not mean in effect, to put it crudely, that you would prefer the central Government to operate on capital expenditure by cutting you down by a system of ceilings or by deciding item by item, rather than that you should be given freedom to choose what you will do at a given rate of interest?——*Sir Harold Banwell*: Paragraph 32 has to be read in relation to paragraph 20. We feel that there are certain items of capital expenditure where we have little control. It is Government policy that schools should be built, and we have to build them.

8404. *Chairman*: We do not want to make it more complicated than it need be. You are saying that in the system of loan sanction there is a very direct form of restriction on capital expenditure?——*Mr. Pollard*: Whenever the Government wish to apply that kind of restriction.

8405. You do not want it to be altered to any other system?——No, and we do not want it to be so interpreted that we want this to apply at all times; but, if the Government feel it is necessary in the national interest to restrict our capital expenditure, this, we believe, is a better way than our having to pay what we regard as penal rates of interest.

8406. But as regards education, it is inherent in what you have been telling us that the Government compels you to spend. Exactly what does that mean: that it offers you considerable financial assistance if you do spend?——*Alderman Hill*: The Ministry of Education lays down a standard for the number of children in a class or for the conditions under which the schools have to be run. When we build housing estates we have to build schools; we have no option as to whether we can build a school or not; and when it is built there is a minimum standard. That is part of national policy.

8407. It is the standard that determines the level of expenditure?——*Alderman Hill*: Yes, the cost per place.—*Mr. Pollard*: There is great pressure on the need for advanced technological education at the present time. We began a new college of technology when the rates of interest were between 3½ per cent. and 4 per cent., but the great weight of expenditure has been running on us over this past recent period, with very high rates of interest on the money which we borrow at the time we are borrowing it. That kind of pressure from central sources cannot be avoided, having regard to the national policy in these matters; and we have to carry it out. We have to raise the money; and we get our grant on the loan charges, not on the capital money that we have to find.

8408. Historically, I suppose, the private Act of Parliament was the source of local authority borrowing; has this system of loan sanctions only come into being recently?——*Mr. Pollard*: No, it has been going for a long time. It was in the Public Health Act, 1875.—*Alderman Hill*: There was control of the use of capital for revenue purposes after 1835, when it was easy for one particular generation of planners to squander the whole heritage. It really goes back to the first Public Health Act.—*Sir Harold Banwell*: By and large the general tendency has been to replace the detailed use of loan sanction by other methods of seeing what the local authority was doing in detail, particularly over the last ten years. That is a matter very much at issue now between the Association and Government departments.

8409. *Professor Cairncross*: I am still at a loss to know what you are proposing should happen, when the Government wants to cut local authority capital expenditure by 10 per cent. or 20 per cent.?——*Mr. Pollard*: I am sorry if it is not as clear as it ought to be. We are saying that, if the Government say that local government expenditure must be cut by 10 per cent., the way to do it is by issuing 10 per cent. less loan sanctions.

8410. To every single authority?——No.; if there is a matter of changing the policy in this direction, they must

make the decision as to which loan sanction shall or shall not be granted.

8411. They must decide between projects?——Between projects and between authorities.

8412. Would you prefer that?——*Mr. Pollard*: We would prefer it at times of necessary restriction to increased rates of interest of a penal character.——*Alderman Hill*: We had discussions with the Ministry last year, and we said that we would rather they did this on a discretionary basis. We are saying that, if there is a need, there is a weapon readily at hand; we do not particularly care for it.

8413. You would rather the central Government wielded a direct weapon than left it to the local authorities to react in some general direction?——*Sir Harold Banwell*: We cannot react in the way you are suggesting in terms of education; whether we like it or not, the standard has been set, and we have to carry it out.

Chairman: Thank you very much, gentlemen; I think that completes our questions.——*Alderman Hill*: Thank you, my Lord; and may I add that if there is any further information we can get for you we shall be very glad to do so.—*Chairman*: Thank you very much. We are very much obliged for your help this morning.

(*The witnesses withdrew.*)

(*Adjourned until 2.15 p.m.*)

The following witnesses, representing the County Councils Association, called and examined:

T. M. BLAND, ESQ., T.D., Vice-Chairman, Executive Council, C.C.A.;

W. J. BENNETT, ESQ., C.B.E., Chairman, Local Government Finance Committee, C.C.A.;

N. DOODSON, ESQ., County Treasurer, Lancashire;

T. WATSON, ESQ., County Treasurer, Derbyshire.

8414. *Chairman*: Mr. Bland, you have given us a very good and informative paper.* Would you have the paper in front of you, and we will see what questions arise on it. The first three paragraphs are introductory. You say that county councils were established by the Local Government Act, 1888, and are principally concerned with:—

"... the provision of educational instruction; the care of deprived children; welfare of the aged and infirm; fire protection; the provision of health services; the construction, maintenance and improvement of highways and bridges; and to a share in the administration of county police forces ..."

Am I right in thinking that the biggest range of that activity is the educational service; then come the health services, the highways and bridges, and the county police?——*Mr. Bland*: Yes.

8415. *Professor Cairncross*: Is housing not a responsibility?——*Mr. Bennett*: Not of the county councils.

8416. Who then is in charge of rural housing?——The rural district councils, urban district councils or boroughs are the official housing authorities. County councils could apply to become housing authorities, but apart from the London County Council I do not think any county council has in fact applied to become a housing authority.

8417. *Chairman*: You have quite large building activities in connection with education?——Yes, that is the largest slice of local government expenditure, over which we have practically no control at all; standards are set.

8418. "No control at all"; could you enlarge on that?——*Mr. Bennett*: If I could use the case of Essex as an example, there we have new towns, the overspill of London and so on, and we have just got to do it. For instance, in the year before last 16,000 school children moved from London into Essex. 16,000 school children means 40 new schools at £¼m. a time, and it is a sheer impossibility to cope with that enormous increase in population thrust into the county. I do not mean by that that we object to it; it is just a physical impossibility to provide all the necessaries within a given time. Finance is not a factor, because we must provide the minimum accommodation for the new entrants. That goes for all the counties around London and possibly for other parts of the country which have an overspill problem.—*Mr. Bland*: Even for counties with no overspill problems, where they only have the problem of parents having children, it is simply a case of fulfilling the statutory obligation laid upon them by the Government to provide education for the children; and the standards of building for education are laid down again by the central Government.

8419. Your statutory obligation is imposed upon you, but in very general terms. It is then interpreted for you in more detail by the standards which the Ministry has power to require you to observe?——Yes.

8420. Within the range of those two things you have to do the best you can to raise the necessary money from your resources?——*Mr. Bennett*: That is so.

8421. Supplemented by Government assistance?——*Mr. Bland*: Supplemented over the years in servicing the loans, but not supplemented in the initial borrowing, which is rather an important point.

8422. You say it would be cheaper if the grant were made without calling upon you to raise the total amount of money by borrowing?——I do not think "cheaper" is the right word.

8423. More economical?——*Mr. Bland*: It would be better economics, I think.—*Mr. Doodson*: The Government would raise the money on their own terms of credit, and local authorities would be relieved of a large slice of their obligation, which would reduce the amount of competition in the mortgage market and elsewhere amongst local authorities.

8424. The money would come from a source which the Government would rely upon as the central authority, not from the sources you can tap as a local authority?——*Mr. Doodson*: Yes.—*Mr. Bennett*: It is tied up with the question of financing from revenue. If the Government financed from revenue it would be a considerably cheaper operation as far as the Government is concerned, as they are financing at least 60 per cent. of the expenditure today.

8425. *Mr. Jones*: Do you mean that, if a county council is spending £1 million on schools in a given period, £600,000 of that would be the proportion that the Government would provide, leaving you to finance, on the basis of the raising of capital and the payment of interest, the remaining £400,000?——That is so.

8426. Would that be easy to accomplish? Do you see any difficulty in operating a policy like that, leaving the central Government to raise the capital in respect of its grant and leaving the county council or the local authority to raise the remaining proportion?——*Mr. Doodson*: Indeed not. At the present time the Ministry of Transport have an arrangement rather on those lines, under which the local authority gets a grant towards the cost of certain road schemes and is left to finance in whatever way it likes its own proportion of the capital expenditure.

8427. *Chairman*: The difference is between the Government making itself responsible for a share of the expenditure and making itself responsible for a share of the cost of borrowing for the expenditure?——*Mr. Bennett*: That is what it comes to.

8428. *Professor Sayers*: May I go back to the expenditure? You said that the expenditure is determined by the national policy, and the standards are laid down separately. We have been talking, by way of, for instance, expenditure of £1 million on a scheme. Is the £1 million determined precisely by the national standards laid down, or is there any play at all for local determinations?——No; the minimum standards set by the Ministry are so cut that it is with extreme difficulty that authorities are able

* Memoranda of Evidence Part IX No. 2.

to get down to that standard. All sorts of subterfuge have to be exercised in cutting out bits and pieces in order to get down to it.

8429. So one expects to find the same standards universally?——Yes.

8430. I am told that in one of the English counties every new secondary school is now provided with its own theatre. Does that mean, from what you have said, that every new secondary school throughout the country is provided with its own theatre?——*Mr. Bennett*: If you are thinking of Coventry, that is rather a special case; I do not think we can argue from the Coventry theatre. That is the only one I know.—*Mr. Watson*: Coventry will have sacrificed some other standard in its school building, probably its finishes, and will have exercised other economies if it has spent more on its theatre. The way in which it operates is that a certain figure is allowed per place provided, and there is some latitude within that, but only to that extent.

8431. So there is no question of spending rather more per place if the county decides that it is worth while?——Not only would there be no grant on any excess, but the Ministry would not approve a loan sanction, I imagine.

8432. That applies to education. Does the same rigidity of amount spent apply to other services?——*Mr. Bland*: Yes. In the case of police houses and public health the departments concerned in each case have the same degree of control as the Ministry of Education has over schools.—*Mr. Watson*: Except that it is not controlled to a cost per unit; but the Government department would approve the plans, or make suggestions for modification of the plans to reduce the cost, and then would only approve a loan sanction for a competitive tender on the basis of those approved plans; they exercise control to that extent. But in the case of welfare (children's homes are an example; that is a 50 per cent. grant-aided service) there are no two problems exactly alike, and there is not the same standardisation of accommodation throughout the country.—*Mr. Bland*: There is unfortunately equal Government control. We have to get every detail approved before we can get loan sanction.

8433. So there is complete rigidity in the expenditure?——*Mr. Bennett*: Yes. We must submit our tender as well to the Government department, and very often they say that they think it is too high and we must go back and think again, alter it, or cut down the floor space of the building, in order to get down to a pre-determined figure set at the Ministry level.

8434. So that exactly how the money is spent may be subject to some local variation, but the money spent is controlled centrally?——Centrally.

8435. It would seem to follow from that that the ease with which loans can be obtained and the rates of interest that have to be paid on them, have no bearing at all on the amount spent?——That is very much our point.

8436. *Professor Cairncross*: Exactly what is meant by calling this local government capital expenditure rather than central Government capital expenditure? What would the difference be if the central Government said: "These will be our schools"?——It is local government expenditure in the sense that 40 per cent of it is borne by the local authority. It is local expenditure to national standards. The controlling interest is the man who pays the piper; the body that pays 60 per cent. (that is to say, the Ministry of Education) is going to exercise some control, and effective control, over the total expenditure, and they decide the standards. It all comes down to what is the conception of education. There are two views: one view is that education is a national service locally administered. The other view is that it is a local service to Ministry standards. It is a play with words, but it is rather important; there is a distinct difference. Hertfordshire and Essex are adjoining counties. We each decide to build a four form entry school; we have different methods perhaps of providing the accommodation, a little local ingenuity and so on by our architects, and all the rest of it; minor differences.

8437. But when you say you decide, what do you decide? Do you decide the time at which the school will be built, or where it will be built?——No, the time at which the school is built is determined entirely by the number of children to be catered for. We have a town development scheme at the moment for 5,000 houses. Five thousand houses is going to mean nearly 10,000 children; which means that 10,000 children have to be worked through the schools. We have to plan it ahead so that the schools and the houses are provided at the same time; we have no control over it. Once we have determined that we are going to build 5,000 houses then we must incur the necessary expenditure to provide the essential minimum services, of which education is the largest part.

8438. What about the replacement of an old school by a new one?——We would like to do that, but we have not been able to do it so far. It may be done in some parts of the country, but in my own part of the country we are so involved in providing new accommodation that we have to wait until this artificial development comes to an end before we can really improve the old rural schools which were built in the 1860s and thereabouts.

8439. Does the central Government tell you that you have to wait, or do you decide to wait?——No; there is a physical limit to the amount of work we can do in a year. They can give us as much money as they like but we can only spend so much a year. In Essex we have been trying to spend £5 million a year for the last ten years; we succeeded for the first time last year, although we have £17 million worth of work on the drawing board and children are still having their education in back rooms and huts. The deciding factor is the sheer physical impossibility of providing the labour and materials for the necessary services for people suddenly imposed on us.

8440. Why should you be obliged by the central Government to build new schools whereas, if it is an old school, the controlling factor is not the central Government's decision but the physical impossibility of doing it?——*Mr. Watson*: Essex have not reached the stage at which they can consider substituting new schools for old, but if they could, and had the physical capacity, the Ministry would control it. Each local authority has to submit a capital building programme two years ahead which is approved after modification. If a new problem were to come along, like overspill, something would be taken out of the programme and the overspill put in in its place as a more urgent problem. If there were to be any restriction of capital expenditure on building programmes already approved, then the Ministry would decide just which schemes had to be set back. In my own county two rural reorganisation schemes have had to be taken out and set back two years just because of the credit squeeze.

8441. *Chairman*: What instrument would it use to give effect to that decision? It has already approved your programme, I gather, a year or two ahead; it has given its sanction for the building involved; the loans have been approved. How do they pull you up and say that you have to alter it or reduce it?——They would ask for a revision of the programme. If the authority insisted, then the final arbiter would be refusal of loan sanction.

8442. We must assume that loan sanction has not been given?——The loan sanction is not given until you get to the point of tenders.

8443. *Professor Cairncross*: Is it reasonable to suppose in the light of what you have said that if the central Government itself assumed the responsibility of building schools and did not involve the local authorities at all, the rate at which school building would go forward would be exactly what it is now?——*Mr. Bennett*: I would not say that.

8444. What differences would be involved? What latitude do you enjoy?——*Mr. Watson*: The Ministry even fix the starting date for each major project; they control the rate of school building to that extent.

8445. Is that not an additional reason for thinking that transfer of responsibility to the central Government (which I am not in any way suggesting) would not essentially alter the volume of capital expenditure?——*Mr. Bland*: I doubt myself if it would alter the volume of capital expenditure.—*Mr. Watson*: I would think it would not alter it very much; there might be some slight alteration of siting. The fear of local authorities, if we had central direction of that sort, would be that there

would be some yardstick laid down to apply to the whole country; at the present time there are certain parts of the country where, because the local authority or possibly the building industry are in a more favourable position than in other parts of the country, one can get an extra school or two.

8446. At the discretion of the local authority?——*Mr. Bland*: "Discretion" is not the word.

8447. *Professor Sayers*: At the initiative?——It might be at the initiative of the local authority.

8448. Then in such a case the amount of capital expenditure would be influenced by local decisions?——*Mr. Bland*: Yes, in such cases I believe that so much is allocated to the Ministry of Education for school building, out of which the Ministry in turn allocate to the individual local authorities who have put forward their programmes. I should think that in the case of every county council in the country the programmes put in are always greater than the amount that is finally authorised by the Ministry, and that invariably every local authority's building programme has been cut down before it is finally carried out.—*Mr. Watson*: It is really a form of block grant.

8449. *Mr. Jones*: Do you mean that the Ministry of Education have a financial programme agreed with all the local authorities, that you can submit schemes only up to that maximum amount, and the amount allocated will be substantially less than that amount?——*Mr. Bland*: No. But in the end the amount allocated is always, I should say, less than the amount that the local authority if left entirely to themselves would consider they ought to spend.

8450. Something else has been said about the physical incapacity of local authorities, particularly authorities like the Essex County Council, to provide themselves with the sort of capital resources that they require for their social services. If they programme to get things done, whatever they can get done physically will fall far short of what is required?——*Mr. Bennett*: Quite.

8451. In this field of education are there any circumstances where there would be substantial numbers of children who are not in school at all at this stage?——You must qualify the term "school"; we have them in church halls, village halls and all sorts of huts and things. The children are receiving some kind of education in all sorts of substandard buildings.

8452. Would you have any children outside educational provision in the county of Essex because of your inability to mobilise all the physical resources that you require?——There could not be because we have an obligation to provide education for the children, and we should do it in any way possible. Even in London we have the same situation; we have rooms over shops, we have half a convent and other empty buildings being used for schools. In other words, the children are being catered for in a very substandard way; they are not in school buildings as a distinct type, but in all sorts of odds and ends of corners. But there are no children in Essex who are not receiving some kind of education.

8453. *Professor Cairncross*: According to what you are putting to us, the decisions that are taken on total capital expenditure are decisions of the central Government?——Decisions of the central Government entirely and in detail. We do not get a block grant; they do not say: "Here is £500,000; spend it the best way you can." They want to know the details of each individual item, and they will even come through in the course of the year and tell us that owing to national conditions we shall not be able to complete the original programme.

8454. *Chairman*: The sanction being the grant control?——*Mr. Watson*: And the starting dates if the scheme has not begun.

8455. *Professor Sayers*: What about the other services, police, welfare, health, fire, etc.?——*Mr. Bennett*: On police services Mr. Bland has more experience, but I think he will agree with me that the Home Office exercise, if anything, tighter control than even the Ministry of Education.—*Mr. Bland*: More rigid and more detailed, and, we think, an administratively uneconomical degree of control.

8456. What about health and welfare?——*Mr. Watson*: The same kind of control; they approve a capital expenditure programme each year and invariably cut the proposals of the local authority.

8457. *Professor Cairncross*: Are there any items in the capital expenditure which you are supposed to finance from revenue from time to time?——*Mr. Bland*: It is not a case of what we are supposed to do; it is what we want to do. We want to finance more from revenue than we are allowed to.

8458. Why are you not allowed?——*Mr. Bland*: Because the central Government does not want to pay a grant in the first year; they prefer to spread their grant over the servicing of the loan in later years.—*Mr. Watson*: On education they control capital expenditure out of revenue, on which up to now they have paid grant on expenditure up to the product of a 3d. rate. They have cut that down for 1958-59.

8459. *Chairman*: In paragraph 91 you say:—

"In the present period of higher interest rates there is an incentive to finance capital expenditure from revenue. The initiative of individual authorities in this matter is restricted by the existence of departmental limitations on the amount of capital expenditure chargeable to revenue which will be admitted for grant in a financial year, chiefly in the case of the education and health services. A limit of an amount equivalent to the proceeds of a 3d. rate is imposed by the Minister of Education; the Minister of Health will not admit for grant any item of capital expenditure exceeding £2,000 for the purchase of land or buildings or £10,000 for other items, or exceeding the product of a 1d. rate, unless special approval has been given."

Has there been some change in that?——*Mr. Doodson*: The change is that, since the document was prepared, the Ministry have announced that as from 1958-59 there is a limit, of £3 m. for the country as a whole, on the amount of capital expenditure to be financed in this way, and an allocation of this £3 m. has been made to individual education authorities on the basis of school population. In the case of my own county, for instance, it has resulted in the amount we would like to spend in this way being reduced by nearly 50 per cent.—*Mr. Watson*: In our case it has reduced it by one-third.—*Mr. Bennett*: I should have thought financing from revenue was an aspect of national saving.

8460. Your point is that with all these measures it is positively discouraged?——*Mr. Bland*: It is prohibited beyond a very small figure, which local authorities can never understand.

8461. *Sir Reginald Verdon Smith*: Does anyone know how the £3m. compares with the product of a 3d. rate?——*Mr. Watson*: We think it is somewhere between one-half and two-thirds of what it was. In Lancashire it is about half, in Derbyshire two-thirds; but everybody is suffering a reduction of some kind.—*Mr. Doodson*: It does represent a substantial cut.

8462. *Professor Sayers*: If there was not this limit, would local authorities of their own free will finance more capital expenditure out of revenue?——*Mr. Bland*: Definitely.—*Mr. Watson*: Certainly while interest rates are high.

8463. Does it depend on that to some extent?——*Mr. Bland*: It certainly influences it.—*Mr. Doodson*: There is a greater incentive while interest rates are so high.

8464. Has there been more spending on capital projects out of revenue, within the limits set by the central Government, since interest rates went up?——*Mr. Doodson*: We have no precise information on that, but I would say yes.—*Mr. Bland*: I should have thought undoubtedly so.—*Mr. Bennett*: In Essex we spend to the limit of our powers from revenue as a matter of deliberate policy.

8465. And before interest rates were high you were not spending to the limit?——We always did in Essex.

8466. *Mr. Jones*: What are the capital projects you would undertake out of revenue, in view of the fact that these capital projects are grant earning from the central Government?——We should not do it on education except to a limited extent in Essex, but we should do

it on health and on welfare services, and on other services where the bulk of the cost would normally fall on the rates.

8467. Have any of the capital projects which you have undertaken out of revenue been grant earning?——Some of them partially so. We have to be very careful on that. There is a limit set on the amount of capital expenditure out of revenue qualifying for grant aid, and the Government will not pay grant on anything over the limit. If we decide to go beyond the limit we just pay the lot, and you would not expect reasonable men to do that when they could get a grant. If it is a service where we have to meet the whole cost on the rates we feel that is within our control, and to that extent we utilise the facility of financing capital expenditure from revenue.

8468. *Professor Sayers*: You have all agreed that with interest rates at the present level county councils are disposed to finance capital expenditure out of revenue up to the limit, whatever it is, fixed by the Government, and Mr. Bennett said that Essex had always gone up to the limit. What used to happen in other authorities before interest rates reached their present level?——*Mr. Bland*: My own guess would be that the majority of counties would have gone up to the maximum. Would you agree?—*Mr. Watson*: Our policy before the war in my present county was to go up to about the product of a 6d. rate in meeting capital expenditure out of revenue. During and after the war when our capital expenditure was limited, we met the whole of it out of revenue and repaid what loans we could. When capital expenditure began to develop and low interest rates came in at the same time, as a matter of policy my council said: "We will borrow for everything so that we can spend more money." We had been seven or eight years without any capital expenditure at all, and everything was in arrears. Gradually, as interest rates have risen, my council have gone more for capital expenditure out of revenue when they could, but that is only a very small proportion of the total.

8469. *Professor Cairncross*: As I understand you, when you speak of using revenue to meet capital expenditure you are not assuming that the capital expenditure itself alters as a result but rather that the method of finance falls more on revenue and less on borrowing?——*Mr. Bennett*: Quite.

8470. I am not clear whether "capital payments" as you refer to them in Table 2 are the same as "capital formation" in Table 1? Capital payments might involve the repayment of outstanding loans, for instance.——*Mr. Watson*: That is not the intention.

8471. The items in Table 2 are comparable with the figures in Table 1?——*Mr. Doodson*: Yes.

8472. There is a reference in paragraph 9 to approximately 90 per cent. of the capital expenditure of local authorities being financed by borrowing. Presumably the remaining 10 per cent. comes from revenue?——*Mr. Bennett*: The remaining 10 per cent. is entirely within the control of the council; no sanctions are needed for that odd 10 per cent.—*Mr. Watson*: Some of this will be capital expenditure financed out of revenue, even though it may be controlled; there are also small items of capital expenditure which some Government departments are prepared to allow to rank for grant without close scrutiny.

8473. 10 per cent. is your estimate, then, not of capital expenditure financed out of revenue but of the expenditure that is within the discretion and control of the local authority without individual detailed vetting by the government?——*Mr. Watson*: I would say the 10 per cent. is very largely, if not wholly, capital expenditure financed out of revenue.—*Mr. Doodson*: That is so; it is very largely capital expenditure financed out of revenue, or financing in minor ways by the use of capital funds.

8474. Is this intended to refer to your own group of county councils or to all local authorities?——County councils.

8475. *Chairman*: Borrowing would not include the use of internal funds?——*Mr. Watson*: No, but I think it would include the application of any capital receipts. If we sold property we could apply that, but again the application of the proceeds would be subject to Government sanction in each case.

8476. Table 3 gives figures of the outstanding debt. Then in Table 4 you give the changing debt structure. If I follow your point there, the significant thing is the change in the percentage of debt from source 1, that is stock and mortgages, to source 2 over the period of years from 1948 to 1956. Reliance on stock and mortgages has gone down approximately from 61 per cent. to 27 per cent., and on the Public Works Loan Board has gone up from 25 per cent. to 54 per cent.—*Professor Cairncross*: And your total debt has trebled. Do you expect your debt to go on rising at this rate for a very long period?——I think so. The main thing is education. The fifteen-year programme which all local education authorities were required to provide under the 1944 Act and which is probably five years in arrears, now visualises, particularly with regard to the expansion of the technical education programme in the last year or two, that for the next 10 or 20 years there will be ever increasing capital expenditure on education.

8477. *Chairman*: And this shift in the structure of your debt was due to the Public Works Loan Board loans being made available to you to a larger extent?——Yes, and the fact that it became compulsory to borrow from the Public Works Loan Board.

8478. You were given no other access?——*Mr. Watson*: No other access.—*Mr. Doodson*: In particular no stock issues.—*Mr. Watson*: 1957 would show a very rapid decline in the Public Works Loan Board percentage of the total.

8479. *Professor Sayers*: Until the end of 1952 your post-war borrowings were entirely through the Public Works Loan Board?——That is so, subject to a very small margin from other sources.

8480. Since then the proportion of other borrowings on mortgage and so on has been rising?——*Mr. Watson*: Steadily, and in the last year or two since the Public Works Loan Board have stopped lending money to local authorities except in the last resort, and there have been few stock issues, it is wholly being financed outside with the exception of a few small authorities.—*Mr. Doodson*: Between 1956 to 1958 stock has been issued to the extent of £50m. for all county councils in England and Wales; of that £50m. £35m. was for the London County Council which is not included in Table 4; in other words, only £15m. of stock was issued on behalf of the other county councils in England and Wales.

8481. *Chairman*: To what sources do you go for your mortgage moneys, since that seems to be your only possible outlet for the moment?——*Mr. Watson*: Apart from internal funds like superannuation funds, mainly to the local government mortgage market; specialised broking firms.

8482. Who makes the market; the firms in London?——They are mainly in London. There is a big one in Chester for the northern authorities. The other main development, which has not affected county councils very much, has been the Treasury sanction to issue mortgages for short periods. Many boroughs, but few county councils, are raising money direct from the public on mortgage for periods of two to seven years by advertising in the press.

8483. What is the public for this purpose?——*Mr. Watson*: Small investors mainly, I should think; but this is a kind of financing more peculiar I think to the north-west than to any other part of the country. Mr. Doodson has more experience of that, because I think he is borrowing in that way.—*Mr. Doodson*: We are getting only a very small proportion of our requirements in that way. Speaking rather more generally, in the north-west the local mortgage market has been pretty active, particularly in pre-war years; there was a lot of relatively small saving amongst private individuals which enabled many local authorities to cope fairly easily with their capital expenditure in those days. But that is a source which does not help county councils a very great deal, because the requirements of county councils are so very much greater, and in any case many county councils have felt there must not be competition between the county council and its own county districts; so in many cases the county council has said: "Let the county districts take the local mortgage market and we will seek to raise our money by other means."

8484. If you observe that policy it cuts you off from the local market?——*Mr. Doodson*: It does.—*Mr. Watson*: That in fact is what has happened to us; we have not entered the local mortgage market because of that. It would put up the rates for the county districts in my county.

8485. Then you turn to other brokers who put you in touch with clients in London, and you get some money by advertising?——*Mr. Watson*: Not by advertising at all; we do not take from the public at all. It is all through brokers.—*Mr. Doodson*: Or Trustee Savings Banks.—*Mr. Watson*: That is so in the case of some authorities; we cannot do that. We are not a trustee authority because we have not issued housing bonds.

8486. You will be under the pending Bill.——*Mr. Watson*: Under the pending Bill, but not at the moment. We cannot take building society money either.—*Mr. Bennett*: We have tried local loans in Essex, but it has not been successful. The boroughs are well in the market and there are certain local loyalties; I am afraid the wicked county council is looked at askance!—*Mr. Bland*: It is quite insignificant over the country as a whole.

8487. *Professor Sayers*: Is this because local feeling is with the borough rather than with the county?——*Mr. Bennett*: I would say so. Take a man with £200 or £300; he has a certain pride in his local authority, and if they are offering 6½ per cent., he would just as soon lend it to them and help them rather than the county council. It is largely psychological.

8488. *Mr. Jones*: You say that county councils in the main do not advertise invitations for mortgage subscriptions because they are anxious to give the fullest possible facility to their county districts. If that is so, to what extent are non-county boroughs, urban district councils and rural district councils inviting mortgage loans?——*Mr. Bennett*: I cannot give you an answer on that; I do not know the national picture.—*Mr. Doodson*: Not only do county councils in many cases not wish to interfere too much with the county district mortgage market but, more than that, they realise that the contributions which that could make towards the county council capital expenditure would be relatively small in any case.

8489. Are any of the authorities that are subordinate to the county council themselves compelled to go into the market for mortgage loans from the public generally?——Yes, indeed.

8490. Are they advertising?——Yes.

8491. *Chairman*: Your resources are mainly what brokers can put you in touch with, either in London or other big cities like Chester, and the Trustee Savings Bank. What kind of lenders do the brokers put you in touch with for this purpose? Institutional lenders?——Institutional lenders, yes; and sometimes building societies.

8492. *Professor Cairncross*: When you say "institutional lenders" do you mean insurance companies, investment trusts, and such groups?——*Mr. Watson*: Yes; and pension funds, but not very much of that now.

8493. Your debt structure, as you show it in Table 4, must have changed substantially in the past two years. In that period I assume that the Public Works Loan Board has not been able to meet the same proportion of your requirements as in the past; or has it still been the principal source from which you have drawn your funds?——*Mr. Doodson*: In 1954-55 the provision made for P.W.L.B. loans to all local authorities was £353m. It fell to £331m. in 1955-56, £109m. in 1956-57, £92m. in 1957-58; and the provision in the Budget for 1958-59 is £65m. of which £52m. will be covered by repayments from local authorities, leaving a net provision in the 1958-59 budget of £13m.

8494. *Chairman*: Those figures are gross new lending?——Yes. Gross new lending has been reduced from £353m. in 1954-55 to £65m. in 1958-59. Incidentally, there has been a more than corresponding increase in advances to nationalised industries; the figure has gone up from £75m. in 1954-55 to £507m. in 1958-59.

8495. *Professor Cairncross*: If you are not able to get accommodation from the Public Works Loans Board, you must have been thrown to a much greater extent on the mortgage market than in the past?——*Mr. Watson*: And on short-term borrowing.

8496. Have you been able to get short-term accommodation?——At a price.

8497. What would be the normal source from which you get short-term accommodation, and at what price would you get it?——*Mr. Watson*: Again brokers; the same brokers in most instances—*Mr. Doodson*: Discount houses, industry, banks, a little foreign money.

8498. Is it well organised as a market, or is it a little haphazard?——I would say it is fairly well organised as a market. There are three or four firms which deal with this, and then local authorities have tried to do a little organisation by running loan bureaux.*

8499. Between themselves?——Yes.

8500. Would the amounts involved there be substantial?——No, I think the largest loan bureau last year turned over about £18m. That does not mean permanent finance of £18m.: it means £18m. turned over.

8501. That is for all local authorities, not just county councils?——For all local authorities within the area of this one particular loans bureau, which is in my part of the country.

8502. *Lord Harcourt*: What is the longest period which you consider to be short in the short-term market?——*Mr. Doodson*: 364 days.

8503. *Chairman*: I would like to be sure what picture you are giving us of the Public Works Loan Board and of this difficulty of getting on the Stock Exchange with a stock issue. Is it that you have not been able to get the money you needed for the services which you had to carry out owing to Government policy, or is it your view that it is a needlessly expensive way of getting the money?——*Mr. Bland*: We all have our own opinions on the details of this; some of us, for instance, may think the Public Works Loan Board a more valuable institution than others. But I think we all feel that there should be some means by which local authorities carrying out Government policy should be able to borrow at roughly the same rate of interest as the nationalised industries. We feel that they should be able to do it through some centralised agency, which would avoid the enormous amount of administrative waste that goes on in scratching around individually like this. We should also be able to do it more equitably that way; it is inequitable that borrowing should be cheaper for the ratepayer in, say, Lancashire or the West Riding of Yorkshire than in Rutland. We think it is extravagant not only for the ratepayers but for the central Government that we should be paying higher rates of interest than could be obtained if there were some form of centralised agency. Personally (I do not know that everybody would agree with me) I am not particularly enamoured of the Public Works Loan Board. But it is still there in the last resort, though it is very much a last resort.

8504. *Professor Sayers*: Do I understand that this move away from the Public Works Loan Board has not affected the amount borrowed at all but only the terms on which you could get the money that you had to have anyway?——That is so; it has not affected the amount borrowed in any way.

8505. How much has it affected the cost of the money? Have the rates you have had to pay gone up by more than the cost of central Government borrowing has gone up in this period?——*Mr. Watson*: I think so. When the Government altered their policy for local authorities and said they were to borrow on the terms of their own credit or on the terms of credit of local authorities of good standing, the Public Works Loan Board rates were fixed on that basis and were increased to more than the Government rates of borrowing. But it is a fact that, in trying to borrow mortgage money in the mortgage market now, a local authority must pay more than the Public Works Loan Board rate; there is no money available at the Public Works Loan Board rate in the market.

8506. So that the rate you have had to pay has gone up in three ways, and these ways are additive: first there is the general rise of interest rates; secondly there is the difference between good local authority credit rates as reflected in the Public Works Loan Board rates and the rates for Government borrowing; and thirdly there is the extra cost you have to pay because you are forced outside the Public Works Loan Board for some of your money. Is that right?——That is so.

* See Appendix to Minutes of Evidence.

8507. How much per cent. is it on account of the last item? Is it ¼ per cent. or ½ per cent.?——*Mr. Watson*: I cannot tell you; we are waiting for a stock issue, and I am not prepared to pay the 7 per cent. that is being asked for mortgage money at the moment, so that I am not up to date with market prices.—*Mr. Doodson*: It is not really possible to give a specific answer to that question because conditions do vary so much between authority and authority.

8508. Are you agreed that there is a difference, that more has to be paid outside the Public Works Loan Board?——*Mr. Watson*: Yes, I think that can be shown in the returns for any week in the published returns of brokers.

8509. Mr. Watson, you have just said that you are waiting for a stock issue. How long have you been now in the queue?——Two years.

8510. Is that a common time to be in the queue?——*Mr. Bennett*: Essex has been in it two years.

8511. How much over two years?——*Mr. Bennett*: We went on just about two years ago.—*Mr. Doodson*: Lancashire has been on about 2½ years.

8512. Are you going up the list or down?——*Mr. Doodson*: I have no definite information; it is hardly moving.—*Mr. Bennett*: We put ourselves on for £3 million two years ago; last year it was raised to £5 million. We have now raised it to £10 million. We are still fifteenth in the queue; I do not know what it is going to be for in the end.

8513. *Professor Cairncross*: How long is the money borrowed for in the meantime?——In the meantime the temporary borrowings are very short periods. We are now thinking about three months. We have been doing it on a seven day basis, which is a headache to everybody; and we have a heavy overdraft of about £2 million on our good friends the banks.

8514. You never get to the point where you think you might have to borrow on mortgage for five years to see you through to the front of the queue?——*Mr. Watson*: Not at these rates.—*Mr. Doodson*: It would be difficult to raise substantial sums on a five year mortgage at the present time, because the people with mortgage money in largish sums are demanding 10, 15 or 20 years.

8515. Would I be right in supposing that you can raise money on short-term, say for under a year, at the going rate which is a high rate, or you can raise it for ten years or longer, but that the period in between is more difficult?——I should say that up to ten years is a difficult period for large sums.

8516. *Lord Harcourt*: Because the lenders of large amounts are looking for long-term investments?——Exactly.

8517. *Professor Sayers*: Have you ever protested against the queue?——*Mr. Bennett*: We have, but it does not make any difference.

8518. Have you ever been given a reasoned answer?——*Mr. Bennett*: Not what we call a reasoned answer; it is a matter of opinion what is a reasoned answer.—*Mr. Doodson*: Apart from the London County Council issue in February, 1958 there have been no county council issues at all since January, 1957.

8519. *Sir Reginald Verdon Smith*: Is that not for want of trying on the part of county councils?——Indeed not; a lot of us have our names down in the queue.

8520. Not only down but actively wanting to proceed at the first opportunity?——We were told last year that there was not the slightest hope of getting a stock issue before the summer or autumn of this year, even if the issues went on in the way they were going at that time; since then there has been a slowing down of local authority issues.

8521. *Mr. Jones*: When you get your stock issue, whether it be for £3 million or £5 million, will you then redeem a good deal of this mortgage and short-term debt as well as making provision for the capital developments you have in hand?——A lot depends on the amount of the issue we get, but I cannot think we shall get an issue which will be sufficient to finance us very far ahead. It will be more of a funding operation for the short-term loan we have already got.

8522. *Chairman*: You say in paragraph 30:

"Since access to the money market was restored to local authorities as from 1st January, 1953, eight English county councils have issued stock and at the beginning of July, 1957, fourteen counties were on the waiting list, the application of longest standing having been made in January, 1955."

—*Professor Cairncross*: In view of what you said, "the application of longest standing" must be one that is still standing?——*Mr. Bennett*: If it is over £3 million; if it is under £3 million it has probably been struck off the list.

8523. *Sir Oliver Franks*: When a county council decides that it wishes to issue stock what is the actual process it goes through? Who sees whom?——*Mr. Doodson*: It is a matter of seeing the issuing house to notify them to make a stock issue, and then they put you down on a list, which I believe is kept at the Bank of England.

8524. They would act as your intermediary throughout?——*Mr. Doodson*: Yes.—*Mr. Watson*: And they would tell us when we are coming up so that we could take the necessary statutory resolutions, and produce the loan sanctions to cover the issue. We would in fact act wholly on their advice.

8525. *Professor Sayers*: You said you had made protests about the queue; have you made them otherwise than to the issuing houses acting as your intermediary? Have you protested directly to the Treasury or the Bank of England?——*Mr. Watson*: There have been no official protests at all from the associations of local authorities. Whether any local authority has made protests other than trying to put pressure on their issuing houses, I do not know. I have not heard of any.—*Mr. Bland*: We do not think it very much use. We feel that these issues are so controlled by general Government policy it really is wasting time to protest to any Government department. We feel that, as soon as the Government think it right, it will so move.

8526. Have you noticed various public statements by the Chancellor of the Exchequer and the Governor of the Bank of England, saying that the policy of the Government was to turn short-term debt into long-term debt? Have you not quoted those statements to the authorities?——*Mr. Bennett*: Not as an association.

8527. *Chairman*: You regard Government policy as immovable on this matter?——Only three months ago we last had this matter up in Essex. They are always very cagey; we were told that we were not in the first ten. We can never get anything further than that.

8528. Have you worked out the extra cost of borrowing as you have to?——*Mr. Bennett*: I do not think we are very anxious.—*Mr. Watson*: At the moment those of us who can do so borrow short term in the hope that the long-term rate will come down, even if slightly. It is so much cheaper to borrow at a higher rate now, if in the next two years the rate is going to fall 1 per cent. We should save a certain amount of money. I am content to be on the list, which allows me to borrow short term without any criticism from the Treasury.

8529. *Chairman*: At the end of paragraph 24 you say: "to meet the capital expenditure which can no longer be financed out of borrowings from the [Public Works Loan] Board local authorities are having to seek alternative sources to the extent of between £300 million and £400 million annually."
From what you have told us this afternoon they are in fact at present finding those sources?——Yes.

8530. *Sir Reginald Verdon Smith*: Is that £400 million all new money or partly replacement of existing debt?——*Mr. Doodson*: That is all to meet current capital expenditure.

8531. *Chairman*: You say in paragraph 33:
"County Councils are empowered by the Local Government Act, 1933, to raise loans by mortgage. Unlike stock, mortgages are not trustee securities unless, the authority has been authorised to issue housing bonds."
The new Local Government Act will come after that?——*Mr. Watson*: That is so.

8532. Will it be of material importance to you?——I think it will open up sources of capital revenue to my authority which are not available now, in normal times. It is not as significant now as it would have been a

number of years ago, because so many of the investment funds that previously were particularly interested in local authority mortgages are now going more for equity shares. I do not think the market is so wide as it was for local authorities in that respect.

8533. In paragraph 35 you say:

> "Other restrictions imposed by the Treasury require that new mortgages shall be for a definite term and it must not be a provision that after reaching the stipulated date for repayment or renewal it may continue to run on at notice."

Did you say that that restriction had been dropped?——It has not been dropped, but it is intended to drop it when circumstances permit.

8534. How old is that restriction? Does it go back to the war?——*Mr. Doodson*: Yes.—*Mr. Watson*: It is only in the last two or three years that the Treasury have allowed these short-term mortgages below seven years at all.

8535. In paragraph 40 you come on to deal with the method of temporary borrowing. There is a growing reliance on temporary borrowing, I gather?——Yes, there is no doubt about that.

8536. You say:

> "there appears to be a growing tendency for industry to lend money temporarily surplus to requirements to local authorities and at rates which compare favourably, from a lender's point of view, with bank deposit rate and the yield on Treasury Bills. At the time of preparation of this evidence local authorities are paying about 7 per cent. for temporary money compared with the bankers' deposit rate of 5 per cent. and the current Treasury Bill rate of approximately 6⅜ per cent."

——That has dropped roughly by one per cent., with the fall in Bank Rate.

8537. *Professor Cairncross*: Can you give us any indication how much of this temporary borrowing there is?——*Mr. Doodson*: The figure for 1956 is not more than £4 millions. The returns are only submitted every two years and the form for 1958 will not be ready until September of this year. If the Committee wished, we could submit a further paper, taking out a sample of all county councils. It would be rather more difficult to do it for all.—*Professor Cairncross*: I think we can wait until the figures appear in the ordinary way.

8538. *Chairman*: Then, to pass on, your general point in paragraph 46 is that the county councils' need for money when they want to raise it is an inflexible social need?——Yes.

8539. *Professor Sayers*: There is some qualification of it at the end of paragraph 47. I wonder if any further qualification is to be made if one looks at the period since the enquiry mentioned there was put?——*Mr. Watson*: I should say the qualification is very slight indeed. There are very few authorities which have amended their capital programmes because of high interest rates.—*Mr. Bland*: I should be surprised if there were any amendment at all.—*Mr. Watson*: My view is that my authority would go on with its capital expenditure if the rate of interest were 10 per cent. or even 12 per cent.—*Mr. Bennett*: The steadily increasing rate is a very important factor, and the authorities are very careful not to drive that too far.

8540. *Professor Cairncross*: I think we are being given two pictures. I understood the capital expenditure was not within your control: that it was dictated to you by the central Government?——*Mr. Watson*: Dictated as to maximum. The authority might be prepared to embark on expenditure, but at the moment the capital programmes are really bare essentials of the various services which, regardless of interest rates, must be carried out, and in fact were carried out in this local government sector because of this reason.

8541. What were the eight local authorities referred to here deterred from doing; building swimming baths?——*Mr. Doodson*: Building county offices, in one case. Fifty-three out of the sixty-one county councils said there had been no abandonment or deferment: three said there had been deferment affecting small schemes and four others specified schemes amounting to £175,000. In the case of one authority the opinion was there had been some deferment: they could not say exactly what it was.

8542. Something not so closely connected with the central Government's schemes?——*Mr. Bland*: For instance, new courts.

8543. *Professor Sayers*: Your most recent answers have been directed to telling us that the capital works of the local authorities are at the bare minimum, and that any further rise in interest rates would lead to no change in programmes. Suppose that rates of interest were very materially reduced; would there be an increase?——*Mr. Bennett*: Not in my case.

8544. Because you are limited by building capacity?——*Mr. Bennett*: We have five years' work in hand at the moment. The interest rate does not influence it at all. I should say for all the big authorities that would be common. There might be small authorities, one or two little counties, where it might be effective, but the overall picture is that the local authority's expenditure would not increase by any reduction in interest rates.—*Mr. Watson*: I would want to qualify that a little, in that I think my authority would wish to push Government departments a little harder if interest rates went down. That was the experience after the war.—*Mr. Doodson*: I would agree with that.

8545. *Chairman*: Then you say in paragraph 48 that you have had several appeals by the Government, which no doubt you have carried out. When was the most recent appeal?——*Mr. Bennett*: Last year.—*Mr. Bland*: In fact they did the pruning themselves.—*Mr. Bennett*: We come back into further education here, because that is one field where a substantial reduction could be made; in the other field they are very small investments.

8546. *Professor Sayers*: Coming to paragraph 58, do the county councils want the £3 million minimum for stock issues to be dropped?——*Mr. Watson*: Yes.

8547. Have you asked for it to be dropped?——Yes; that was refused.

8548. Were you given any reasons?——*Mr. Doodson*: The reason given was that it was to reduce the pressure on the issue market.—*Mr. Watson*: The proposal was put from the County Councils' Association that three or more county councils with £1 million requirements might come together and go in the list for £3 million or more, but that has been turned down very recently.

8549. *Chairman*: If you apply this £3 million limit to the county councils, and take out all that do not want to borrow £3 million, that assumes that councils with requirements for less than £3 million have an easier means of finding money elsewhere?——It assumes it, but those who are issuing stocks, say, for £1 million, which two or three county councils have done by private issue, have found it relatively simple, because the whole amount of it was taken up by three or four large institutions. We would very much like to be able to revert to that practice of private placing.

8550. You are not allowed to do that either?——*Mr. Bland*: No. One assumes that it is deliberate policy to limit the demand on the capital market and keep the local authorities in the mortgage market.

8551. *Professor Sayers*: It does not affect your capital needs at all?——No. Admittedly if they did make it easier for the smaller counties to band together and come together to the market, it would only mean the queue would be longer.

8552. *Chairman*: Do you think it is a fact that the county council with smaller requirements, which may be the smaller county council, can more easily find money outside stocks issue?——I do not think so.

8553. Has the selection of £3 million rather than £2 or £4 million worked particularly to the disadvantage of county councils rather than other authorities?——*Mr. Watson*: One does not know what boroughs were in the list for smaller amounts, but so far as one knows the private placings that were allowed of £1 million were mainly county council issues. There were very few borough private placings that one knows of; but there is not much publicity given to it.

8554. Could you say the experience with the £3 million minimum has produced a tendency to borrow more than might actually be needed?——*Mr. Doodson*: I do not think one can say that.—*Mr. Watson*: There has been

no issue, and time has gone on, so that those who might have gone for £2 million are now ready to borrow £4 million.

8555. *Mr. Jones*: Might not an issue of £3 million be more than a county council required?——*Mr. Bland*: It would be much too big for my county, which is one of the fairly small ones, though not among the smallest.

8556. So if you were afforded the privilege to issue £3 million worth of stock, you might have a situation where you had more money than you required, and there would be a waste of the national credit. Could it happen like that?——*Mr. Bland*: No. We must have loan sanctions to cover it.—*Mr. Watson*: It means that we must be able to visualise expenditure within the next two or three years for that issue.

8557. Could you see, say in Derbyshire, a situation in which you could be more efficiently served by a stock issue of £2 rather than £3 million?——Not in Derbyshire because our capital expenditure is running at £2 million a year, but I could see it in the case of, say, Shropshire; there a £2 million stock issue would cover three or four years' requirements, which one might think reasonable.

8558. When an authority like yours raises £3 million worth of stock, does it redeem mortgage stock and redeem short term loans as well as making provision for forward capital development?——It would have to be partly for the redemption of short term money and partly forward development. When our turn comes, we shall look closely at our requirements and decide just what the issue should be. It will be subject to agreement, but it will certainly have to be more, if we can get it, than the figure on the list now.

8559. To the extent therefore that you redeemed short-term loans and mortgages, there would be money available for the provision of further credit?——Yes.

8560. *Professor Cairncross*: In paragraph 60 you say: "Action by the banks does not appear to have had any general effect on county councils' arrangements for meeting that short-term requirement"; but you say in paragraph 44 that some county councils have been refused overdraft facilities pending the raising of stock. Has this been common? You imply here that the inability to make a stock issue at the time you like has put you in some difficulty because the banks have not always been prepared to give you an indefinite overdraft and you have had to go elsewhere?——*Mr. Doodson*: In a minority of cases.

8561. When it has occurred have you been able to get accommodation at the lower rates referred to in paragraph 60?——Yes. Finance has been secured in some way or other.

8562. Cheaper than the banks?——Possibly, yes. The difference at the moment would be about ½ per cent.

8563. *Chairman*: In paragraph 87 you refer to money bills for temporary finance. Do you know the reason why you are not allowed to use that instrument today, except in a few cases?——No. The Treasury apparently do not like it. They possibly consider it unnecessary competition in the money market. Perhaps that is rather an unfair observation: it may be that they had some experience with a few authorities who have had the power to issue them; but they are still being issued and one does not hear of such difficulties.

8564. *Professor Sayers*: How can you say the Treasury do not like it? Do they not do it themselves on an enormous scale?——They do not like it for local authorities.

8565. *Chairman*: You cannot think of any reason why their use should not be allowed?——No.

8566. Then we come to the summary of conclusions. Are we right in thinking that it is one of your principal propositions to us you are treated less favourably than the nationalised industries, that your capital expenditure is under a more rigorous control than the capital expenditure of the nationalised industries?——*Mr. Bland*: I should say that our chief complaint is that we should be where they are. Carrying out Government policy we should be able to borrow virtually at Government rates.

8567. *Professor Cairncross*: You refer in paragraph 78 to the fact that you are paying a half per cent. more than the nationalised industries. Is that a major point in your evidence today?——*Mr. Watson*: Not a major point, I think. We feel a little hurt that the nationalised industries have taken the place that we used to enjoy *vis-à-vis* the Public Works Loans Board. We cannot go to the Exchequer as we used to be able to. Someone else is getting the money, and at favoured rates; but we think our services are such, and are so controlled by the Government, that we ought to be virtually on the same terms as the Government in the matter of financing our expenditure.—*Mr. Bland*: We also complain that our task is made much more difficult administratively with the amount of messing about that has to be done. We have to find the money as and where we can.—*Mr. Watson*: We get a little incensed when we see ourselves in competition with each other. One only has to look at the national papers; some authorities offer more than others. One in the Midlands offers at a higher rate than an authority in the north-west. It is unfortunate that this should be happening, we think; it is all the same kind of expenditure, the same kind of security, and it ought to be at a level rate.

8568. *Chairman*: I thought you did not really expect to rely on local money, so that the local element of money does not matter. Do you not go for your money, when you cannot go to the Public Works Loans Board, to a centre like London or Chester?——*Mr. Bland*: Even there we are competing with each other through our brokers.

8569. Do you not get some sense of security from the fact you are competing with each other?——Not with money as short as it is today.

Chairman. I think that completes our questions. We are much obliged to you, gentlemen.

(*The witnesses withdrew*)

L. A. WILSON, ESQ., Chairman, and R. E. LIDDIARD, ESQ., representing the British Federation of Commodity Associations Ltd., called and examined.

8570. *Chairman*: In the paper* which you have been good enough to send us, you begin by telling us the history of how the Federation came into existence, and you say: "The trade associations which the Federation represents provide rules for membership and a framework of discipline and a power of sanctions that has been found essential in the arrangements made between the commodity markets and the Bank of England for banking activities." Would you enlarge on that?——*Mr. Wilson*: Possibly "found essential in the arrangements" could be misleading; it might be better to say that the sanctions which were required in implementing the schemes of the Bank of England require that market executives should be able to exercise control over their members, in the case of infringements of the regulations or trade getting out of hand. That is what is meant.

8571. What sort of thing happens? If there were breaches of exchange control regulations, would they be reported by the authorities to the Federation's governing body?——It would not be to the Federation; it would be to the respective trade associations; and if it came to the notice of the authorities that there had been infringements of exchange regulations I imagine most of the associations, certainly the one I am more closely associated with, would take very strong disciplinary action, even to the extent of expelling them.

8572. Do you fine them at all?——There have been occasions of fines, but I cannot recall a case of expulsion or fine in connection with the Bank of England schemes.

8573. *Professor Cairncross*: Can you tell us what commodities are now covered by the associations?——Wool; chemical and dyestuffs trades; edible nuts; general produce, by which we mean gums, peppers, spices and that sort of thing; cotton; cattle food; copper; jute; metals; oil and tallow trades; shellac; sugar; rubber; and timber. Some of these commodities are divided up among more than one association. There are about twenty-two altogether.

* Memoranda of Evidence Part VII No. 3.

8574. You include practically all of the major staple commodities?——With the exception of grain and cocoa.

8575. *Professor Sayers*: In paragraph 3 you mention the tendency to shift over the years from acceptances into cash advances and overdrafts. Has there been any acceleration of that tendency since the war?——*Mr. Liddiard*: This Federation did not exist before the war, and I am not really old enough to know how it worked before the war. If you compare the immediate post-war period with the present the number of bills are increasing; but at the present moment and over most of the post-war period the rates for cash advances have been more attractive than those for bills, which also entail a commitment for a longer period.

8576. *Chairman*: You also make the point that you do not have to take more money than you need from day to day on a banker's line of credit. Is it also to any extent the fact that in the case of the bank overdraft you think the banker might be a little more tender?——I would doubt that. To some extent there is also the point, which affects trades with certain foreign countries that ask for 60 or 90-day drafts: if they are drawn in London there remains final recourse against the trader who also has his name on the bill. This point is particularly valid if the bills are on a foreign bank in London which might close down.

8577. *Professor Cairncross*: Have you observed a shift in individual trades over long or short periods of time in response to differences in interest rates?——The Federation has not a secretariat to be able to give that sort of answer. If I could bring that back to a single commodity, sugar, there are undoubtedly times when producers ask for credit facilities; by that means very often the London bill is introduced in the movement of their goods. In other words, sometimes they prefer to get their payment immediately, and it is financed in London; on other occasions they prefer to wait until the goods arrive and get their money when the buyer pays for it.

8578. *Professor Sayers*: Later on you talk about the use of day-to-day call money; you say that such day-to-day borrowing "has its obvious dangers unless kept within very close bounds." Do you mean dangerous to the borrowers or dangerous to someone else?——A commodity trader requires sufficient credit facilities behind him in proportion to the commodities which he is handling. If he is taking all his money to finance goods afloat on a twenty-four hour call, and he finds they are all called in, he may find himself without even the second line of defence and in trouble.

8579. The answer to my question is that the dangers you were thinking of are dangers to the borrowers?——*Mr. Liddiard*: Dangerous to the trader as a method of financing.—*Mr. Wilson*: If I could supplement that, the merchant does not always know when documents are to be presented to him. He may not always be able to tell; he may get a great weight of documents to take up.

8580. *Chairman*: Then you go on in paragraph 4:

"At no time during the recent credit squeeze have the commodity markets been seriously hampered in their operations by inadequacy of the credit facilities available to them. There is evidence, however, that tight money conditions which have been experienced almost throughout the world have had a marked influence in lowering the prices of the commodities in which they trade. Consumers have been encouraged to reduce their inventories. . . ."

——*Professor Sayers*: What evidence have you in mind there?——It has been the experience of both producers of primary commodities and merchants handling them in the course of shipment and distribution that if they were to avoid the embarrassment of the credit squeeze they must get rid of their goods as quickly as possible or hold less stock.

8581. You are speaking here of what has happened to people?——I am speaking of recent history, yes.

8582. This is not speculation on what might have happened?——*Mr. Wilson*: No, that has been an experience.—*Mr. Liddiard*: It is a little difficult to know which came first, the falls in the commodity prices or the credit squeeze. We have stated it here that the tight money brought about the falls. I think it is not fair to put such a complete emphasis on tight money, because it also depends to some extent on the crops. In certain commodities we have had a shortage of supplies, followed by greater surpluses, and the greater surpluses have required more financing. Tight money on top of that has accelerated the fall in price; it is not necessarily the sole reason for it.

8583. You are now speculating about reasons. The statement there is that there is evidence that there has been a marked influence in lowering the prices. What is the evidence? Has it been the experience of your members that because people have not been able to get credit on previous terms they have bought less, or what?——Again, I should like to bring it back to a single commodity: rubber in this case. I think there is definite evidence that the tight money conditions reduced the forward and current buying in the world. Production remained fairly static. That cannot change quite so quickly. Therefore there was automatically a position of under buying which produced the lowering of price. Evidence that the drying up of buying is due to the tight money can only be found out, by people such as ourselves, in discussion with manufacturers or producers. The fact they are cutting down production means that they cannot see so far ahead.

8584. Have your members actually learned this from people with whom they were trading?——*Mr. Wilson*: The Chairman of the Rubber Trade Association said at their annual meeting in February last:—

"The effect of the credit squeeze and the tight money conditions almost throughout the world is I believe partly responsible for the present somewhat depressed price of natural rubber. Whether you be a producer, consumer or merchant, it has been an economic necessity to reduce holdings to a minimum. Consumers have therefore bought less in order to reduce inventories, and producers and merchants have been anxious sellers for the same reason. Markedly easier money conditions have recently been established in the United States and some continental countries, and the alleviation of our present financial restrictions, even if only in a small way, would prove a stimulant to our market."

Those remarks are made in the light of the Chairman's own experience in a considerable business with world wide ramifications, and, as Mr. Liddiard has just said, we know these things from discussion among ourselves, from experience. We do not analyse these reasons. We do not keep records or prepare statistics, and it is very hard to produce anything in figures.

8585. *Chairman*: This question of separating cause and effect from each other is one of the most difficult things we come up against, and we should like to get your own experience. I gather from what was being said when a question of "under buying" arose, that one of the questions which emerged was the expense or shortage of money. Did I understand you to say that?——*Mr. Liddiard*: Yes.

8586. *Professor Sayers*: Has it been at all noticeable whether the easier money conditions that have been experienced almost throughout the world in the last four months have had a marked influence in raising the prices of commodities?——The easier money conditions are rather patchy in the world. We are finding the contrary is rather the case; a large number of countries are without foreign exchange and their purchasing is in fact very much restricted.

8587. *Sir Oliver Franks*: We are really talking about carrying stocks over a period; it might be merchants' stocks; it might be manufacturers' stocks. If I understood it rightly, you have been saying that for a period of time there has been a tendency to reduce stocks both among producers and among merchants, and that a part cause of this has been tight and dear money. But I have an impression that over most of 1957, stocks in this country did not fall. Now I think that stocks in the sense in which I am using the word includes work in progress, which is not what you are talking about; but over what period would you say that stocks in the sense to which you are referring, namely, raw materials or raw food stuffs, have tended to fall, so far as your own experience and that of people with whom you are in direct contact goes?——I think in this type of commodity trade the physical level of stocks in a country is as a rule of little direct bearing on the price. The producer is producing for delivery later, and it is the impact of drying up of forward purchasing that will lower the basic world commodity price level.

8588. When did that factor of reduced forward buying become noticeable?——*Mr. Wilson*: I think the first

major influence was American Government stockpiling, which has undoubtedly had an effect on consumers and on manufacturers; whether or not it is claimed as stockpiling for strategic purposes only, they know the stocks are there.

8589. That is in fact an administrative decision and not a market factor of the market, though it has consequences on the market?——It is the most potent factor. Then we have missed the speculator from most of these markets since 1939. The effect of the speculator buying forward and paying a premium enabled the merchant to import and carry stocks, thereby performing a service in the movement of these commodities. Those are two general facts which have an effect on the price.

8590. If you contrast the first six months of 1957 with the second six months of 1957, would you say that there was any noticeable difference in the amount of forward buying or not, in some major commodities?——*Mr. Liddiard*: One must take them individually, because they are so individual. If you take sugar, there was a tremendous difference. Historically there it was as much a supply and demand feature as anything to do with the financial situation; buying in the first half of the year was so high that it lifted the world price, and in the second half it came down. For the first few months of this year there is an atmosphere of a surplus to come which has held nearly all countries' buying back to the minimum. That is holding the price down. There are other factors such as the buying of the Iron Curtain countries; they have come in for big blocks on occasions, and have thus supported the price.

8591. Is not this still a change in physical quantity overhanging the market and acting on prices, rather than the high cost of money?——I think that is true; but I do not honestly know how you can divide those two in the minds of prospective buyers.

8592. I am not pretending these are easy questions. The problem is to see from your direct experience of these matters how much certainty we can find: it may be it cannot be found. I am really pursuing the questions just to see what you really think when pressed?——I think the degree of influence that the supply of money has is quite secondary to the statistical position of the individual commodity concerned. The statistical position, I think, plays the most predominant part; then the tightness or otherwise of money probably has an adding or a detracting effect.

8593. *Professor Cairncross*: In paragraph 5 you say: "During the period of high interest rates in London and of the consequent widening of the forward premium at which many currencies have been quoted in terms of sterling, there has been a certain tendency to invoice exports in terms of dollars, marks, or other currencies". Have you noticed some widening of the discount on forward sterling in consequence of the raising of interest rates in London?——I would like to ask a banker that question: I do not know. This came from some of our merchant bankers*.

8594. Are you able to tell us by way of illustration what commodities have been invoiced in this way in recent months?——*Mr. Wilson*: I should like notice of that question. If it is important I would like to submit the evidence a little later†.

8595. It is suggested later in the paragraph that this phenomenon, which I must confess is new to me, "is a reminder that abnormally dear money in the London market and the attendant discount on forward sterling must in the long run be inimical to the use of sterling as the currency most widely used in international commodity trading." The high rates in sterling may be inimical to the use of sterling as an international currency, but I do not think we have had this particular reason put to us before. We would be interested for any further information you have.—*Chairman*: Perhaps you would let us have a note explaining it. If we should wish to ask any further questions on it after that, we would ask you to come back again.——By all means, my Lord‡.

8596. *Professor Cairncross*: Does the information in paragraph 6 about the total turnover in commodities, which you say may be set at £750 million to £1,000 million, cover just the commodities covered by the members of your Association?——*Mr. Wilson*: I think we would have to admit that it covers a wider field than our own members. It was intended to refer to commodities generally and, as I said, there are some not now represented in the Federation. Again, very few commodity trade associations keep records of turnover. It is only where there is a settlement house where contracts are registered that actual figures are available; but it is possible to build up fair estimates of general turnover. In 1944 this Federation carried out a survey of what we called the invisible trade, that is to say the trade which does not touch these shores. It is quite dated now, but we did get some very accurate figures then from members which in turn covered only a proportion of the markets, and we arrived at a figure of approximately £400 million. Allowing for increases in prices recently we do not think it would be a wild figure to reckon about £750 million to £1,000 million approximately of business, the physical side of which does not touch this country.—*Mr. Liddiard*: One can check this against the Bank of England's reports on the turnover through their schemes, most of which are within the commodity groups we are discussing. They take it as "sales to non-sterling area destinations", and I think in 1956 that was of the order of £420 million to £430 million.

8597. *Sir Oliver Franks*: From the order of the thought in paragraph 6 it would seem that, while the bulk of the trade is in commodities which never touch the shores of this country, it is the total turnover of these commodity markets which may be set at £750 to £1,000 million; so that may presumably include both what comes to this country and what is dealt with, never reaching this country?——I do no think so. I am sure these particular figures of £750 million to £1,000 million are meant, if they have not been clearly expressed, as the invisible trade not to this country.

8598. *Professor Cairncross*: Perhaps we could be given two figures in that case: one for an estimate of the volume or turnover of trade which includes both items, and one excluding actual imports into this country?——We will certainly do our best, but it is a very difficult one to find out§.

8599. *Chairman*: I wonder if, after these queries today, you would check up with whoever formed the calculations and let us know whether there is any enlargement you would like to make on them?——*Mr. Wilson*: We are in process of trying to arrive at something like accurate figures, but it is very difficult. We have been working on it for some weeks.

8600. What happens on the *post hoc* inspection of commodity scheme accounts, referred to in the earlier part

* *Note by witness to Qn. 8593:* The answer to the question would appear to be that high interest rates attract "hot money" from abroad and the covering exchange operation adds to the pressure on the currency and results in a forward discount.

† *Note by witness to Qn. 8594:* It is not possible to say what particular commodities may have been invoiced in other currencies than sterling but, in general, such practice would apply where a British concern operates through oversea associated firms which could benefit by invoicing in a hard currency.

‡ *Note by witness to Qn. 8595:* It is important to this point that high rates of interest of themselves have very little effect on the choice of currency used. It is the relative rate between sterling and other possible currencies, say the dollar or the deutschmark, and the degree of stability on the forward exchange premium or discount. As a rule the forward discount settles at a figure which makes the cost of financing in sterling very similar to the cost in other currencies. It is during the period that these are out of line that finance and trade is taken to any cheaper market. If the movement of internal rates is rapid, the movement in forward exchange rates becomes a disquietening factor and foreign traders are inclined to withdraw into a steadier currency. This may well be a reason for the action of moving internal rates violently, but each time use is made of such a weapon confidence is lost and the harder it is to persuade them to return to sterling trading.

§ *Note by witness to Questions 8596–98:* The total turnover of the commodity markets could be divided into:—

(*a*) imports into and the re-exports from the U.K. (available from Board of Trade returns);

(*b*) trade to non-sterling area destinations from sterling area (excluding the U.K.) or non-sterling area origins (available from the Bank of England in so far as scheme commodities are concerned);

(*c*) trade to sterling area destinations excluding exports from the U.K.

It is confirmed that the estimate of £750 mn. to £1,000 mn. refers to trade under (*b*) and (*c*): trade not touching the shores of the U.K.

of paragraph 7? The operations are carried out and finished, I suppose, by the time the inspection takes place?——*Mr. Liddiard*: Yes.

8601. What happens? Are people sent for?——No. The Bank of England people send representatives to the offices of the firms, and they make inspection and enquiry.

8602. If the inspector does not approve or queries something, what happens?——I presume, to begin with, he takes it up with the firm concerned. If he is not satisfied, that goes back to the Bank, and the Bank under the scheme will either take it up, if it is a matter they think the market should deal with, or if it is an illegality they will presumably deal with it direct.

8603. You have not actually had experience?——*Mr. Wilson*: No experience of any complaint, but plenty of experience of the machinery working.

8604. These accounts, so long as they are properly operated, are outside exchange control?——Yes.

8605. *Professor Cairncross:* You know of no case in which the Bank of England has expressed hesitation about these schemes?——None whatever. Every one of these markets has a liaison committee with the Bank of England which meets regularly, as well as these individual inspections of books. After inspection has been carried out it may occasionally be suggested that there should be some very slight adjustment of internal bookkeeping, and they have called attention to that; but that is very different from any irregularity.

8606. *Chairman*: At the meetings of these liaison committees you do not remember any question of any substance arising out of an inspection being brought up?——No. The Bank now has relaxed a great deal; it does not inspect as frequently or as many accounts; nor do we have as many meetings. We discuss every subject connected in any way with the market.

8607. *Professor Cairncross*: Are there still countries prepared to buy commodities for sterling which they are not prepared to buy for dollars?——Yes*.

8608. You are still free to sell to those countries?——Yes.

8609. Does that happen on a substantial scale?——Yes.

8610. The Bank of England have never suggested these transactions should be limited in any way?——The Bank have always said that we may sell goods to any country provided that we get payment from the appropriate account.

8611. This applies to all exports independently of the country concerned?——*Mr. Wilson*: I cannot say for all exports. Those purchased for dollars may not, I agree, reach this country and may therefore never appear as imports.—*Mr. Liddiard*: The bulk of it would be direct movement.

* *Note by witness to Qns. 8607 et seqq.:* It may not have been appreciated when the questions were put that for the purpose of commodities under Bank of England schemes dollars and transferable sterling are convertible abroad and only vary to the extent that the official and free market rates vary. By the growth of the trade in commodities produced in both dollar and non-dollar areas being handled in sterling many countries are now only buying in sterling. In addition traders abroad sometimes buy in sterling although their own Government allocates dollars to them.

8612. There is no restriction as to the countries and currencies that are acceptable?——Only the ordinary exchange control restrictions. If, for example, we sell sugar to China we must obtain transferable sterling, because China is in the transferable sterling area; we cannot take French francs; but that is the only restriction; the normal restriction of trade between the U.K. and that country.

8613. When these markets were re-opened and dealings were freed was there an increased resort to purchases from dollar sources for sale against sterling? I am excluding the grain case.——I think that is certainly true. The entrepot trade was limited before these schemes came into force, at a time in which the total movement of many commodities was on the increase, and the commodity companies in London by this facility undoubtedly obtained more of the world movement.

8614. That is not quite the point I was on; the question is whether the change that took place at that time and progressively over the past few years has been one involving extensive purchases for dollars and sales to countries not themselves prepared to buy for dollars but prepared to buy for sterling?——*Mr. Liddiard*: I am not sure we could answer that question very well, because in certain countries traders have access to dollars or sterling; while other countries still keep controls on that. The total volume that is in fact bought in sterling is larger; the amount of trade flowing through London from the dollar area to the transferable sterling area is undoubtedly growing. I do not quite know how we could differentiate between those countries which do not want to spend their dollars and those which would spend dollars, because if they have sterling, some of them at least could go and obtain dollars with that sterling.—*Mr. Wilson*: Is not this a question which really only the Bank of England can answer? They have the records of all the commodity transactions and all schemes operating. They must see this picture all the time: we do not, except for the figures we see from the Bank of England, which we promptly have to return and are not allowed to retain.—*Mr. Liddiard*: If I may bring it down to the particular and again take sugar, which is my own commodity, and Japan: Japan was initially a dollar buyer. Over the last few years there is no doubt that she has been buying far more sugar for sterling than she was before. Whether that sterling derives from sterling trade under the Anglo-Japanese trade and payments arrangements or whether it is dollars granted by their exchange control and converted into sterling, I am not sure; they do have that facility now

8615. Has there been a change in the exchange control regulations, permitting sales to Japan to be against sterling rather than dollars?——As soon as this scheme came into force, and as long as the profit received from Japan was in sterling, we could take sterling or dollars.

8616. It has nothing to do with any change on the part of the Bank of England?——No. It is entirely in the hands of the recipient country.

Chairman: Thank you very much, Mr. Wilson and Mr. Liddiard, for your help.——*Mr. Wilson*: I am afraid the subject is very highly technical, Mr. Chairman; I would like to be able to supplement it, if your Committee has second thoughts on other questions which you would like to put to us.—*Chairman*: If so, we will let you have them; any help you can give us will always be welcome.

(*Adjourned until Thursday*, **15th *May*, 1958, *at* 11 *a.m.***)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-THIRD DAY

Thursday, 15th May, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.	PROFESSOR R. S. SAYERS, F.B.A.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	SIR REGINALD VERDON SMITH
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	SIR JOHN WOODS, G.C.B., M.V.O.
W. B. JONES, ESQ., O.B.E.	MR. R. T. ARMSTRONG, *Secretary*
	MR. G. PENRICE, *Statistical Adviser*

R. H. OWEN, ESQ., C.M.G., i.d.c., Comptroller-General, R. W. BURKITT, ESQ., i.d.c., Deputy Comptroller-General, A. F. TOMS, ESQ., Assistant Secretary, Underwriting Division II, K. W. COTTERILL, ESQ., Principal, General Division, of the Export Credits Guarantee Department, called and examined.

8617. *Chairman*: You have given us an excellent memorandum* with a great deal of information in it, which we shall all have in front of us; I should like you to have it in front of you too. I think we have briefed you in advance with the nature of the various suggestions and comments on the work of the Department which we have received from outside witnesses. There is one preliminary question I should like you to take up and enlarge upon before we begin to run through your paper, and that is the nature of your relationship with the Berne Union. You give us the history of it in paragraphs 92 to 95 of the document; the Union is "an international association of credit insurers set up in 1934 by four founder members", the United Kingdom, France, Italy and Spain. "Since 1934, the number of members has risen to eighteen . . . in sixteen countries plus one associate member, the Export-Import Bank of Washington, D.C. The Union now employs a full-time Secretary-General." Would I be right in thinking about the Union that it is not an association upon which Governments are directly represented but it is an association of credit insurers?——*Mr. Owen:* It is an association of credit insurers.

8618. What relationship have the governments, which I suppose in many cases stand behind the credit insurers, got towards this association? Do they take part at all in its deliberations?——Governments play no part. The people who attend the meetings of the Berne Union are the actual practising credit insurers.

8619. Then you say:—

"93. The main objects of the Union are 'to work for the rational development of credit insurance in the international field' by providing for the exchange among members of information and views. To this purpose various meetings are held and a considerable amount of correspondence is entered into.

"94. The Union's Management Committee has the power to set up a Technical Sub-Committee consisting of experts from several member organisations who study particular problems of credit insurance principles and techniques. The views of all members are normally sought before a final report is made, and the questions are discussed at the Annual Meeting which has been held every year since 1947.

"95. In addition the Union seeks to establish a common approach to the credit terms upon which members are prepared to insure business."

If the reports are made and resolutions adopted, have they no binding effect other than as declarations of a given principle?——They have no binding effect. No member makes commitments, or asks any other member to make commitments, but as a result of the discussions which take place on the many problems common to all credit insurers, irrespective of nationality, it is usually possible to detect a code of sound credit insurance practice from which any member knows that he departs at his peril. But it is at his personal peril, or rather the peril of his company, because he makes no commitments and no one asks him to make any commitments. What we are all interested in as credit insurers is the practice of sound credit insurance: the practice of that form of insurance which exists to make sound credit-giving safer.

8620. With regard to that no doubt important element of the common problem which involves the length of the terms of credit insured may not some countries be in a very different position from other countries from the point of view of what they think sound and wise? How is that met in the discussions on what to do?——There is very little difference between the point of view of the various credit insurers as to what is sound and wise from the credit insurance point of view; I personally have little doubt that, if credit insurance were to be left in the hands of professional practitioners of credit insurance without governmental interference there would be a marked similarity between the results of that practice. It does, however, happen that, by nature of the relationship between the credit insurers and the Governments which stand behind the credit insurers in one form or another, circumstances do exist in other countries, as they could exist in this country, where the administration issues an order to the credit insurer to do a certain thing. The credit insurer may advise against it; he may say: "If I do this the consequences of the doing of this on the rest of my business will be such and such, and the consequences of the doing of this on my relations with my fellow practitioners in other countries will be such and such". But that advice can in the last resort be thrown out of the window, and an instruction can be issued by the administration to the credit insurer. In such cases there is no remedy. We may discuss it, after the credit insurer has reported that he has done something which is so widely inconsistent with what he knows to be the general view of himself and his colleagues on sound credit insurance practice that he ought to bring it to the notice of others; we may deplore it, but in the last resort there is nothing we can do about it. In our discussions, however, and in the interests of the world practice of credit insurance on sound business lines we do seek so to conduct our operations that the hands of the professional practitioner of credit insurance in any country are made as strong as possible.

8621. What does that mean in practice? What is represented by "are made as strong as possible"?——It means that he will obviously be involved in arguments with the administration of his individual country. We are prepared to join with our colleagues, the credit insurers

* Memoranda of Evidence Part IV No. 6.

from other countries, in the preparation of reports and studies which will indeed contain an expression of the views of world credit insurance opinion, which I do not think any country would lightly disregard.

8622. Would such a report or resolution be made public, or would it be transmitted through the national association to the government?——I cannot speak for the practice of my colleagues in other countries, but I imagine that in most cases it would be made known by the credit insurer to the government which was standing behind him, either in whole or in part; but it would not be made known to the outside world. The deliberations of the credit insurers are kept extremely confidential.

8623. *Sir John Woods*: This implies that the credit insurance institutions as such attempt on occasions to make a united front against any individual government?——It does not work quite like that. There would be, for example, no question of the Berne Union as a body taking a united stand against the German government, or the Swedish government, or the government of the United Kingdom.

8624. No; but you attempt to get a concerted view from the professional credit insurers related to what you think is sound practice, and you expect the individual credit insurer's institution in any country to make a stand for that practice against its own administration?——I would, yes.

8625. You spoke a good deal about insuring on sound principles. That sounds to me as though one of your main objects is the solvency of your own undertaking in each case?——It is.

8626. You would put that right in the front of your consideration?——Right in the front.

8627. Is that so in all the other institutions?——Yes, it is.

8628. And are they in fact solvent?——They all seek solvency; and, speaking from impressions I have without reference to any figures, that aim at solvency is in fact achieved. I know of no cases of insolvency, except one or two small ones, which by reason of the smallness of their business are unable to spread their risks on the same scale that the very large companies like my own company do, if I can call mine a company. Circumstances do arise where a small company may suffer temporarily severe losses in Australia, in Brazil, in Turkey, in Colombia, in Egypt, to mention the obvious countries which have caused the most loss to credit insurers over the past six or seven years. There might well be a time in the history of a small company's accounts in which it would show very substantial losses owing to the necessity for it to make disbursements and to wait for, in some cases, many years before the recoveries actually flow in. But apart from that particular kind of difficulty about the small company, the large companies all maintain their solvency.

8629. *Lord Harcourt*: Are the accounts of all these companies published?——No.

8630. If they are not published are they available to the other members of the Berne Union?——They are available to other members of the Berne Union, but under reciprocally confidential arrangements.

8631. *Chairman*: You say: "the Union is making a firm stand against demands for excessively long credits". I quite understand the importance of that. Would the present practice of your department, which I understand to be seven years from the date of the contract, or five years from shipment, be the result of the Union's policy?——Not altogether. Seven years from date of contract is not an absolute maximum. In so far as there is a maximum at all in the thinking of the Department's Advisory Council about the period from date of contract, it is probably in the neighbourhood of ten years. What really matters is what we call the credit period, and here our terminology is not, I think, on all fours with the terminology used by the professional banking world. What we call the credit period is the period after shipment. The maximum terms which the Advisory Council have authorised us to underwrite have been a total span of terms of payment within which the period of years after shipment has been made is not more than five. This may in fact result (I have an actual case in mind) in a total period of risk insurance of as much as nine years. There might well be a contract on which the first year after the contract was signed was spent in drawing offices, three more in the process of manufacture, and then five from delivery to completion of payment. Overseas countries will tend to represent that to the outside world as a nine year credit. In banking terminology it may be a nine year credit; in credit insurance terminology it is not a nine year credit, but a five year credit after shipment.

To come to your question, to which that was by way of footnote: so far as we are concerned the decisive voice as to whether we shall or shall not insure a particular span of terms of payment is the Department's Advisory Council. When a proposition is put to the Advisory Council we make our departmental comments, and included in those departmental comments will obviously be what we think is likely to be the practice of the other credit insurers; but we have not made any commitments which bind our hands, any more than the other credit insurers have made commitments which bind their hands. What binds our hands is the direction of the Advisory Council. Under the curious constitutional position of the Department an exceptional range of authority is by convention rather than by statute vested in the members of the Advisory Council. We are in fact a Government department charged with the responsibility of carrying out a vast trading operation (I think we are not one of the least successful of the country's national trading concerns); and since 1930 the conduct of the trading policy of this operation has been left by successive generations of Ministers in the hands of the Advisory Council. There is no precedent for the Government of the day declining to accept the advice of the Advisory Council on a matter of trading policy which the Government have left in the hands of the Council.

8632. Where would a change, such as the recent change announced in the Budget speech from £250,000 to £100,000 with regard to the minimum size of a guarantee to bankers, emanate from? Would it be from a recommendation of the Advisory Council?——The Advisory Council had at an earlier stage envisaged with approval the situation which would arise if the Department were to supplement its standard guarantees by giving guarantees from a particular stage in the history of the contract and at the instance of the exporter to the exporter's banker. That principle was made known to and approved by the Advisory Council many years before. The administrative machinery adopted in 1954 to keep under control a measure which could have had some inflationary significance when the facility was made more generally available for the bringing forward of finance for large capital goods contracts was a matter of administrative detail. The rules which the Department applied from 1954, when the facilities were introduced on a generalised basis, until the present time were worked out between the departments concerned, namely the Treasury and E.C.G.D. and the Board of Trade. The diagnosis of the situation which led departments and Ministers to the conclusion that some relaxation was required was made initially by departments; we were asked if it would produce any particular administrative complications or any impact on our trading policy. At this stage I consulted the Chairman and the Deputy Chairman of the Advisory Council, and they both took the view that whether the qualifying limit was £250,000 or £100,000 was merely a matter of administrative detail, with which on its present scale the Advisory Council need not really concern themselves, once we had assured them that the impact on the main scheme would be comparatively slight.

8633. Is the rule of five years only from date of shipment one which we may attribute to the views and policy of the Advisory Council?——That is correct.

8634. As you say we have made no commitments with regard to this point to our colleagues on the Berne Union, what does the Union's "firm stand against the demand for excessively long credits" refer to? Is there a resolution passed by the Union which lays down permissible terms and length?——Not anything so formal as that; but there are recorded in the proceedings of the Union discussions on what we all regard as the desirable horizon of risk, and particular kinds of contract and particular kinds of goods. As I found coming in as a newcomer five years ago to credit insurance, there is a remarkable unanimity of view between the practising credit insurers about the terms of payment which, from the sound commercial credit insurance point of view, are appropriate to particular kinds of contracts and particular kinds of goods; but there is no formal binding resolution.

8635. *Sir John Woods*: It seems that five years after delivery is the principle laid down by the Advisory Council, and that in some mysterious way it is also so in the general run of credit insurance institutions, though there is no commitment by the members of the Berne Union. Is that the true picture?——Yes; the true picture is that the commercial credit insurer in this country, as in other countries, finds it impossible to take a commercial man's judgment of the future over a period which involves a credit period after shipment of more than five years. That is the view of our Advisory Council. It is also the view of our counterparts in other countries.

8636. Is there no Treasury influence in this at all?——No; this is credit insurance trading as advised by the body of independent commercial and financial opinion on our Advisory Council.

8637. *Professor Cairncross*: Is this view based on any examination of the outcome of longer credit? Have you tried to establish whether, when you have extended medium and longish credit insurance, those particular transactions have been less profitable in the long run than the others?——If I can interpret the view of the Department's Advisory Council, there does come a point in time at which the commercial credit insurer draws a line and says: "Any terms of payment in excess of these terms of payment partake of the character of investment". The Department's Advisory Council, rightly or wrongly, have drawn that line at five years. There is a difference in function between the export credit, which a seller provides in order to enable his buyer to purchase at a more comfortable rate in relation to his capital structure, and the financing of a project out of income. We feel that once the credit insurer ventures into this field, which is the field I referred to as investment, he is not in fact insuring the credit-worthiness of the buyer but is insuring also the efficiency and ability of the administration of the scheme in question to operate in a profitable fashion. It is a different quality of risk, if I could put it that way. My Council have felt that the right place to draw that line is at five years. I do not think it is based on any particular scientific assessment; it is based on the kind of impression and hunch that the very experienced men who serve on our Advisory Council have from the conduct of other businesses. Under our statutory powers it would strictly speaking be possible for us departmentally, and outside the scope of the credit insurance scheme as the scheme is today being interpreted and worked, to venture into this new and different field; but it would require a totally different approach and totally different techniques.

8638. It does not seem to me that this distinction is in practice followed. If a manufacturer ships machinery and plant direct to a power station abroad, on, say, five year credit terms, would not that transaction qualify for credit insurance?——Yes.

8639. Is that not essentially the type of transaction you dislike bringing within the compass of credit insurance?——No, we do not mind bringing it within the compass of credit insurance; in fact we do a vast amount of business of that very character. But we should find difficulty in bringing within the compass of credit insurance an obligation on the part of the buyer to pay which involved a period of credit after shipment of, say, ten years.

8640. In that case you are making the distinction turn on the period of credit. That is not the distinction I thought you were drawing earlier as one between on the one hand investment in fixed capital from which income would accrue in due course and on the other the ordinary transaction in something which is bought and then disposed of, and the proceeds applied. I do not quite see the force of your five years as you now put it to us; is it not rather arbitrary?——Five years is arbitrary, for this reason: we are charged to administer a credit insurance scheme on a commercial basis. The Government rely on the Advisory Council to apply the commercial judgment. The Advisory Council say: "We are prepared to foresee a horizon of risk for five years after shipment, but not beyond that."

8641. And all the other members of the Berne Union subscribe to roughly the same period?——All the other members of the Berne Union seem to go through the same sort of mental process; it is without any deliberate and conscious contriving. I suggest that is because they are most of them very experienced practitioners of the art of credit insurance.

8642. *Chairman*: Do you find that in practice the other members of the Berne Union have been able to maintain a firm line about this five years after shipment?——There have been very few examples in the last five years of what could be regarded as a breach in the line.

8643. Are the examples spread evenly over the five years, or has there been an increasing tendency with the change in conditions?——There has been an obvious pressure in the course of the past two or three years to see the five years made six or seven. A certain amount of that pressure springs from the overseas buying countries which are anxious, as I indicated in the evidence, to play off one credit insurer against another, to play off one source of supply against another, and to postpone as long as possible the evil day when they will have to make any payments for anything. We know that a great deal of that goes on, and the only safeguard, indeed we think the most effective safeguard in the interests of commerce and industry in this country, against the momentum which is gathering, to the embarrassment of commerce and industry in this country, is the collaboration and the discussion which can and does take place between credit insurers. In the past two or three years, so far as we know, credit insurers under pressure from their Governments have probably been forced to give way to that pressure to an increasing extent; but at the moment I cannot recall over five years more than about five cases.

8644. *Sir John Woods*: It has been put to us in evidence that in one particular case a British firm lost a contract in Portugal because, although credit insurance was given within the limits you have described of five years after delivery, a further period of credit was allowed to the customer for another three years or something, and was taken either by the exporter or by some other institution in the country of the exporter, so that the buyer had a total credit period after delivery of, say, eight years, although only five were taken by the credit insurance institution. We were told that this facility, if you can call it such, would not be allowed by your Department; and the suggestion put to us in evidence was that that was an instance in which the Berne Union "rules" were breached in favour of the foreign exporter. Is this understanding, that export credit guarantees should not be given in respect of a contract involving credit over a longer period than five years after delivery, even though you are not in it for more than five years, sponsored by the Advisory Council and generally agreed to by the Berne Union?——My Advisory Council have reconsidered within the past few weeks that very question of what we call in our jargon "part period cover". The Advisory Council agree unanimously that this is a practice to be avoided. They take the view that the transaction which is not insurable on account of credit-worthiness of the buyer, or the market, or the suitability of the credit period, or for any other reason, cannot be considered a good risk, and to insure a part of it, and thus to encourage what the Advisory Council considers, taking the risk as a whole, to be bad business, would be poor commercial practice. That is not only the view of my Advisory Council, which they were invited to reconsider within the past couple of months; it is also a subject which has been investigated by a technical sub-committee of the Berne Union, which reported to a general meeting of the Berne Union. This sub-committee's conclusion was that part period cover, to cover only part of a risk which in turn is objectionable, is bad business; the Berne Union agreed that that conclusion represented the best and soundest credit insurance practice.

8645. That goes back to the general view that it is not sound credit insurance policy to go further than five years, that being admittedly an arbitrary period?——Yes.

8646. Your general position is this, if I have it right. You are credit insurers and not investors. In so far as you provide insurance for what you call medium term capital goods it may or may not be the case that the ordinary investment period for borrowing for such a project might be ten years or fifteen years; that is not your business. You are there for the specific purpose of insuring credit. While it is true that your arrangements facilitate the provision of finance, you draw a sharp distinction between the facility for sound export credit and anything beyond that which would run into what one might call the normal investment period in heavy capital

goods. Is that right?——That is broadly speaking correct. That is the way in which under Ministerial direction we are at present exercising our statutory powers.

8647. *Sir Oliver Franks*: If the five years as such must always be an arbitrary limit, in the sense that you have to draw the line somewhere and just where is a matter of simple decision, do you think that the distinction which you have drawn between a commercial transaction and investment really helps in determining whereabouts that line should be? It would seem to me that while conceptually there is a clear distinction between the commercial transaction and capital investment, in fact the "all right-ness" of some of these large projects as commercial transactions really turns on their ability to pay, and you may get into a tangled world in which the distinction becomes blurred. How can you or your Advisory Council by reflection on these clear concepts get to the point of time which is, say, between 4½ and 5½ years?——I think it is largely a matter of hunch. What I have said about the investment conception is an attempt to interpret some of the things that will have been going on in the minds of our city advisers who bring a great deal of varied experience to the conduct of the credit insurance business. In the last resort they either feel that a thing is right and should be done, or they feel, although they may not be able to set out all the reasons in the order in which they find them cogent, that something is wrong and they do not like it; and it will not be done.

8648. *Sir John Woods*: I would have expected that your city advisers would sometimes feel that there were projects for which it was reasonable, from the point of view of the customer and the nature of the asset and when it begins to earn its keep and so on, that the credit period should be not five years after delivery but ten years. Is not that indeed the way in which these things used to be financed in the old days?——They appreciate that there can be a need for that sort of thing; the sort of need which the International Bank, and the Export-Import Bank through its development loans, exist to satisfy.

8649. Is there nothing here which exists to satisfy that need?——The City is still with us.

8650. *Lord Harcourt*: The City is not allowed to lend overseas for long periods.——That is a matter outside my departmental competence.

8651. *Professor Cairncross*: Has the five-year period existed for very long, or is it comparatively recent?——We have been insuring appropriate capital goods contracts on these terms certainly since the late thirties.

8652. Is not the true distinction on the five-year period one in respect of the type of indebtedness? Five years is significant in banking and the discount market; is not that the real distinction? It is, if you like the period of credit rather than the underlying transaction which interests you?——Yes, it is the credit period which interests us; and our view is limited by our ability or inability to see forward what risks may actually eventuate.

8653. Is it not the liquidity of the debt which interests you?——*Mr. Burkitt*: This developed; it began with thirty-day business, and it has gradually been extended, until it has reached what some people think is a dangerously long period. That is how it has grown up.

8654. *Chairman*: Professor Cairncross was putting to you, I think, that the five-year period had a relevance to the kind of period which would be attractive to those who had to find credit for the person insured?——*Mr. Owen*: I do not think we really take that into account. We regard the qualifications for a five year credit as a project of a certain type or size, and a project which can be reasonably financed by a certain pattern of terms of payment.

8655. *Professor Cairncross*: Let me put it to you in these terms: if it were possible to draw a negotiable instrument which could be subscribed in the City of London for a period not just of three months but of, say, seven years from the date of shipment, and accepted in the City, would you perhaps revise your judgment as to the period?——My Advisory Council would not.

8656. *Sir John Woods*: Are we not really approaching the point of saying that the Advisory Council takes the view that it is too risky to guarantee credit, or if you like to invest, in respect of large capital projects more than five years after delivery?——I think that would be a fair description of the point of view of the Advisory Council.

8657. *Sir Oliver Franks*: You say that that view is broadly the one which is also arrived at by the other professional credit insurers; would it be fair to assume that therefore any views that the Treasury may have from time to time, which might change in emphasis, about the desirability or otherwise of unrequited exports are quite irrelevant to the conduct of the credit insurance scheme which is carried out with the advice of the Advisory Council?——If the Treasury changed their view, as you suggest, about unrequited exports, it would be quite possible for us without additional legislation to give our guarantees in respect of longer terms of payment, as indeed the Chancellor indicated in the last Budget speech; but that would have to be a totally different kind of operation, and would mean different administrative procedures, different types of inquiries, different types of guarantees; in short a type of administrative operation quite separate from the conduct of the commercial credit insurance scheme.

8658. *Chairman*: Outside the field of the Advisory Council?——Outside the field of the Advisory Council.

8659. You would still under current practice expect it to be self-supporting, and the premia taken would cover the operation?——The scheme is not in existence today, and it is very difficult for me to forecast what might be in the minds of Her Majesty's Ministers at the time when they might wish to introduce it; but successive Ministers have shown no particular disposition to have our statutory powers exercised in a way which leaves them and the industry of this country open to the charge of a concealed subsidy.

8660. Have you not in fact operated in certain guarantee schemes without being under the wing of the Advisory Council?——We have.

8661. Have those been self-supporting?——They have; indeed they have made a small profit. It is extremely important that they should for the sake of our relations with the United States. The special facilities which we offer, which we call dollar market policies, and which are unusually risky, are underwritten under section 2 of the Export Guarantees Act, 1949; the United States are aware that the accounts of section 2 business are made available at a small charge to anyone who wishes to get hold of them, and they know that implied commitments have been made to Parliament by successive legislation that even under section 2 of the Act credit insurance judgment will still be applied, and that credit insurance operations carried out under section 2 of the Act will be operated on a self-supporting basis.

8662. If you get beyond this five years after shipment you get into a field that you say is beyond a horizon that can be scanned?——Beyond the horizon that our commercial advisers are prepared to scan, and to which they are prepared to apply their views as commercial men pronouncing on a reasonable commercial risk.

8663. It would mean that the rate of premium for this longer period would be almost a speculation, because you were taking a risk incapable of being scanned?——We should do our best to reduce it to rational principles, but it would be extremely speculative.

8664. *Professor Cairncross*: Is not this in the nature of insurance, that you cannot tell just what risk you are taking?——It depends on the kind of insurance. There are certain types of insurance where actuarial principles are detectable and can be applied; and there are other types of insurance, of which credit insurance is one, where insurers cannot apply actuarial principles, but where they will apply certain trading principles and take certain prudent safeguards, which may or may not be right. For example, if I may talk quite imaginatively, the fact that there has been no appreciable failure of the rains in South Asia for the past ten years does not mean anything so far as the next five or the next ten or the next twenty years are concerned.

8665. To take the practical implication of this, the reluctance to embark on a period longer than five years really does not spring from your fears that any longer

period would involve loss on the total of transactions?——It springs from the fact that my Advisory Council decline to take a view on it, and that up to the present Her Majesty's Ministers have not felt that the advantages of having this done under section 2 as a new type of operation outweigh the disadvantages.

8666. *Professor Sayers*: Near the beginning you said that the scheme was based on sound principles. You have also said that this operation is based on the advice of the Advisory Council and so on. What is the sound principle that determines this five year limit, and does not make it four years or six years?——The practices and conventions in international trade. It may be, for example, sound commercial practice that table glassware should be sold on thirty days or ninety days, or whatever it is. We would decline to insure consignments of table glassware on three years' credit because it is not the practice of the trade; it is not the practice of the sound exporting business man, either in this country or in any other country. We hope we are not deluding ourselves if we say that we are in pretty close touch with commerce and industry in this country, both through our contacts with individual firms and also through our contacts with organised commerce and industry, the trade associations, the Federation of British Industries, and so forth. We know through our contacts with them what the conventional pattern of the terms of payment is in any trade, and if we do not we have only to ask. We know from our other sources of information what the conventional pattern of terms of payment is in international trade; there is an international convention or custom by which the right pattern of terms of payment is a certain period. All that we take into account. Any application to us for the insurance of business on terms of payment widely inconsistent with the conventional terms on which traders, uninsured as well as insured, are doing their business would not be looked upon by us or by the Advisory Council with approval.

8667. *Chairman*: It would be consistent with that position that if, in the case of these long term and large scale constructional and other contracts, international terms of credit were found to be extending (which is a possibility) you would feel that it would be quite proper to follow those terms?——Yes, I think so.

8668. Surveying the next few years, do you see a likelihood of the terms of credit in that kind of operation lengthening?——I can see the pressures for them to lengthen, but I would by no means regard it as hopeless to attempt to hold the terms of payment where they are today. They are not over-long, and, as I understand it, they suit the machinery and resources of banking circles here and suit also a very wide range indeed of British exporters who view the pushing of terms of payment even to the five years which we will insure with considerable dismay. Only a few weeks ago I was talking to the chairman of one of the leading industrial groups in this country, to get his views on this topic; his view was that he has to have a very large amount of cash in real short term business (he is in the capital goods business) in order that he can carry the business that he has today on terms up to five years. It seems to me very much in the national interest that by every device we should prevent these terms from lengthening, and that we should at all costs avoid a credit race, which I am sure would bring a great deal of national disadvantage to this country, and perhaps distress to many elements in commerce and industry. But there will be those on your Committee who know infinitely more about this than I do.

8669. I do not want to question your view that we do not want a credit race; I was really wanting your view as to whether the race was on, and whether the impulse was capable of being resisted?——There are signs of runners lining up for a race, but I do not regard it as hopeless to attempt to cancel the race.

8670. *Sir John Woods*: It is true that there is a possibility of a credit race, and there are certain apprehensions, as you well know, in this country that we might get left behind in the race. The other point of view is, forgetting about terms of payment for the manufacturers, and looking at it from the point of view of the customer, that certain business may not materialise at all, or not materialise for a very long time, unless the customer is somehow or other enabled to borrow his money and repay it over a longer period. There must be great force in your argument that the manufacturer himself will not want to see his terms of payment extended over a long period; what some of the critics have been trying to find is a way in which the customer can borrow for, say, 15 years and the manufacturer gets paid on the ordinary terms of credit. I gather from what you have been saying that you may well think that there is something in this but that it is not your business, at any rate under section 1 of the Act, to try and fill that gap?——It could not be done under section 1 of the Act, so long as my Advisory Council holds its present views; and since they have expressly reaffirmed those views in the past couple of months, I think the answer is that it would not be done. There are possibilities, of course, under section 2 of the Act, but, as I have said, it will have to be the kind of operation which we have not hitherto done, the kind of operation which would involve almost project by project the same kind of exhaustive, detailed investigation that the staff of the International Bank, and the staff of the Export-Import Bank on the development loans side, go in for. This may not have been necessary in the days of City of London lending in the 19th century, but I understand that the quality of the administration in projects then could be assured in other ways which are not practicable today.

8671. I can illustrate what I mean by another example, not from the nineteenth century but the twentieth century. I have seen guarantees given to debenture stock put up by a foreign buyer extending over 15, 20 or sometimes 25 years; but it did not take 15, 20 or 25 years to pay the builder of the ship or whatever it was. Is not that what we are all striving after?——Yes.

8672. *Chairman*: That really arose by way of introduction to your general position; it covered, as I expected, rather a wide field! I think that it will now probably be convenient for our purpose to go through the memorandum and pause when we come to any particular question which arises. In paragraph 6 you say

"The insurance facilities afforded by E.C.G.D. are administered and accounted for under three separate, though inter-related, schemes . . . :

(a) the Credit Insurance Scheme, under which nearly 90 per cent. of the Department's business is done; this includes all that export business which the Department's Advisory Council advises may be underwritten as a commercial proposition. . . .

(b) the Special Guarantees Scheme, under which guarantees may be given in the national interest where the Advisory Council is unable to advise that the business can be underwritten on a commercial basis . . .

(c) the Economic Assistance Scheme . . . "

I gather that this last has had very little operation up to date?——It depends on what is meant by "very little". Under this Economic Assistance Scheme we have within the past five years given a £10 million loan to Pakistan and a £10 million loan to Persia; and we have given Yugoslavia very substantial amounts of assistance from 1947 up to the present time. The total amount involved is small in relation to the vast size of business which we do under section 1 of the Act but it might be deemed to be large in relation to another criterion.

8673. *Sir John Woods*: Are sums advanced under the Economic Assistance Scheme in respect of particular projects, or are they just general assistance?——They could be advanced in relation to particular projects, or particular aspects of policy. They have to be tied to satisfy the requirements of our Act; the £10 million loan to Pakistan, for example, was related to measures designed to increase production of foodstuffs in Pakistan, but a loan could equally well be tied to the building of a nuclear power station, the establishment of a new transport authority, or the building of a new port, or any major project. We should be loath to see them tied to the purchase of consumer goods.

8674. In the case of Pakistan it was put in that general form? It was not, for example, related to a particular irrigation scheme?——No; it was to assist measures designed to increase food production.

8675. In paragraph 16 you refer to the intermediate field of "quasi-capital" goods. Is that the scheme which is sometimes called the "extended term" scheme? What

is the period of credit insurance in the "quasi-capital" goods scheme?——Not exceeding three years after shipment.

8676. In that field you require a whole turnover or a spread of business guarantee; why is that necessary?——It is another aspect of the whole turnover principle, referred to two paragraphs earlier. The origin of that principle is to be found some twenty-five years ago, when the Niemeyer Committee was set up to report to the Government on what ought to be done about the up to that time disastrous record the Department had had in conducting credit insurance. One of the recommendations of that Committee was that the Department should operate on commercial lines and seek a spread of business, like any other insurance company. Although the business then was very small, nevertheless those responsible for its management at the time imposed for the first time this insistence (and in those days it was an absolutely firm, unvarying, rigid insistence) on the application of the whole turnover principle to the Department's short term business. It was the successful application of that principle that rescued the Department from the disrepute and bankruptcy into which it had sunk in the 1920s, and which established it on the firm and solvent foundation which still applies today. In 1945, as indicated there, we felt able to relax the full rigour of the "whole turnover or nothing" principle as applied to the Department's short term business. From then we have been prepared, and we are prepared today, to consider insuring an exporter's short term business on an "acceptable spread" that is to say, we are prepared to discuss with him, in the light of the business that he has done, and the light of the business that he expects to do, what will be the spread of risk which will be reasonable both from his point of view as the exporter, and from our point of view as the insurer. The same sort of principle is carried over and applied in the sphere which, in our jargon, we call "extended terms".

8677. Do you have to get a spread of risk with each particular company?——Yes.

8678. You might have a company which did quite a large export business, but, say, 80 per cent. of that business might be in what is regarded as a safe market, such as some Commonwealth countries. On the face of it it looks a little hard that that company should have to insure a very large proportion of its business when all it really wants to cover is 10 or 20 per cent. I accept, of course, that you have to get a good spread; but have you got to do it company by company?——We think that is the way of doing justice, and being seen to do justice, to all firms.

8679. *Chairman*: Surely that does not arise out of a recommendation of the Niemeyer Committee? I should have thought, subject to what you say, that a recommendation, that the Department should operate on commercial principles and seek a spread of business means that it should not concern itself only with a few lines in the business which it dealt with, not that it should require each person wishing to insure to give it the whole of his turnover?——I do not think that is what the Niemeyer Committee had in mind; certainly, that is not the way in which successive Ministers and officials since 1929 have interpreted it.

8680. I see that as the result; but it struck me when you said it that it really was not the point that you were dealing with. You say it has been interpreted differently?——The main trading principle is still the application in the short term field of the "whole turnover" or "acceptable spread" principle, by which alone can we get such a substantial cushion against all kinds of risks as to enable us to underwrite on a specific basis medium term contracts. Medium term contracts are underwritten specifically, and have always been underwritten specifically, but the only reason we can do that today is that 80 per cent. of our business today relates to short term business, and mostly to consumer goods.

8681. People always use the word subsidy in these days; but the fact is that short term business to some extent carries the medium term business and thus enables you to reduce the premium for medium term business?——It does not enable us to reduce the premium; but by reason of its size and its spread over the markets of the world, and because of the short, comparatively controllable terms of payment, the short term business provides a cushion which enables us, as an insurance company, to take the quite considerable shocks we have had to take in the past few years.

8682. *Professor Cairncross*: What proportion take the "acceptable spread" principle, rather than the "whole turnover"?——*Mr. Cotterill*: The proportion of "selected markets" policies to the whole is relatively small, certainly no more than 10 per cent.

8683. 90 per cent. prefer to have all their markets included?——*Mr. Owen*: Yes.

8684. We have had it put in evidence by one firm, which had an agent in Canada, that it would be very awkward to take recourse against an agent of the company at the request of E.C.G.D. As I understand it, what you are telling us is that it would be open to someone in this position to ask for the exclusion of that one market. Would that be in any circumstances acceptable to E.C.G.D.?——*Mr. Owen*: It might be; equally it might not.—*Mr. Cotterill*: It would depend on what he left.

8685. It seems that only 10 per cent. of your clients on short term business have taken advantage of the loophole offered in 1945. Is that because you limit the number that you are prepared to make this concession to?——*Mr. Owen*: No, it is not limited; that is the result of a process of negotiation with firms, on a firm by firm basis. The largeness of this 90 per cent. who opt for "whole turnover" is not by itself a tribute to the eloquence and advocacy of the Department's staff. We find that bankers are usually disposed to indicate to their clients that there are certain advantages, from the financial point of view, in having a "whole turnover" policy. There is another advantage: an exporter who has a "whole turnover" policy with us gets our most favourable rates. Selection implies selection against us, and an exporter whose policy is rated on a "selected market" basis pays, for obvious reasons, higher rates than an exporter who gives us the whole of the business.

8686. I notice that when you speak of the spread of business you speak entirely in terms of markets, and not in terms of lines. The whole emphasis of what you are putting to us is in terms of markets?——*Mr. Owen*: That is correct. What my predecessors of twenty-five years ago would have thought about this, I am not quite sure, but today we do not have to worry about getting a spread of business over lines. The business is so vast that we are adequately cushioned against disasters that might prevail in individual export trades from this country.—*Mr. Cotterill*: We do not do a "selected lines" policy for an individual manufacturer.

8687. *Chairman*: Does the Trade Indemnity Company impose on the people it insures the condition that it is given an acceptable spread of business or whole turnover?——*Mr. Owen*: If your Committee would like to have evidence about the trading policy of the Trade Indemnity Company I would prefer that you took it from themselves. I only know a little about what they do, and still less about why they do what they do. The evidence that has been sent in by us because you asked us about the Trade Indemnity Company was in fact written by that company, to whom I felt I had to explain the circumstances. I would prefer not to have to answer questions about their trading policy.

8688. I understand that, if it all comes from them. Are they not only dealing with short term credit?——That is correct.

8689. They say in paragraph 75: "The policies issued by the Trade Indemnity Company fall into two main categories. The first consists of Whole Turnover Policies under which the trader insures the whole of his business . . . . The second category consists of Specific Account Policies which cover part of the trader's transactions or even single contracts." It looks as though they run two separate lines, which are open to the trader to take up as he pleases; but you do not know?——I am not sure.

8690. *Professor Cairncross*: Do you regard yourselves as in active competition with the Trade Indemnity Company?——They cover a very small sector of the exporting field. The range of risks against which the Trade Indemnity Company insures is comparatively limited; it is only the so-called commercial risk. In addition, their

export credit insurance is not widely spread; the overwhelming part of their credit insurance business is internal, within the U.K.

8691. *Lord Harcourt*: From certain evidence that we have heard there seems to be a certain resentment about this enforcement of the "acceptable spread of business" principle, and certain witnesses have expressed a preference for a relaxation of that rule, coupled with the payment of considerably higher premiums for the business which they do want to insure. Would that not be possible?——It would not be possible without doing such a degree of violence to the Department's principle of solvency, and its hopes of maintaining that solvency, as would give me, as an official responsible for advising the President of the Board of Trade, grave doubts as to whether he would not be in an extremely embarrassing position in a year or two on the outcome of the underwriting account. I have no doubt at all that many exporters in this country would like to see us operate on the basis of their own hand-picked selection of the worst risks in the world; but with great respect to those exporters we had that in the 1920s, when the scheme sank, as I said, into bankruptcy and disrepute through an attempt to run a credit insurance scheme on the basis of insuring only the exporters' hand-picked insurance of the worst risks. It just cannot be done; and the extent to which we can control our business by the use of the premium weapon is extremely limited.

8692. *Chairman*: You could not find a premium that would safely match the risks, if they were put upon you by the man's own selection?——That is quite correct. If we were to reverse our policy now, we would be throwing to the winds the experience of very nearly forty years, the first ten of which showed us what happens if you try to do this sort of thing. Over the last thirty years we have insured in peace and war something between £5,000 and £6,000 million worth of export trade on a solvent basis, so that we have today a small underwriting reserve of £12 million; and we have been able throughout the period progressively to lower the cost and extend the range of the insurance. We feel that those results constitute at any rate *prima facie* evidence that we are on the right lines as we are.

8693. *Professor Cairncross*: You say in your memorandum that in 1930 the buyers' insolvency was the only insured cause of loss. Does this imply that at the time you are speaking of political risks were not insured at all?——That is correct. It was only in the course of the thirties that we began to make our first tentative experiments towards devices by which the political and transfer risks could be reduced to a manageable administrative insurance proposition.

8694. So when you spoke of the selection of the worst possible risks at the period when the scheme was in deficit, you were referring to the selection of individual commercial risks, not of markets which might be particularly susceptible to exchange control?——There was not very much exchange control in those days.

8695. No, but if this proposition is put to you now, that it might be open to an exporter to select his own markets at an acceptable premium, does your point apply? ——Yes.

8696. You cannot cite your past experience to establish that, since you have no past experience?——*Mr. Cotterill*: The selection that was practised against us in the twenties was essentially selection of business geographically, or contract by contract. There was, I agree, no selection of risks because we were only covering one risk.

8697. Suppose that it were suggested that there should be a separation of commercial and political risks in the broad sense, with separate rates of premium for each; would you see any objection to that?——*Mr. Owen*: We should see grave objection to any idea of splitting the risks. A concession on those grounds would fly in the face of the Department's main trading principle, that only by maximising the business of all kinds at all times can we devise a scheme which will withstand the shocks of countries' balance of payments difficulties from time to time, and continuously offer commerce and industry in this country the widest possible spread of risk for the longest possible time at the lowest possible rate. We can only get that by running a vast business; if we start taking chips and slices off it, our business becomes less vast, and our capacity to give our very valuable services, which are widely appreciated in commerce and industry, is reduced.

8698. You seem to be rather pessimistic in saying this. You cover at present about one-eighth of total British exports. Your fear, as I interpret what you say, is that you would lose a lot of business on the commercial side if you separated commercial and political risks. Might you not gain more business on the political side? Might you not attract some of the seven-eighths which you do not at present cover at all?——The proportion of business which we insure may not look large, but the scale on which commerce and industry in this country manages to do its business on cash terms, even cash with the order, is a never-ending source of surprise to me.

8699. Have you made any examination of why seven-eighths of the total exports do not result in contracts with E.C.G.D.?——That is a subject which is under more or less continuous study. We did an investigation some two or three years ago. There is a variety of complex reasons: there is the one that I have given, that much of the business is in fact done on cash terms; secondly, there is the business which is done by a few vast concerns which are so large as to be able to carry their own insurance. There are not many of them, but there are some, and they are extremely important. Then there is a volume of commodity merchanting business which finds even our very low premium rates rather too much to be carried by merchants' narrow margins. Then there are the firms whose business is, they think, adequately spread, with the overwhelming proportion in markets that they tend to regard as continuously safe. Those are the major classes.

8700. *Lord Harcourt*: Why can you not divorce the commercial from the political risk? It is something which is frequently done by insurance companies. If you go to insure your car with a company they do not say; "Certainly, on condition that you insure your house against fire"; they do not ask for all your business. Why can you not separate the risks?——I do not think that is a fair parallel. Such experience as we have had seems to us to indicate that the best interests of the insurance scheme are served by not splitting risks, and so we do not split them.

8701. *Sir John Woods*: That is a very robust and general answer. Could I make it easier for you? Are you not really saying that you cannot afford to diminish your total turnover and give the services you do?——Yes.

8702. Is not the political risk greatest in the medium term business.——*Mr. Owen*: Not necessarily.—*Mr. Cotterill*: It can be argued that it is less.

8703. Why? The longer the time, surely the greater the risk?——Political risks impinge far more sharply on consumer goods, which a buying country can do without, than on capital goods, which it cannot.

8704. Would it damage you all that much if, in respect of the medium term contracts, you allowed a split between the political and commercial risks? Are not those exporters on the whole fairly well able to assess the credit risks, but quite incapable of being able to do anything about the political risks?——*Mr. Owen*: May I ask what advantage the exporters would get?

8705. There would, presumably, be less premium to pay? ——Not at all. Once the range of our insurance field came to be reduced, it would no longer continue to be possible for us to maintain the very low rates of premium which our vastness makes it possible to provide.

8706. That is assuming that the total range of your business would be reduced; but I do not see why it should be.—*Professor Cairncross*: How did you get along before the war, when political risks were not covered? Surely you had about as high a proportion of the total possible business then as you have now?——The average premium charged before the war on the Department's short term business for insolvency risks alone was between 12s. 6d. and 25s. per cent. The average premium charged today for the Department's short term business, under the comprehensive guarantee, is less than 10s. per cent.

8707. With the political risks covered?——Everything; a package insurance offer.

8708. The risks covered are much wider than they were before the war at the higher rates of premium; this is not, however, the outcome of a bigger turnover?——There are various reasons. One reason is that the size of the Department's business has multiplied roughly ten times since 1939. The size of the Department's business in 1939 was about £50 millions; today it is about £500 millions.

8709. I see from Appendix 1 that you covered 10 per cent. of total British exports in the year 1941; you now cover 14 per cent. You do not now cover a very much higher proportion of British exports than before the war?——That is quite correct.

8710. Your expansion in turnover reflects the expansion in British exports; it is not a change in the habits or practices of E.C.G.D.?——I would not exclude those.

8711. *Sir John Woods*: What are the arguments against insuring the political risks 100 per cent. as distinct from 90 or 95 per cent.?——The main argument, again, is an argument based on the experience not only of the credit insurers in this country, ourselves and indeed the Trade Indemnity Company too, but of credit insurers everywhere in the world. I cannot use better words to explain this principle than the words used by the man who probably more than anybody else is responsible for the invention of the device of credit insurance: Mr. Cuthbert Heath, whose name appears throughout the recent history of Lloyds' insurance institution. The trading principle which he was able to identify with great imagination and vision in those days (I am now speaking of 40 or 50 years ago) is that "the insured must bear part of the risks on his own account, to induce him to consider his buyers with discrimination, to avoid over-trading, and to pursue his debtors with proper vigour when the first signs of financial difficulty arise". At the time when Cuthbert Heath enunciated that principle it was, so far as he was concerned, a hunch, but its validity has been proved by the experience of credit insurers in every country in the world since it was first enunciated. No credit insurer of any importance in the world goes beyond 85 per cent. in respect of commercial risks, nor beyond 90 per cent. in respect of political risks.

8712. *Professor Sayers*: But this principle surely does not apply to the political risk?——Most certainly it applies to the political risk.

8713. Then why not to all insurance?——I am unaware of the principles on which all insurance is conducted. I can only talk about credit insurance.

8714. *Chairman*: But you must be quite familiar with ordinary insurance principles. You insure your house or your car and your goods?——I insure them against the onset of disasters over which I can have no control, either before they happen, during their happening, or after they have happened. The essential difference is that, even in the case of the political risk, we place great reliance on the ingenuity and the resource of individual British exporters who hold our policies in avoiding risks arising, and, when they do arise, in salvaging as much as possible of their interests from the wreck. Our experience shows that that reliance is not misplaced.

8715. The point being put to you is that the political risk is very much the kind of thing which you just described, with regard to insuring one's house against fire, or one's car against damage: it is something which a man's own care and attention is not able to cope with?——Yes; but once the disaster takes place it would be quite wrong to assume that there is nothing that the insured exporter can do about it. There is, on the contrary, from our experience in dealing with insured exporters to whom we have paid claims in the last five years in Australia, Brazil, Turkey, Colombia and Egypt, a very great deal that the exporter can do and has done about it.

8716. But surely that is done in the case of ordinary insurance by the insurer taking over the name and the position of the person he has insured?——We feel that the best interests of E.C.G.D. as an insurance company are served if, instead of having a small handful of civil servants taking over this vast risk, we create a situation in which we have all the ingenuity and resources of British industry behind us in the execution of salvage and recovery operations.

8717. They have the 5 per cent. which is left uncovered by you?——They generally have more than 5 per cent. 5 per cent. only applies to the post-shipment risks in consumer goods business. We do not afford cover in excess of 90 per cent. in the large medium term contracts.

8718. *Professor Cairncross*: But are not these the very contracts where, in a sense, you might more readily make a concession, or go above 90 per cent.? You are dealing there with a limited group of large transactions, in the course of which something may arise, in the form of exchange control, which would render payment void?——Which would interfere, we would hope temporarily, with the capacity and the desire of the buyer to make payment across the exchanges.

8719. Do you think in those cases that the shipper is able to exert himself usefully?——It is surprising what he can do.

8720. *Professor Sayers*: The householder can and will do quite a lot if his house catches fire. Is it not the same?——I do not think so. In any case, the insurance company does not pay 100 per cent.; it only pays the replacement value of the articles.

8721. But all insurance companies press their customers to insure fully. In fact, they seem to think one is being quite improper if one does less. Is not that so?——*Mr. Owen*: I do not think it is improper.—*Mr. Burkitt*: You will not get more than the replacement value of a car, whatever you insure it for.

8722. *Chairman*: But that is not on the principle of leaving the insured with a percentage of risk?——*Mr. Owen*: This is a very specialised form of insurance. It is easy to adduce principles which apply elsewhere in the insurance field, and feel that they should apply in the field of credit insurance. If that were to be the case, the constitution of the export credit insurance market in the world today would be very different from what it is; Lloyds could and would be doing it, instead of having passed the self-denying ordinance which they passed thirty-five years ago, under which they do not do it.

8723. I think the point put to you was not quite the same point. I can quite understand Mr. Heath's principles when applied to the ordinary case of consumer goods; he had it in mind, I think, that one must not find a purchaser and then throw the whole burden of the risky contract on the insurer. What is being put to you is this rather special consideration of the large contract on long term, when the nature of the contract, and the person who is carrying out the contract, are such that you can rely upon his good faith and his wish to carry the thing through and get what he can out of it, without any further security?——So far as large medium term contracts are concerned, our experience shows that ways and means seem to be open to our exporters to effect salvage and recovery, which would probably not be open to us. This is one of the arguments against the credit insurer appearing openly as a principal. If there are difficulties, the buyer can present difficulties as existing to impede him making payment across the exchanges to his supplier. If he knows that his supplier is at no loss and that the loss, if any, is being suffered by a vast, faceless Government insurance machine, he is not likely to bestir himself very actively to make payment of the amounts which are owing. That is one reason why we prefer to keep the fact of credit insurance, even in the large medium term contracts, completely secret between the insured exporter and ourselves, and rely on the insured exporter and his efforts and his skill to get back the money which is due to him.

Chairman: That has raised another point, on which I am sure there are some questions; but I think we might break off now, and start again at 2.15 p.m., if that is convenient to you.

(*Adjourned until* 2.15 *p.m.*)

MR. R. H. OWEN, C.M.G., MR. R. W. BURKITT, MR. A. F. TOMS and MR. K. W. COTTERILL, further examined.

8724. *Chairman*: When we broke off, Mr. Owen, you made an allusion to a principle that the fact of credit insurance should be kept secret between the exporter and the Department. How far does that principle go? Does it put the exporter under an obligation not to let it be known by his customer that he is applying for credit insurance?——*Mr. Owen*: It is intended to do so.

8725. Can it be kept secret in that way?——We are under no illusions as to the extent to which it can be kept secret. Undoubtedly there have been leaks, and very embarrassing leaks they have proved to be. There is a variety of reasons why we ask exporters to keep this secret, and why we retain in the last resort the right, if an exporter discloses even the fact of insurance, to refuse to pay under the policy. One is that this is a contract of the utmost good faith between the insurer, that is E.C.G.D., and the insured, that is the policy holder, and strictly speaking it is no business of the buyer whether the contract is insured or not. As buyer his relations are with his seller; he makes a contract with him. If the exporter does allow it to be known that the contract is insured, then we can have two rather different sorts of complications. In the first place we feel that the odds are that a buyer who knows that the exporter is insured as to 90 per cent. will not behave with the same loyalty to his obligations as if he thought the exporter was not insured. Put in more specific terms, we feel that buyers abroad will wish to retain, for example, the goodwill of United Kingdom exporters, like the English Electric Company and the Bristol Aeroplane Company, but that, if they thought that in the event of their failing to honour their obligations it would not be the English Electric Company or the Bristol Aeroplane Company that would really suffer any damage, but merely again that faceless Government insurance machine, the odds are that they would be less disposed to make their due payments than otherwise would be the case. That, I admit, is arguable; but we have a certain body of evidence which justifies us in the feeling that it is worth while pursuing the practice of that particular principle.

8726. Do you not avoid that danger by keeping the exporter at risk for some percentage?——Yes; but the margin of profit on commercial contracts varies, and the margin of profit could be such that the exporter, having been covered as to 90 per cent., still has some small fragment of it left.

8727. *Professor Sayers*: But he still loses?——He still loses some of his profit.

8728. *Sir Oliver Franks*: Is it not one of the difficulties that this is a very open secret? For example, I have discovered that, in relation to two fairly large propositions, one of which matured and one of which did not mature, for exports from this country involving the E.C.G.D., the foreign parties concerned had been informed about the situation and about the possibility of an E.C.G.D. guarantee by Ministers of the Crown. In other cases to my knowledge they had been informed by the officials of their embassies who advise them on commercial matters. The whole thing seems to be extremely well known, and I have been rather at a loss to see, even if the advantages were as you describe them, that the situation was not in fact unreal?——We agree that this is a very open secret. We agree that there have been leaks. We agree that the commercial intelligence resources of the diplomats in London are sometimes quite considerable. But we are still averse to relaxing the principle, for this reason, which is rather more important than the other one. If it became known that the Department's rate on a particular transaction for a particular country was a named figure, and that the Department's rate on another transaction, identical except for the buying country, was another rate, we could have a situation in which the rates of premium charged by the E.C.G.D., which after all is a department of Her Majesty's Government, could become the subject of diplomatic representations. Indeed I have known it to be made the subject of diplomatic representations. It is not possible to conduct a credit insurance business on the basis of being diplomatically agreeable to all the buying countries; it just does not work. The only safeguard, therefore, is to insist that the exporter shall not disclose the information; if we find out that he has disclosed, and if we find out that loss has supervened because he has disclosed, we should be fully within our rights in refusing to pay any claims on the policy. We are, however, under no illusions as to the extent of the leakages that take place.

8729. I understand your disciplinary attitude, but, when the secret is as open as it is, it seems to me that it is difficult to sustain it. I have not in fact ever known anyone on the foreign side who did not know about it, and from his diplomatic advisers.——I think we ought to stick to it. Some overseas buyers to our knowledge, according to our information from exporters, have taken umbrage at what they think is an expression of doubt regarding their creditworthiness.

8730. I can see that these problems are necessarily involved, but it still seems to me unclear that you avoid them by maintaining the principle, when the facts are going the other way?——We do our best to maintain the principle. Within the last six months I have personally signed a letter to every policy-holder reminding him of his obligations and of the embarrassing consequences which will ensue both for him and for ourselves if this principle of confidentiality between insurer and insured is not maintained. To a certain extent there is some parallel with banking practice: if an uninsured exporter cannot give the credit which a buyer requires for some reason connected with some risks between himself and his banker, we feel it is unlikely that he will say to his customer: "I cannot give you this credit for which you ask because my banker will not trust me any further." If he is unlikely to do that, can he not apply the same principles and practice in his relations with his credit insurer? Why do we have to come into it at all?

8731. There seems to me to be a difference; the bank is scrupulous about discussing the affairs of its customers but does not mind if the customers talk about their relations with the bank; you are in the opposite position of minding whether the customers talk. I raise this general question because I happen to think that, when things can be public without damage, it is a good thing that they should be.——I agree.

8732. In this case, given that there well might be reasons for keeping it secret if one could, it seems to me that the knowledge is sufficiently widespread as to remove a good deal of the strength of the argument; therefore I wonder whether in fact the balance might not lie in leaving it open?——I do not think so, because of the risks that our whole system of premium rating could in the last resort be made the subject of diplomatic representations if it was known.

8733. Is the Foreign Office aware of that aspect of it?——*Mr. Owen*: The Foreign Office would not greatly mind whether credit insurance was conducted on the basis of friendly diplomatic representations or not; the effects would fall on the credit insurer. I personally would find it difficult to reconcile the open disclosure of our rates and the risk of diplomatic representations with my responsibilities as the Accounting Officer for what ought to be a solvent credit insurance scheme, the solvency of which would be gravely impaired if our rates were to be made the subject of diplomatic representations.—*Sir Oliver Franks*: That seems to me still to be a position of theory rather than of fact.

8734. *Professor Sayers*: Are open statements by Ministers of the Crown to be described as leaks in this context?——I was not aware of the circumstances of the case to which Sir Oliver Franks referred. Circumstances do arise where information can properly be disclosed; they are exceptional.

8735. *Sir John Woods*: The Indian steel contract was one?——Yes; but that was a very exceptional case, where part of the financing was being done on a Government to Government basis, using statutory powers through the E.C.G.D.

8736. I realise that it was a very exceptional case, but still there is a case where it was openly disclosed between the Governments. I should have thought with Sir Oliver that most of these transactions are in fact known to the customers. If that is so, ought not these repercussions on your rate structure and on your solvency to have made

themselves felt already?——It is a matter of opinion how widely they have gone. The views which you have just expressed suggest that disclosure of this information in critical cases to customers has gone very widely. That is not quite in accordance with our impressions.

8737. *Sir Reginald Verdon Smith*: Did the letter in which you drew the attention of policy-holders to the need for confidentiality produce a number of replies of any interest or significance?——*Mr. Cotterill*: It produced a number of replies. The main central point of the replies was the apparent discrepancy between the fact that the Department publicises its facilities in general terms, but nevertheless requires confidentiality for individual transactions. This was a reasonable point within limits, and I wonder how far Sir Oliver's point is not in fact caught up with it. We do publicise our facilities in general terms; and certain overseas buyers write from time to time and say: "We know that all British exporters are insured with E.C.G.D. We have read this account of their services." This is a very different matter from the relationship between a particular buyer and seller, and between insurer and insured, which we regard as confidential.

8738. *Sir Oliver Franks*: I was referring to the buyer who shops around in the countries of Western Europe and compares the credit insurance rates as well as the prices, our own included, and comes to a conclusion.——*Mr. Owen*: We cannot stop the indiscreet or careless German, French or British exporter disclosing in the make-up of his price the specific element for credit insurance, but all credit insurers of whatever nationality are unanimous that we should do everything we can to stop this.

8739. *Chairman*: Have you ever in fact voided a policy on the ground of disclosure of this kind?——Not to my knowledge. There is a further reason why in the interests of the exporter it is undesirable that the fact and the cost of insurance should be made known. If both the fact and the cost are made known, there is nothing to stop the buyer, accompanied by his diplomatic representative in London, calling on us, and even if we refuse to see him, calling on the Board of Trade, and starting a process of negotiation on the credit terms. He will obviously seek to put us in the position in which we say something he can use to the embarrassment of the United Kingdom firm from whom he is seeking credit. We feel that it is to the advantage of everybody, including the suppliers whose credit the buyers are seeking, if the whole responsibility is centralised openly and efficiently in the hands of the seller. If the buyer wants suppliers' credit he must talk to the supplier. The supplier will tell him if he is prepared to give him any credit at all, and, if he is, subject to what conditions; and the extent to which the supplier feels it necessary to be supported by credit insurance is, we suggest, no business of the buyer whatsoever.

8740. The supplier's dealings with the customer on those terms must depend on his knowing whether he himself can get credit insurance at that time, and under what terms. Some of the people we have heard have said that they had some difficulty in knowing where they stood with you early enough to be able to carry out their negotiations with their customer. I would like to know how you would enlarge on that aspect of it. How soon can a man know where he stands with you?——As soon as he is in a position to draw reasonably firm outlines of the type of contract into which he proposes to enter. There is no difficulty about this at all. There is no difficulty in getting an answer in writing at the earliest possible moment that the outlines are reasonably firm; or if he rings us up at 2.30 this afternoon and says: "I am seeing a buyer at 4 o'clock", gives us his name, his address and some information about the circumstances of the contract, provided the customer can produce the essential information, he will have his answer by 4 o'clock.

8741. *Sir John Woods*: I should say that that was true in respect of short-term policies. I am not so sure it is true in the medium-term ones where the negotiations for a contract in competition with other people may be a long-drawn-out process?——*Mr. Owen*: Perhaps Mr. Toms would say a word about the medium-term ones, as that is his department. My impression is that, provided the information is sufficiently exact and we know what the terms of the proposed contract are and we know who the buyer is, if he is a private buyer or some sort of public authority, what his connection is or can be made with the central financial machinery in the buying country, if this is a big capital goods contract: provided in short that he can give sufficient information to our underwriters, there is no reason why he should not have an answer almost in a matter of minutes.—*Mr. Toms*: If he has our comprehensive cover he knows which markets are covered (that is an argument in favour of the "whole turnover" type of policy) and the question becomes one of whether we can agree the solvency of the buyer for the amount required. In the case of specific underwriting dealing with the circumstances of a particular contract, all the circumstances, such as the buyer, the terms, the goods, the shipment period and any other special feature of the contract, may have some bearing on the underwriting, and it is very difficult to give any firm indication, still less a commitment that cover will be available, until the exporter himself can provide firm answers to those questions. We always try as early as possible to give an indication in principle whether or not cover will be forthcoming, and what further information will be required before we can confirm it.

8742. *Chairman*: It sounds a very difficult business, if I may say so?——I am afraid it always is when we are dealing with contracts on a contract by contract basis, but in my experience the criticism amounts to no more than that, and the people who can supply the information required to make even a preliminary judgment will get that preliminary judgment from us at a very early stage. They may even get an indication, or a bracket of indication, of premium rates, which they need for costing purposes. They can get that quite early, provided they give us sufficient information to form a judgment.

8743. These contracts must emerge as fairly complicated legal documents; there must be difficulties which emerge on that?——Indeed, yes.

8744. Will not your premium ultimately depend on an assessment of what all those will amount to?——Yes, but for obvious reasons we try and avoid getting too involved in the contractual details. We ask for certain fundamental information about the contract.

8745. *Sir John Woods*: The suggestion we have been getting is that it does put the negotiator who is in a strongly competitive position in a very difficult spot, because he does not know at any given time whether his competitor has already struck the vital blow; in general terms it seems to be very important to get this indication?——One must not underestimate the difficulties of the Department. A good many of these contracts take two or three years for the negotiations to be completed, and, if the Department were to commit itself with absolute certainty to giving cover on that contract, within that period of two to three years catastrophes might occur in which the Department would be facing a certain loss and could obviously not go through with the underwriting. The exporter gets an indication or a decision in principle, but the absolute certainty of cover cannot be given until we are ready to make a firm offer, which means until the exporter is ready to disclose the details of the contract he wants to insure.

8746. Of course contracts of this type take two or three years to negotiate; but it constitutes a difficulty for the negotiator if he has not got something reasonably firm to go on?——*Mr. Toms*: The Department is well aware of these difficulties and will stand behind the exporter as long as it is humanly possible to do so.—*Mr. Owen*: I see no way out of this difficulty except the way to which Mr. Toms referred: close and intimate contact between the Department and exporters. I think that in large measure that already does prevail; but we cannot, for reasons with which you will sympathise, make firm commitments in the middle of 1958 that by the middle of 1960 we shall be prepared to meet commitments in respect of a certain size on a certain country. On the last occasion when a very large Supplementary Estimate was debated on the floor of the House of Commons in the early part of 1953, when we had to go to the House and ask for a large additional sum to pay for our disbursements on the Brazilian default, there was a certain body of opinion on the floor of the House regarding the length of time that the Department had remained open to insure new business after, so the

critics urged, the red lights were painfully apparent. It is for that sort of reason that, although we are prepared to give indications, nevertheless we like to reserve until as near as possible the signature of the contract the firm commitment that if the exporter gets the contract on those terms we will insure it.

8747. That is a slightly different thing. It is not because you do not know quite enough about the project and contract; you are saying that where there is any doubt at all about what the creditworthiness of a country might be two years hence you cannot commit yourself until much nearer the date.——I was trying to deal with what I thought to be the source of difficulty in your mind: the apparent slowness and reluctance of the Department in giving indications. We hope we are not slow; we try not to be slow. There will always be people who think we do not work nearly as fast as we should. We try to give indications to exporters with the minimum delay possible, but these can only be indications; we cannot make firm commitments, for reasons that I have tried to explain, until much nearer the actual assumption of the obligation.

8748. *Sir Reginald Verdon Smith*: I have heard it suggested that it would be more convenient, at any rate to the supplier, that a firm quotation rather than an indication should be given, but that it should only be open for a comparatively short period and that it should be known then to expire, as many offers are in ordinary commercial companies. Is that a practical possibility?——Not only is it a practical possibility, but it is something which we regularly do.

8749. On large medium-term contracts?——*Mr. Owen*: Yes, that is regular.—*Mr. Toms*: I am not quite sure how that would help Sir John's point about the certainty of cover, because a firm quotation, on which the Department commits itself and on which the exporter by taking up the offer of cover can insist upon a guarantee, can only be made when we have sufficient information to be satisfied that it is a reasonable risk.

8750. So that in fact it is not a firm offer when made? ——A firm offer can only be made if the Department is prepared thereupon to issue a guarantee on those terms and conditions.

8751. I am suggesting that it is a proposition which is reasonable, assuming that you have the information you want?——That is always done as soon as we have enough information. It is valid for a period which we think will give the exporter time to complete his negotiations, usually a matter of two to three months, and if at the end of that time he has not completed his negotiations he can apply for a renewal. If the circumstances are unchanged we shall be quite prepared to renew it. Once we have reached the stage of making a firm quotation the exporter has the certainty that he can accept it at any point of time and put us on risk.

8752. The difficulty here being arriving at firm quotations?——We do not want to commit ourselves to a firm quotation until we have sufficient information from the exporter.

8753. The impression sometimes seems to have gained currency that this is one of the problems which is for some reason more difficult in this country than it is in other countries. Would it be within the Department's knowledge that practice in other countries differs from ours, is in some way more flexible or to the contrary?——*Mr. Owen*: From the many conversations I have had on these technical matters with credit insurers in other countries, their procedural approach to these things is identical with our own.

8754. *Chairman*: Do these medium-term contracts involve you in a lot of legal work in assessing the significance of the terms?——Not always. We leave to the exporter the responsibility for drawing up the contract in the terms which he has described to us. He asks us to underwrite on a certain basis. If be says: "I have drawn up a draft contract; will you have a look at it to see that it is all right and conforms to the intentions contained in our exchange of letters?", we do not have the resources to cope with that. We have to leave the responsibility fairly and squarely on the exporter to draw his contracts in such a way as is valid under either the law of this country or the law of the buying country, whichever system has to apply, so that the results of the contract achieve the ends which we have suggested.

8755. If you had your own legal department to deal with the assessment of what these terms stand for or involve, would it help you to act quicker?——I do not think so; I think, indeed, that it would slow the machine down, because we should have to have grafted on to our organisation experts in the law and practice of all the countries where we underwrite risks. That would mean that before any obligation was assumed the contract would be looked at by the firm's administrative and executive staff, by the firm's legal advisers and by our legal advisers. We are normally quite content to leave the responsibility for drawing the contract fairly and clearly and prudently on the exporter because, as you will recollect from our discussions before lunch, we have deliberately created a situation in which it is to the exporters' advantage to act with the same care and prudence being insured as they would if they were uninsured.

8756. I wondered whether, if you provided a central service, the fact that you are dealing over a period of years with the laws of a great variety of countries might enable you to speed things up with your advice and knowledge?——We find as a rule that with these large medium-term contracts firms have access to the legal services in this country and through their agents to legal advisers overseas so as to make sure that a contract is acceptable and administrable by the law of whatever country is concerned. There is, however, a class of case where we do, as a Department, play quite a large part in the actual process of documentation; that relates to the drawing up of bank guarantees, particularly the kind of bank guarantees on which we have underwritten certain risks in the United States. These are extremely complex documents. We have been able with the advice of our legal advisers to underwrite on the basis of new types of security. This applies particularly in the aircraft world. We do play a part openly in this kind of documentation, involving our legal advisers here, exporters' legal advisers, banks' legal advisers, and in the case of the United States our own legal adviser attached to our New York office. Broadly speaking that is the only kind of case where we wish to play a part in the building up of the legal documentation relating to a contract to which we give insurance.

8757. *Sir Reginald Verdon Smith*: I had wanted to ask you about the apparent inconsistency of the United States situation and what you say about confidentiality in all other cases. When you use the word "openly", you do mean that your representatives are engaged in the negotiations with banks and customers concerned?——Yes, but we like to think that those are very exceptional circumstances. We have these principles to which we like to cling as long as we possibly can, but we are not so rigid and so inflexible that we will not depart from them when circumstances make that the reasonable thing to do.

8758. *Professor Cairncross*: It has been put to us in evidence that it might be open to the exporter to insure elsewhere the 15 per cent. that the E.C.G.D. will not insure, but that E.C.G.D. would rule that out. Is this so?——That is so.

8759. On what grounds would you rule it out?——On the same grounds that I was trying to describe to you before lunch: we like to leave a sufficient measure of responsibility with the exporter on his own account to ensure that he will behave, being insured, with the same degree of prudence and skill as he would if he were not insured. We could not be assured of that same degree of prudence and skill if we deliberately created a situation in which, if a colloquialism may be forgiven, he could not care less.

8760. Do you believe that he might be able to find another insurance agency which might be interested? Is it a real question or is it an academic one?——I have heard reports, how well authenticated I am not really in a position to say, that this organisation or that company might be prepared to take a share of the uncovered ten or fifteen per cent.

8761. *Mr. Jones*: Do you reject much insurance business, short term or medium term?——We reject business from time to time on particular countries where

for the time being the economic outlook is so bleak as to make them temporarily uninsurable. There are certain countries which could be named where the prospects of their paying anything for any imports over the next six or twelve months is negligible. Those countries for obvious reasons we are not prepared to insure, and therefore propositions for those countries would be rejected. Apart from that class of case I do not think there is much business that we reject. We might, of course, reject insurance on grounds connected with the pattern of terms of payment; take my example from before lunch: we would not insure table glassware on three years' credit terms. Or if an exporter came to us and said: "I can get a lovely contract for a power station worth £5 million, and the terms of payment are nothing by the time of shipment and twenty-five per cent. three years after the power station has been in working order; will you insure that?", the answer would be "no".

8762. It would appear that about ninety-nine per cent. of applications for underwriting are granted. Is that what you are saying in effect?——*Mr. Owen*: I think they probably are, yes.—*Mr. Toms*: I do not know what the percentage is on medium-term; but the length of time that negotiations take does give us an opportunity to influence negotiations, we hope for good. We are very conscious that underlying the Act is a kind of general directive that we should encourage exports, and it is sometimes possible, at least on my side, for the Department to suggest another way in which the transaction could be covered which would make it insurable although the original terms proposed to us did not look too good. If a proposition is on the face of it unacceptable we try and say on what terms we would be prepared to insure it, if the exporter could negotiate those terms.—*Mr. Owen*: So far as short-term business is concerned my impression is that we give affirmative answers to the vast bulk of the propositions that are put to us; indeed we have to in the interests of speed. We know that, try as we can, we never work quite as fast as the commercial community would like to see us work; but on the short term side we employ a device we call our "non-vetting limit"; that means that we say to our insured exporters: "We will give you in advance authority to make commitments on these terms up to these figures. Below these figures do not consult us; do it yourselves. We will back you; we will rely on your judgment." That is yet another example, if I may say so, of the virtues in the practice of leaving an exporter some of the risks for his own account. If we created a situation where none of the risk was to the exporter's account, we could not apply a service which in the short term sector is widely welcomed as giving exporters a degree of delegated authority to make commitments without asking us.

8763. *Chairman*: Do you employ brokers for underwriting?——Not for underwriting. We employ brokers for the procurement of business and for the servicing of policies, which means the interpreting of the Department's procedural needs to the exporter, but the responsibility for underwriting, subject to the exception of the non-vetting limit, is vested in the Department's officers. In the last resort it is public funds which are at stake, and my responsibilities as the Accounting Officer for the Department in respect of the public funds are absolute; I can be called to account, as you know. So we use brokers only for sales and service.

8764. Does not a broker stand between you and the exporting customer who wants insurance?——*Mr. Cotterill*: Only if the exporter himself so desires; he can approach us direct.

8765. Would not a broker give you a guarantee, in practice, of the good faith of the person seeking insurance? ——*Mr. Burkitt*: I think perhaps you are thinking of the broker at Lloyd's who is part of the machine. He is quite different. The external broker in commercial terms is really a sales organisation and nothing else.

8766. A sales organisation covering what?——Acting on our behalf for his own benefit. He is paid commission by us on the business he brings to us.

8767. Do you not look to him to some extent to secure that the business he brings to you is satisfactory business? ——*Mr. Owen*: Only satisfactory in so far as criteria of size and quality are concerned.

8768. *Professor Sayers*: What does quality mean in that context?——It means that we would welcome an approach from a broker who brought us propositions of the value, say, of £10 million in the better markets of the world more cordially than we would welcome an approach from a broker who brought us propositions valued £50 million in some of the less reputable markets of the world.

8769. *Sir Reginald Verdon Smith*: Does a broker in this context mean a member of any defined professional group? ——Generally speaking it has to be a member of the Corporation of Brokers; someone who is habitually engaged in the practice of insurance broking.

8770. *Sir Oliver Franks*: And is that true in all the cases? ——*Mr. Burkitt*: That he should be habitually engaged is essential for our recognising him as a broker; we do not do that unless we are reasonably satisfied that he is a reputable person and is doing a job in this direction.—*Mr. Owen*: The occasional intermediary, who sought to procure cover of a certain size on an individual proposition, which is the sort of activity which has in commercial terms neither ancestry nor posterity, would find it very difficult to convince us that he was performing a service of a character and quality and continuity which would justify us in regarding him for our purpose as an insurance broker.

8771. *Lord Harcourt*: How large a proportion of your clients employ their own brokers to negotiate the terms of contracts and policies with you?——*Mr. Owen*: My impression is that about two-fifths of our business is brokered. —*Mr. Burkitt*: I believe it is about two-fifths of the number of policy holders, but in fact it is the larger value policies which are brokered, and therefore I think over half the business by value is brokered.—*Mr. Owen*: We are not solely dependent on the brokers for our selling and servicing organisation. We have fifteen offices in the provinces staffed by the Department, whose business it is to make our facilities better known, to sell the services and to minister to the needs of policy holders during the currency of their policies. So the exporter who does not want to bother with brokers, and prefers to talk to us direct, can do so, and can find in these fifteen different centres in the provinces members of the staff ready and able to minister to his interests. But if an exporter uses brokers for all his insurance, and finds it convenient to use a broker for his dealings with us, there is no objection at all from our point of view.

8772. *Mr. Jones*: Do you regard yourself as a public service or as a commercial undertaking?——We regard ourselves as both, with one reservation: we are in business to provide this service as extensively, as continuously and as cheaply as possible; we are not in business to make a profit. We have so to conduct our commercial affairs as to make sure that we break even; in spite of the vast volume of risks we underwrite we have to ensure that the business is so conducted that there is no cost to the tax payer. We try to achieve that result by applying certain trading principles. So we are in a sense both, with that one reservation.

8773. *Chairman*: In paragraph 25 you say:

"The general aim in fixing premium rates under the Scheme is to achieve, taking one year with another, an overall level of income sufficient to balance, but not greatly to exceed, net claims payments plus the administrative expenses of the Scheme. This is the only standard against which the correctness of E.C.G.D. premium charges can be measured in any absolute sense. Individual rates have only a relative significance."

I do not think I understand exactly what you are wanting to tell us in that sentence?——Only that we are interested in having a sufficient size of income to enable us to pay the cost of administering the scheme and pay claims under the policies, but not in having more than that.

8774. When you say:

"This is the only standard against which the correctness of E.C.G.D. premium charges can be measured in any absolute sense."

what is the point you make there? You do not average out your premiums and charge an average premium to everybody?——No. We build up the premium structure in a somewhat complex way. We charge by the term of payment. For "cash against documents" terms we charge a certain rate; and progressively a little more for 60 days,

90 days, 180 days, one year, two years, three years, five years after shipment. Then there are five classes of countries. The structure is designed on the experience of the past and the anticipations of the future, to produce a certain level of income which will enable us to carry out the scheme.

8775. *Professor Cairncross*: How can you tell whether you really are in balance or not? Does not the success of the scheme depend on whether you have an adequate reserve? Since you do not know what the future risks are, is it not a matter of judgment whether the reserve you have built up is sufficient?——Yes.

8776. So that your solvency at any moment in time is a matter of judgment?——Our hopes of future solvency may be a matter of judgment, but our solvency at any particular moment of time is a matter of fact. We can give you the figures for the position at the end of March, 1958; we can tell you that at 31st March, 1958, the cumulative trading accounts of the credit insurance scheme since 1st April, 1930, showed a certain result.

8777. *Sir John Woods*: That is in respect of transactions completed at that date?——Yes.

8778. *Chairman*: The unexpired risks at the close of any one year must be enormous. You have not reserves against those risks, in the sense that a commercial organisation would have reserves, but you have an account which shows that up to that point you turn out a balance?——Yes. At 31st March, 1958, we had reserves, which are held for us by the Treasury, amounting to just under £13m. The commitments then amounted to about £452m. By conventional commercial standards those were not large reserves; but when circumstances have required us to make payments in excess of the size of the reserve held for us by the Treasury we have, in effect, taken an overdraft on the Treasury, by means of the Supplementary Estimate procedure.

8779. Do the Treasury in fact hold a specific reserve for you out of the accumulations of past years?——*Mr. Owen*: They hold it notionally, and pay us notional interest on the notional reserve.—*Mr. Burkitt*: The only measure of reserve for insurance companies of which I am aware is that required by the Board of Trade under the Insurance Companies Act, which is a certain proportion of the premium income. The exact proportion escapes me (it may be double); but I know that ours is above that at the moment.

8780. *Professor Cairncross*: Is that for life assurance or general assurance?——General assurance.

8781. *Sir Oliver Franks*: In paragraph 26 you give in a general way the range of rates which might apply to medium-term policies. How do those compare with the rates which your opposite numbers in rival countries would offer? Are they in effect the same, or do they differ a bit? If so, which way?——*Mr. Owen*: They differ from case to case. The rates of premium which credit insurance companies in other countries charge spring from the nature of the business that they do, the nature of the external trade which they do, the size of the business which the insurance company does and the particular premium policies adopted by the company in question. There are variations.

8782. I realise that an exact reply is not possible, but is it possible to produce a reply which is valid as a general impression?——I think we can say pretty confidently that United Kingdom exporters are at least as well served by their credit insurance companies in this country as far as cost is concerned, leaving other things out of account, as their competitors in Western European countries.

8783. *Mr. Jones*: What about Germany, for instance?——That is true for Germany.

8784. *Sir Reginald Verdon Smith*: In paragraph 29, you say:

"The Board of Trade Solicitor has further advised that the wide powers under Section 2 of the 1949 Act must be construed ' in a reasonable manner '."

Has this proved to be a serious limitation?——*Mr. Owen*: No, it has not. The particular case of which my colleague reminds me was one where the benefit to United Kingdom interests was debatable.—*Mr. Cotterill*: It was questionable whether it was not too remote for this purpose.

8785. *Sir John Woods*: Not for the first time I am not sure I understand what the Board of Trade Solicitor means. Is it just a general cautionary restricting phrase?——Yes.

8786. *Sir Oliver Franks*: It means that any action which the Department takes should be one which it would be prepared publicly to defend?——*Mr. Cotterill*: Yes.—*Mr. Owen*: And in relation to the statutory powers.—*Mr. Toms*: We do occasionally have applications which are, as Mr. Cotterill has said, only very remotely connected with exports.

8787. *Lord Harcourt*: You say in paragraph 34:

"1953-54 included heavy payments under guarantees mainly relating to exports to Iran and U.S.A. and turned the balance into a debit one of £128,000."

The Iranian exports I understand quite easily. What was the failure in U.S.A. in 1953-54?——*Mr. Owen*: I do not think we can say more than something in general terms because it is somebody else's secret, and might be identified. But perhaps I might clear up some of the mystification that I think is in Lord Harcourt's mind if I say that oddly enough from the point of view of the U.K. credit insurer the United States and Canada represent two of the worst insolvency risks in the world.

8788. *Professor Cairncross*: Are you happy, then, when it is suggested that these markets be omitted from the business which is brought forward to you by an exporter?——That depends on what kind of importer we are asked to be underwriter on. There are some importers in the United States who are extremely poor risks, others who are good risks, and others who are poor risks which with certain particular kinds of additional guarantees and reinforcements can just be made reasonable risks.

8789. *Mr. Jones*: You are guaranteeing credits on exports to Poland. Have there been defaults there?——*Mr. Owen*: The record of the Polish State has been very good.—*Mr. Jones*: You seem to be advocating East-West trade!

8790. *Sir Reginald Verdon Smith*: Where does the initiative lie in the application of the Economic Assistance scheme. Are you approached because the Government wishes to make a move in a certain direction, or because some large development project is contemplated and the government in question needs to organise funds?——Within departmental circles in this country the initiative is usually taken by one of the political departments, based on the reports of our diplomatic mission in the country concerned. The Foreign Office or the Commonwealth Relations Office will examine the reasons for giving economic assistance to such and such a country, for whatever purposes, to see how cogent they are. There may well be good political reasons why out of the United Kingdom's limited capacity to give economic assistance some should be given at this time to that country for whatever the purpose may be. It could be a general kind of purpose, like the food production programme in Pakistan, or it could be for the execution of a particular project. There are examples of both. Circumstances could arise, of course, where the overseas country itself took the initiative. Its urgent desire to carry out a particular project, its inability to raise credits from elsewhere, its knowledge of the fact that a plea for economic assistance through the United Kingdom at a particular time might be favourably received, might lead it to make an approach to the U.K. Government.

8791. *Chairman*: If you give economic assistance under this section, let us say for a food production project somewhere, can the money be spent locally? Is there no tie up with the U.K.?——All the money must be spent on goods and services of U.K. origin; otherwise it is not strictly within the Act.

8792. *Sir Reginald Verdon Smith*: This is a credit, not a guarantee?——That is an export credit granted by us under section 3 of the Act.

8793. *Lord Harcourt*: It is, in fact, E.C.G.D. acting as an export-import bank.——Yes. We get the money from the Consolidated Fund; the Consolidated Fund puts us in funds and we in turn pay the money out.

8794. *Professor Cairncross*: Do you determine the rate of interest in those cases or is it laid down by the Treasury?——It is laid down by the Treasury.

8795. *Sir Reginald Verdon Smith*: Have you had sufficient experience to feel that as an instrument it would be capable of more expanded use if required?——Yes, so far as the E.C.G.D. departmentally is concerned there is no difficulty; but the wider use of our powers under section 3 raises financial problems which are the concern of the Treasury.

8796. *Professor Cairncross*: In paragraph 49 you say that you insure credit up to three years on quasi-capital goods. There are some cases where perhaps a rather longer period might be appropriate. Have you considered going above three years?——When we speak of quasi-capital goods we are thinking of small transformers, electrical motors, pumping machinery, and that kind of thing, which is conventionally sold in the markets of the world on something like eighteen months to two years. In the case of larger single orders three years is probably reasonable.

8797. It was put to us that in the case of earth moving equipment and things in that category rather more than three years would sometimes be appropriate?——*Mr. Owen*: Rather more than three years has been given in respect of earth moving equipment.—*Mr. Toms*: The question of appropriate credit terms is always very difficult, but we are open to argument from the trade on this.

8798. There is no fixed limit?——If the order has other features which seem to put it in a category deserving longer credit, and it is reasonable to insure that transaction, we are quite willing to consider it.

8799. *Sir John Woods*: There must be quite marginal cases which can slip in between extended and medium?——*Mr. Owen*: Certainly. The position can be best illustrated by taking two examples at the end of the scale. If an exporter wanted to sell one piece of equipment to a buyer in Brazil, the odds are that that one piece of equipment would be sold on something like twelve months' credit or less. On the other hand, if £10m. worth of earth moving equipment was required in order to build some vast new national highway from one side to the other in India or the Argentine or something like that, then obviously the terms of credit which we should be prepared to contemplate for insurance would be very different.

8800. *Professor Sayers*: A similar argument would point to elasticity in the five-year limitation; but you are not in fact elastic in your five-year limitation?——No.

8801. *Chairman*: You made this point in paragraph 64:

"However, credit is a dynamic concept in the international as in the national field, and it is not easy to determine at any one point in time whether the credit terms of payment demanded or proposed in relation to a particular transaction are excessive or merely the expression of a rapidly changing situation in the world market for the goods in question."

Then you go on:

"E.C.G.D. take advice in their efforts to deal with this problem, from national and international bodies. At the national level there is close liaison with Trade Associations and other representative bodies who, especially in the field of consumer goods and commodities, are able to advise the Department on the terms of payment currently being employed, not by individual exporters, but by the trade as a whole."

Assuming you keep the liaison actively going, I imagine that keeps you currently up to date with regard to consumer goods and commodities. What use is the trade association to you when you get beyond the field of consumer goods?——If we wanted advice on current practice in a sphere of, say, heavy electrical plant and equipment we have the British Electrical and Allied Manufacturers' Association to ask. Equally in the mechanical engineering field we have the British Engineers Association, and for the aircraft industry we have the Society of British Aircraft Constructors.

8802. What have you got in the way of active liaison with them? How does the thing work?——I personally have a close personal friendship with the permanent executives in these Associations. That is mostly by historical accident; I happen to have known them in my many different incarnations over many years. So far as the changing office holders are concerned, many of them I know already; those whom I do not know I like to get to know. That is not only true of me, but that is true of the general division of my Department, part of whose duties it is to study continuously trade practice and the needs of all branches of commerce and industry for credit insurance. All that work and contact takes many forms. My colleague, Mr. Cotterill, is in I think I may say continuous contact with trade associations and chambers of commerce large and small, as well as with the bodies organised at national level, like the Federation of British Industries, the Association of British Chambers of Commerce and the National Union of Manufacturers.

8803. Would you take advice from the kind of association that you have mentioned on the subject of the currently prevailing terms of trade with regard to your five-year limitation?——Yes indeed. It would not be anything like the first time that I have discussed terms of payment, for example, with the B.E.A.M.A. Council and individual members of it.

8804. If you have a fixed rule with regard to the five years, as I think you have, do you check up the validity of that rule in consultation, or is it no good discussing it with them owing to the rule?——I would not say that it was no good discussing it with them, because obviously if circumstances arise in terms of world trade where the limitations on the horizon of my Advisory Council's foresight are impeding the Department's capacity to give an urgent and much needed service to British industry, that is something of which we should have to take account. But we are not there yet. There are some industries in this country which take the view that they would like to see us in E.C.G.D. use all our powers and all our influence, national and international, to see that if anything the terms of payment are shortened rather than lengthened.

8805. I suppose you might at times find these bodies prompting you to do something which your present rules do not allow for?——That is not unknown.

8806. I imagine that that would then be referred to the Advisory Council with a report of the representations received, and it would then be for them to decide whether they would give way to it?——We would certainly make it known to, and discuss it with, the Advisory Council. Up to the present where we have made known these cases to them they have not felt any disposition to push their horizon a bit further out.

8807. *Sir John Woods*: On paragraph 62, I am not quite sure that I follow this business of the "regulators". Could you elaborate it just a little for me?——The circumstances where some form of regulator is usually required are where we are beginning to be somewhat uncertain about the economic outlook in a particular country, and we are not prepared to underwrite unlimited risks on that country. We have to devise some method of making sure that our risks are reduced to the minimum, and at the same time that when exporters approach us for cover on a deteriorating situation they are doing it with their eyes wide open as to the risks. One obvious form of regulator is to put up very sharply the rates of premium. But we found, odd as it may seem, from experience in dealing with business with Brazil and Turkey on the eve of the Brazilian and Turkish "disasters" that a sharp and steep increase in rates to positively penal dimensions, so far from damping down business, resulted in a more desperate rush than ever to get in and get the cover while the going was good. There are limits to the extent to which the use of the rate method will keep risks under control. An alternative method which has been discussed from time to time is to vary the percentage of cover. If an exporter comes to us with a proposition on a deteriorating risk we do not refuse to do it at all, but we offer to cover 60 per cent. or 50 per cent. of the risk. But we have a certain reluctance to use that particular regulator for a variety of reasons, one of which is that we hold ourselves out to commerce and industry at large as their supporters by way of credit insurance in good times and in bad, and we like to maintain the full range of cover to the very last possible moment. The other types of regulator mentioned here are underwriting devices to enable us to try and keep some control of a risk in a deteriorating situation.

8808. *Sir Oliver Franks*: They are ways of moderating demand on your services?——Yes.

8809. *Sir John Woods*: Naturally raising the premium tends to moderate the demand. The device which was puzzling me was the limit on annual maturities; it seems rather an automatic kind of device and it would make it difficult, as far as I can see, to differentiate as between one form of export and another. It really must almost operate on the basis of first come, first served; if you put a total limit on the amount of risk you are taking in a particular country, it has that element of rigidity?——*Mr. Owen*: I agree that there is an element of rigidity, though it may not be absolute; for example, we may be prepared at a particular time to continue to offer short and extended term insurance because the volume is small and the risk period is comparatively short, but not to take on large single medium-term commitments until the situation becomes clearer. But I agree there is that sort of element of rigidity about it.—*Mr. Toms*: But the alternative might be equally difficult to contemplate, that the Department's officers should have to judge between the desirability of one export against another, everybody making his own case.

8810. *Sir Oliver Franks*: In so far as it was successful it would be invidious?——Yes, I think that puts it very well.

8811. *Professor Cairncross*: When you insure the whole turnover of an exporter, do you charge different premia in respect of different markets?——*Mr. Owen*: We rate each market.—*Mr. Burkitt*: And on each length of credit in each market.

8812. *Chairman*: Am I right in supposing that there is no one in the United Kingdom except yourselves who is prepared to give credit insurance covering the political and transfer risk?——No one.

8813. It is inherent in a lot of what you said to us this morning that you must have a very large turnover in order to carry this kind of risk. Would I be right in supposing that, owing to the volume of the business offered to you, you feel there will not be anyone?——*Mr. Owen*: I should think it extremely unlikely.—*Mr. Burkitt*: Lloyd's have a decision forbidding their members to indulge in this kind of insurance. They had every opportunity of doing it before we ever came into the field, and they deliberately refused.

8814. When you say "this kind of insurance" what exactly do you mean by that?——All credit insurance. I think I am right in saying that re-insurance under strictly controlled conditions is covered by Lloyd's.

8815. That is credit insurance. I was thinking of credit insurance against transfer risks, and I had it in mind that it is unlikely that anybody else would touch that, owing to the very large turnover of business required to cover that kind of thing? Do you agree with that?——Yes. I just thought there might possibly be a flavour of monopoly about it.

8816. *Sir Oliver Franks*: Are you not in fact a monopoly?——*Mr. Burkitt*: We have no monopoly powers.—*Mr. Owen*: Anyone who likes is quite free to start.—*Sir Oliver Franks*: Certainly. It is not a matter of principle; you merely enjoy the fact.

8817. *Sir John Woods*: Arising out of what you say in paragraph 95 about the Berne Union's objects, have you any knowledge of this new German financing institution which has been talked about just lately in the press?——We have very little information about it, but we have no grounds for believing that there is anything in this new financial institution's activities which implies that our German counterpart are prepared to insure longer terms of credit than we ourselves are.

8818. You mean that, so far as you know, it is a separate institution of a direct financial kind, not an insurance agency?——It is not an insurance agency, and if the earlier parallel is followed finance will only be forthcoming on the "Hermes" guarantee. If that is so a limiting factor is to be found in the risk which the credit insurer is prepared to envisage, and I believe that the German horizon is still the same as ours.

8819. It is not yet certain that this will only provide finance on the basis of a Hermes guarantee?——It is not certain; we do not know that.

8820. *Sir Reginald Verdon Smith*: Is there any published report, year book or any other document of the Berne Union?——It is all kept extremely secret.

8821. How did it come about that the Export-Import Bank became an associate member of the Berne Union, and, unique in that respect?——As credit insurers we all recognise that the Export-Import Bank, as it has great powers for good, has also great powers for ill. If it chose it could exercise those powers in a way which would be inconsistent with the trading approach of the credit insurer. The Export-Import Bank does two very different kinds of things: it gives its development loans, after scrutiny of the merits of such and such a project, usually for very long periods of time, for repayment over fifteen or twenty years; but in addition to that it gives exporter credits. It only gives those exporter credits in circumstances where finance from non-official sources is not forthcoming, and until the very recent past the terms on which the Export-Import Bank gave exporter credits were identical for all practical purposes with the terms of payment on which credit insurers would insure similar goods. It is demonstrably in the interest of all of us that the trading policy and the mental approach of the credit insurers and the Export-Import Bank on these exporter credits shall be as close as they can possibly be got. There is a large sphere of our activities, therefore, in which credit insurers and the Export-Import Bank have got a common interest in this question of terms. We are also interested in the economic outlook in the countries where we are under writing risks and where, though they are not underwriting risks, they are taking risks with their own money. There is, therefore, scope for collaboration between all credit insurers and the Export-Import Bank. There is a great advantage to be derived from a process of mutual wit sharpening between the Export-Import Bank and credit insurers in regard to the economic outlook in most countries in the world. Although the Export-Import Bank are not credit insurers, it was this obvious identity of interests between the credit insurers and the Export-Import Bank, coupled with the desirability from the credit insurers' point of view of exposing the Export-Import Bank as frequently as possible to what we like to consider sound credit insurance doctrine, that made us all welcome them when they were prepared to allow themselves to be considered for associate membership in this association of credit insurers.

8822. *Sir Oliver Franks*: Apart from members and associate members, do you have any observers at the meetings of the Berne Union?——Only from the International Bank.

8823. *Sir John Woods*: As far as the Export-Import Bank is concerned, the cynical would think that the arrangement is grand for the Export-Import Bank; it merely shows them what they have to beat.——The same applies to anybody who goes to the meetings; but advance commitments are not made. Discussions take place in general terms, and there is no guarantee that for special reasons any member there may not do something rather unusual for a special purpose.

8824. *Sir John Woods*: I am aware of that; but the cynical view would be that the Export-Import Bank were the last people to have in. But perhaps I should not have said that!—*Sir Oliver Franks*: You prefaced it by saying it was a cynical view!——How far it is possible to influence the course of Export-Import Bank policy I am not quite sure. In a fortnight's time I shall know much more about it than I do now, because I shall have tried to do it.

8825. I take it that these exporter credits from the Export-Import Bank mean lending money to the American exporters?——*Mr. Burkitt*: The Bank says that provided the purchaser will produce 20 per cent. cash down, and provided the seller will put up 20 per cent. at his own risk, it will buy outright the purchaser's paper for the other 60 per cent.

8826. Does the length of period over which the customer repays correspond roughly with the Berne Union underwriting?——*Mr. Owen*: It does; but there have been one or two examples in the last year which have rather disturbed us, and we hope it may be possible to persuade the Export-Import Bank to go back to the practices they were adopting a couple of years ago, which were really quite unexceptionable.

8827. *Sir John Woods*: On Appendix I, is it possible to have figures of premium income in 1957-58 divided between short term policies, extended short term and medium term?——I am not sure that it will be administratively practicable to separate short term and extended term. We can give you a combined figure for the two, and a separate figure for medium term business. I will send that to the Secretary, if I may.*

8828. *Chairman*: Then we come to Part II, on the role of Export Credits Guarantees in the monetary and credit system.—*Sir John Woods*: I want to ask about guarantees of cash advances to the customer. We had it put to us strongly in evidence that it would be much to the advantage of many exporters if the Department could give more freely than they have been giving a direct banker's guarantee for a credit raised by the customer. You say here that you only do that exceptionally; I am not sure that I understand why you are increasingly reluctant, as it appears, to give that kind of facility. In paragraph 7 (*a*) of Part III you give two reasons: the first is that "the banks will extend such facilities only to the extent that they are guaranteed; it is contrary to fundamental credit insurance practice to guarantee 100 per cent. of the credit given." That may be; but you are not here in direct contact at all with the manufacturer, and I do not see much reason why the manufacturer must always have a stake in the credit if somebody is prepared to lend money to his customers. The second reason is: "the Department may not be able to take recourse to the exporter as easily as it is enabled to do where the bank finances the exporter by discounting his bills." I have the feeling that the second is the more important argument; would you expand it for me?——*Mr. Toms*: We like to have the manufacturer as our insured for two reasons: one is the philosophical reason, if I can put it that way, that the Act says that we shall give guarantees to exporters; the second is the practical reason, that if the exporter is joined to the Department in a contract of insurance we can use the exporter to help with recoveries after a claim has been paid; we can use his knowledge of the buyer and of the technical side of the contract much more easily than we could if we were guaranteeing a contract between a bank and an overseas borrower.

8829. In other words, you are in a position to put the squeeze on the unfortunate manufacturer one way and not the other way?——I would say on the defaulting buyer rather than on the "unfortunate manufacturer", because our concern is to recover the money from abroad if it is possible to do so.

8830. Is this at all concerned with the fact that, where you have a policy with the manufacturer, that policy contains a provision whereby you may at any time at your discretion withdraw cover?——No; the recourse point is a slightly different one. In the case of the bankers' guarantee which is given when an exporter discounts his bills with a bank, we take recourse to that exporter for any amounts which we may have to pay the bank because of our obligations to them which would not have been payable to the exporter had the transaction been simply insured under a standard policy. If the guarantee is given on a contract between the bank and the overseas buyer, we really ought to write a conditional guarantee which says that we shall not be liable for loss if the buyer fails to pay for one of the causes that we do not cover, for instance, breach of contract or warranty. But such a conditional guarantee would scarcely be acceptable to the bank. That is the problem; so long as we have recourse to the exporter we can say that we are restricting our coverage to those causes of loss which we cover under the standard credit insurance scheme, because the recourse to the exporter covers any difference.

8831. Is not that what I call putting the squeeze on the exporter?——*Mr. Toms*: I think we should rather look at it this way: that we do not want to give any unconditional guarantees to cover finance absolutely, because that is rather different from credit insurance.—*Mr. Owen*: The scheme is designed to enable finance to be brought forward. Finance will not come forward unless it is covered 100 per cent. An unconditional guarantee for 100 per cent. flies directly in the face of credit insurance principles, and the best way in which we can safeguard our position is to secure the services of the very skilful manufacturers as allies.

8832. I see some advantages in that from your point of view, but from the point of view of the manufacturer there are great advantages about the case where you insure the credit given to the customer. If it is done the other way round, the way you prefer, the manufacturer has to get bills or promissory notes, and has to try to raise money on the basis of discounting those bills or selling the notes. As those bills cannot be discounted and the notes cannot be sold until after the goods have been accepted by the customer, the manufacturer has to stand out of his money, if it is a long-term contract, for quite a long time. He is sometimes told to go and borrow from his bank on the basis of these uninsured notes or bills; but his bank may say that they are under instructions of high authority to restrict their lending and they cannot do it. Alternatively, the manufacturer may find himself being told to go and borrow sums of money which may be very large in relation to his turnover (especially if it is a relatively small turnover on a few large contracts) which (*a*) he ought not in prudence to borrow, or (*b*) he may not be allowed to borrow by reason of his articles of association. This kind of situation, we are told, does put great hindrances in the way and has in several cases led to manufacturers not tendering.——*Mr. Toms*: There is a real danger that credit insurance given in this sense may be used as a basis for trying to overcome a difficulty we feel is not at the moment soluble through credit insurance. We have taken the view that these guarantees ought to be in all ways consistent with the credit insurance scheme we have described.

8833. *Chairman*: I wonder if I could be quite clear what your position is. You have been outlining to us the view that the purpose of credit insurance is to take care of the position of the person assured, and that it is a direct matter between him and the insurer; that the instrument brought into existence for the purpose of protecting his position should not be affected by the question how he can raise money upon it, but is something outside the concern of credit insurance?——Yes, I think that is fair; and the bank guarantee was added to this to give additional protection. The Chancellor described it in 1954 as being only for "those manufacturers who have to finance credit"; those are the operative words: manufacturers who have to finance credit. He went on to say that, to the extent to which the bank guarantee was given by the Department, the City would find the finance without recourse to the manufacturer himself. The logical interpretation of that to the credit insurer is that, if he gives a credit insurance guarantee from the date the contract is signed, that leaves the manufacturer to raise any necessary finance on his own resources or from such credit as he can raise until the time the bank guarantee becomes operative. From that point in time, that is for the credit period proper, the bank which agrees to finance the business will get the additional protection of an unconditional guarantee; during that period the credit insurer is under an unconditional obligation to pay the bank and has no say in whether or not the cause of loss was one which he would normally have insured. That is the real problem. A difficulty in giving insurance simply against a financial contract between a U.K. bank and an overseas borrower is that that is the only commercial document upon which the credit insurer can rely; he has no other protection. He can make no exclusions.

* *The witness subsequently supplied the following additional information:—*

SECTION 1 BUSINESS, 1957–58

	Short and extended term(1)		*Medium term*	
	No.	£mn.	No.	£mn.
Guarantees current at 31.iii 58	4,288	544·5	800	238·2
Business declared(2)		422·9		60·6
Claims paid		1·924		2·751
Recoveries		3·494		1·370
Premium income		2·009		2·834

(1) It is not administratively practicable to show figures for short term and extended term business separately, but the Department estimates that extended term business accounted for about 3 per cent of the business declared and about 10 per cent of the premium income earned for short term and extended term business combined in 1957–58.

(2) Value of goods shipped from the U.K. in the year under contracts covered by E.C.G.D. guarantees, as declared by exporters to the Department.

8834. *Professor Cairncross*: Are the residual causes of loss in practice important?——I think they are.

8835. *Sir John Woods*: What sort of things are they?——Breach of contract or warranty, and any form of contributory loss. We rely on the exporter to behave prudently, to get a good contract and to do all that he can to prevent and minimise loss and so on; but we cannot lay that obligation on a bank, which is not in that sense conducting a commercial transaction at all.

8836. *Professor Cairncross*: How do you arrive at the judgment of importance in practice? Has it in fact been your experience that, where you have given a guarantee to the bank and the bank has given credit to the buyer, the Department has suffered substantially as a result of being unable to take recourse on an exporter for the other forms of loss that you referred to?——The cases where we have guaranteed an overseas loan arrangement have not been very many, and they have been in respect of rather large and specialised contracts. I do not recall any case where we would have had to have recourse to the exporters for one of these causes of loss; but that is because of the nature of the transaction.

8837. That may be, but if you had swallowed the gnat as well as the camel would you have been any worse?——This particular type of facility does, in fact, relieve the bank of a great many obligations and risks; I think if we were not very careful about this we should be faced with the prospect of doing it for everybody.

8838. *Sir Oliver Franks*: You speak as if the manufacturer, unless he was tightly controlled, would be idle and would not worry about great loss; I would have thought that most manufacturers of standing are very jealous of their good name, and would be very anxious to pursue their proper advantage and to do all that they can in whatever circumstances come along for their own good reasons. One could emphasise too much the necessity of having the manufacturer tightly controlled by the Department?——I think it is not only a question of morality; it is enabling the manufacturer to trade beyond his capital structure.

8839. *Professor Sayers*: The more requirements E.C.G.D. put on him the bigger the capital structure he requires; is not that all you mean by that?——Is it not the more trade he wants, the bigger the capital structure he should have?

8840. *Sir John Woods*: Yes, but there seems to be an argument in this that it is the business of the manufacturer to enlarge his capital to such an extent that he can also become a moneylender. That does not seem to me to be right.——*Mr. Owen*: I do not think that is quite right. Surely the argument is that for the period of financing work in progress a manufacturer, with the assistance of his bank, ought to have adequate capital resources at his disposal for the financing of work in progress. Once the work is completed and accepted by the buyer, then from that date the manufacturer is clear of the whole problem of credit-giving, except so far as this tiny fragment is concerned in respect of which there is recourse to the manufacturer; the bank takes the problem of credit-giving off his shoulders. But it is true that information has come our way which we interpret as evidence that there are some manufacturers who are inadequately capitalised today for the financing of work in progress.

8841. That would vary, of course, from company to company. In the old days these people borrowed their money in London, and then arranged terms of payment with the manufacturer, who got progress payments. Those progress payments were part of his working capital for financing his work in progress. He has difficulty today because his customer is not in funds to give him progress payments. On your theory the proper way of doing that is for him to increase his capital, but I am not sure that is right. Why is it wrong that the overseas customer should be put in funds so that the transaction could go on as it used to?——*Mr. Toms*: I do not think it is our theory that he should increase his capital, but it is our view that present Ministerial directives do not want credit insurance used to bridge that gap. There is an insurance reason, I think, why we should not insure unconditionally finance which is raised during the period of work in progress.——*Professor Sayers*: That is something entirely different from the argument about the amount of capital a man should have, which was the reason you gave me.

8842. *Lord Harcourt*: You said, Mr. Toms, that, if this system was carried out, it would enable people to over-trade in relation to their working capital; but when this business was done in the traditional way nobody ever said that a foreign loan might not be made because an exporting company would thereby be enabled to over-trade. What it did was to provide the foreign loan. The foreign loan provided the progress payments; that money is not now available, and therefore a large working capital is now required.——*Mr. Owen*: There are two alternative methods of finance. One is the cash advance facility to the buyer, which has certain credit insurance disadvantages. Although we do not exclude it altogether and that is a way in which our guarantees can be used, nevertheless we prefer to keep it for the exceptional case. We prefer the other way; and we hope, and indeed we observe from what is going on, that a vast majority of manufacturers in this country are able to cope adequately with large capital goods contracts, resting themselves for working capital for the work in progress on the financial accommodation that they will get from their banks with the backing of the Department's standard policy, which is exempt by Treasury directive from the credit squeeze arrangements. The manufacturer has his standard policy, issued direct to him. His bank will be able to make up its own mind as to the extent of the financial accommodation that it will give him for the work-in-progress period, on the basis of the Department's standard policy. Once the goods are accepted a totally different situation arises. The whole burden of credit giving can be unloaded on to the bank, on the basis of our unconditional guarantee to the bank, which supports the bank as to 90 per cent. of the credit, so that it only requires to be supported as to 10 per cent. by the resources of the manufacturer.

8843. *Chairman*: When you use the phrase "once the goods are accepted", in regard to constructional contracts, for such things as power stations and irrigation works, does that not really mean completion of the contract or after?——There is a difference between the two kinds of cases to which you have referred. The electrical industry have been able satisfactorily to demonstrate to us that acceptance of goods can take place within a very short period after the completion of the actual manufacturing of the plant. There can be then a period of between four and five years after the goods have been accepted during which payments are still to be made, and 90 per cent. of the amount of credit outstanding during that period can be and is covered by the Department's unconditional guarantee. So far as constructional work is concerned, the kind of work which is being done in building roads, dams, bridges, in that case we agree that it is very difficult to define the point of acceptance. We have had long discussions with the trade association representative of this particular industry, the Export Group for the Constructional Industries, and we have been able to go a long way with them to meet the realistic needs of their particular industry and devise a method satisfactory to us and realistic and reasonable to them, providing for acceptance in certain stages. We are prepared to look at each case on its merits and to go as far as we possibly can in establishing the concept of acceptance in instalments, so that our unconditional guarantee to the contractor's banker can be dated from as early a moment as possible.

8844. *Sir John Woods*: Have you not in fact given a few guarantees of credit to the customer?——A few, yes.

8845. So under the Act you have power to do that?——Yes.

8846. This policy which you are outlining to us is an administrative policy, so to speak?——It is a matter of trading prudence.

8847. Mr. Toms said that one fear is that if you went very far with this idea you would be forced into a position of doing it for everybody. I suggest to you that that is perhaps a little unjustified. I do not see why you should not be pretty selective. We have had it in evidence from good and reputable people that because of the difficulty of borrowing to cover work in progress they have had to refrain from tendering for jobs which they had a good

chance of getting. I do not think that we can accept it as a general answer to all those cases that they ought to have more capital. Would this not bear re-examination from the point of view of being considered on a selective basis?——*Mr. Burkitt*: Might I make bold to put a counter question to that? I fully accept your contention that there is this difficulty with the manufacturer which did not exist before the war; but why do you jump from that to assuming that credit insurance should fill the gap? By definition credit insurance is meant to do something different.

8848. I merely quote your own paper where you say that you have become a means of bringing forth finance?——*Mr. Burkitt*: Perfectly true: we do not however claim that could cure all the world's ills.—*Mr. Toms*: If I may go back to the case I think Sir John may have had in mind, the question there was not entirely one of raising more capital but of a limitation which was imposed by the company on itself. It is going a little far to suggest that credit insurance should fill the gap rather than the company's own structure.—*Mr. Owen*: It is after all the company who want to give the credit.—*Mr. Burkitt*: But may I place E.C.G.D. on record as fully agreeing with Sir John Woods that there is a gap?—*Mr. Owen*: I agree; there is a gap.

8849. *Professor Cairncross*: In section 7 of part II you refer to promissory notes that were drawn by the governments of the U.S.S.R. and Afghanistan, guaranteed by E.C.G.D. and sold by the Government broker on the London market. Would you regard this method of operation as superseded now by the economic assistance facilities under section 3 of the Export Credits Guarantees Act?——Not necessarily. It is still theoretically possible, but there are financial difficulties. Those of our colleagues with whom we have discussed this feel that the implications of the restoration of this practice would produce more disadvantages than advantages. There are, I understand, weighty internal financial reasons why the extension of this device, although theoretically possible, would not really be a very good idea. But this is really right outside my department.

8850. What was the maximum period for which these promissory notes were issued?——Five years.

8851. And none were issued, I take it, after 1939?——That is correct.

8852. In section 8 (*d*) of part II you refer to the practice of rediscounting credits by central banks in Belgium, Canada, France and Germany. Is this a suggestion you are prepared to consider for adoption in this country?——Certainly; but how reasonable it is is not for us to judge.

8853. *Professor Sayers*: Have you discussed it at all at the Bank of England?——We know that the Bank of England has had this under consideration. But these are questions which should be addressed to the Treasury or the Bank of England.

8854. *Professor Cairncross*: Would it be your impression that in some of the other countries that are members of the Berne Convention this method of finance of exports supplies a substantial part of total export credit, and that therefore their use of the credit guarantee mechanism is perhaps not so extensive as in this country?——*Mr. Owen*: I do not know.—*Mr. Cotterill*: Even where there is a rediscounting mechanism in effect, in many cases credit insurance of the transaction to which the paper refers is a pre-condition of the rediscounting.

8855. *Lord Harcourt*: We have bad it represented to us that, if there were a negotiable form of export credit guarantee, that would much facilitate the provision of finance. Am I right in thinking that there is no form of credit insurance given by E.C.G.D. at the moment which is capable of being negotiated?——*Mr. Owen*: That is correct. E.C.G.D. had at one time powers to guarantee by endorsement, and thereby to create a negotiable instrument; these were used on a small scale in the thirties, but were withdrawn for administrative reasons in 1939 under the shadow of impending war finance procedures and regulations. They have not been restored.

8856. Can you tell us why those powers have not been restored?——That is again a question to be addressed to the Treasury or the Bank of England, or both.

Chairman: I think that brings us to the end of a full day. Thank you, Mr. Owen; we are much obliged to you and your colleagues.——*Mr. Owen*: Thank you, Sir.

(Adjourned until Thursday, 22nd May, 1958, at 11.00 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-FOURTH DAY

Thursday, 22nd May, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. B. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O. (Questions 8993 to 9139 only)

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser* (Questions 8993 to 9139 only)

The following witnesses representing the Council of Scottish Chambers of Commerce, called and examined:

W. I. FRENCH, ESQ., D.S.O., O.B.E., T.D., President, Glasgow Chamber of Commerce,
R. M. CARNEGIE, ESQ.,
MATTHEW NEIL, ESQ., Joint Secretary, Council of Scottish Chambers of Commerce.

8857. *Chairman*: We are much obliged to you for your memorandum* which we have all read through. If you will have it in front of you, we will ask you to amplify certain parts of it from your own experience. You say that: "The Council of the Scottish Chambers of Commerce has in membership sixteen Chambers in Scotland and represents collectively about seven thousand Scottish firms giving employment to many thousands of people." That gives you a wide coverage. Would what follows in your paper have been drawn by any questionnnaire process from the people who make up the body of your Council?——*Mr. French*: It was drawn up by a committee of about eighteen people broadly based from all parts of Scotland and representing various sectors of industry.

8858. You have a theme which arises for the first time in paragraph 5:

> "The varying fiscal policies on initial capital allowances and investment allowances have had a disturbing effect on business planning."

What have you in mind there? Do you mean that in your own experience people planning their business have been much influenced by the prospect of what allowances they are going to get?——It varies from case to case. There is no doubt that the frequent changes in these things made some business people rather cynical. They might plan a capital operation under one code of allowances, and by the time it was carried through in the extreme case the allowance would have been withdrawn altogether for a time; in a few other cases it was made more generous. A project that might take two or three years to plan and carry out might finish under very different rates from those obtaining when it was first planned.

8859. If they become cynical about it they get less and less disturbed, because they do not really attribute much importance to the actual changes?——"Cynical" was a rather stronger word than perhaps I should have used.

8860. Do you think from experience the current rates or the rates expected have had a sizeable influence on business planning?——I should say so.

8861. Which has had the most: the investment allowance or initial allowance?——The investment allowance was very attractive while it was in force.

8862. Are there particular kinds of trade or industry in which they have more significance than others?——It depends on the type of trade. Certain trades that use a large quantity of fixed assets, that is machinery, plant and buildings, are obviously more affected than a merchanting business which holds stocks.

8863. *Professor Cairncross*: Do you know of cases where investment was put in hand that would not have been put in hand but for the investment allowance?——I could not quote a specific case, but in conversation with industrialists one hears that certain projects may be very attractive while the allowance is good, so that it is very disturbing, say eighteen months later, when the bricks and mortar are going up, to find the allowance has changed. By then one is committed and must make the best of it.

8864. *Chairman*: It is not your experience that when the change makes a project less favourable it prevents the project from being carried out?——In the extreme case it possibly might; I am thinking of the building of ships.

8865. Have they not always received rather special consideration?——They have indeed had more generous treatment; but at one stage it was cut down even for ships. And I think I am right in saying that at that time one did hear of a few contracts being cancelled on these grounds, though not very many.

8866. *Mr. Woodcock*: In paragraph 7 you say that a trend "which has not by any means been universally welcomed, has been the tendency for wages to be fixed on a national basis . . ." Obviously it is literally true that it has not been universally welcomed; but who objects to it?——I think it is the rigidity that is objected to. It may be that circumstances are different in one part of the country from another. For example it is known that the cost of living in Scotland is rather cheaper than it is in London. There is no doubt there is a rigidity that was not present, say, 25 years ago.

8867. Are you saying that wages in Scotland should be lower because the cost of living is lower?——I suppose that is the implication of what I said; but it is only a matter of degree. We were really trying in this part of the memorandum to review the changes that had taken place since the time of the Macmillan Report, and that was one thing that was quite clear: that there was a rigidity in wages which was not present 25 years ago.

8868. You say that this "prevents, in theory at least, the most efficient firms from attracting labour"?——That is so; they might have attracted them by paying more.

8869. That is not the same point as saying that wages are higher because the cost of living is lower?——It is a relative question all through. The point in that paragraph is that wages are more rigid than they were.

8870. Rigid downwards, but who stops anybody from paying above the trade union rate?——It can always be done within the economic context of the particular firm; but the firm must, we hope, operate at a profit, and wages is a factor in the cost of production.

8871. But you say that this system is preventing firms from attracting labour. I do not know anything in the system of national negotiations that is able to stop employers from paying more than the agreed rates?——*Mr. French*: That is true, and of course it is known in

* Memoranda of Evidence Part VII No. 2.

Scotland that certain employers do do it.—*Mr. Neil*: That is why the phrase "in theory at least" appears. It is known that employers do not in fact stick to agreed rates in many cases.

8872. It is not this system then, which is the cause of the trouble. Would not the same thing happen if the agreements were local? Are there not efficient and inefficient firms within the same town?——*Mr. French*: The key word of that paragraph is "rigidity". We are not entering into a detailed examination of wages, but there is no doubt, in tracing the developments of the last five years, that there is a rigidity which was not present 25 years ago.

8873. There is a tendency in wage rates, which has been going on for 25 years or more, to establish a national rate; but there is also a tendency to adopt a system of payments by result which does not lead to rigidity at all, which gives the efficient firm every chance, I should have thought, of improving the earnings of their people —*Professor Cairncross*: Some firms offer more overtime rather than raise their rates to get more labour?——That is the practice.

8874. And wages vary between different parts of the country and between different firms; they are rather higher in England than in Scotland?——That is generally believed, though there are always important exceptions.

8875. *Chairman*: In paragraph 9 you are talking about the development of the use of hire purchase in regard to plant and equipment. Apart from motor vehicles, what kinds of plant and equipment have you observed being acquired for industrial purposes on hire purchase?——Motor vehicles are the biggest single instance; but there is a growing tendency that any type of machinery can now be obtained on hire purchase.

8876. Would you put it as high as that?——That is very wide; but I would say a very large range.

8877. You are thinking not only of mobile machinery but also of fixed plant?——Yes; for example a loom.

8878. *Professor Sayers*: Has this been increasing in the last three or four years?——I do not think that the giant businesses are doing it, but I think there is that tendency among the smaller businesses.

8879. *Mr. Woodcock*: Surely nobody buys a single loom?——It might be an additional loom.

8880. That surprises me. Generalising from my experience in Lancashire, I should have thought one either had 500 looms or nothing?——Take, for example, a carpet loom; that, as you know, is a very big piece of plant.

8881. A company would not acquire capital assets on hire purchase?——It is possible. You will see many advertisements inviting them to do so.

8882. They would not start a mill of 500 looms with all the preparatory machinery and what-not on hire purchase?——That is a big proposition; but it would be possible in these times to finance small extensions in that way.

8883. *Mr. Jones*: Is this tendency to acquire capital equipment on hire purchase a steady development or is it something that has developed substantially within a short period of time?——The impression I have is that it has grown rather more quickly during these last few years. One has only to read the trade papers, and indeed the newspapers, to see the advertisements of companies that will give these facilities; and one has read articles which show that the practice is becoming more widespread. It is in part due to the restrictions on bank advances.

8884. You said that this was substantially limited to the smaller business industrial undertakings; do you mean undertakings with a capital of £15,000 or £20,000?——I would say rather bigger than that; but not the larger public companies. Larger private businesses perhaps, and medium and small private businesses certainly.

8885. The larger private undertakings are doing this, then?——I would say yes, without having investigated in detail any cases. It is a course they would have to consider, if it was essential to obtain new plant and other methods of doing it were not available. Again I would emphasise that it is probably the medium to smaller ones who are for the most part doing it.

8886. *Chairman*: This does provide these smaller concerns with a way to provide finance for capital for development, which is a point you make later on?——Yes, that is so.

8887. *Professor Cairncross*: In paragraph 16 you say:—

"... projects which would be useful to the economy are having to be cut back because bank finance is not available."

And you go on to elaborate that in paragraph 18, where you say that the lack of credit has forced some companies to reserve such liquid resources as they have for purposes of trade credit. Is this a matter of observation or theoretical speculation?——It was discussed in our committee, and there is no doubt that the committee had in mind particular cases. It is not pure theory.

8888. Is it something which is thought to have become more important in the course of the last six months?——*Mr. French*: I would say so.—*Mr. Neil*: After we had submitted our memorandum we were asked to undertake an enquiry as part of a national enquiry by the Association of British Chambers of Commerce. The result of the questionnaires sent out suggests that people are being stretched all the way along the line. 40 or perhaps even 50 per cent. of those who replied to the questionnaire said that their trade debtors were very much higher than they would regard as normal. That would refer specifically to the last eight months, since September, 1957.

8889. In that case they are being obliged to give more credit. Do they raise the cost of that credit or the terms on which it is offered?——*Mr. French*: Most businesses are reluctant to do that until it becomes absolutely essential. It creates a certain amount of loss of goodwill to start charging interest on overdue accounts unless it is a custom of the trade as it is in some cases.

8890. Do you know of any changes that have occurred in the discounts offered for cash payment?——*Mr. Neil*: I think there has not been much up till now; firms have been accepting the position.—*Mr. French*: Obviously one does not wish to damage goodwill.

8891. In the interests of preserving goodwill cash has been used for the purpose of extending credit and this has reacted on the fixed capital investment programmes?——That is so.

8892. Has that been particularly marked in any type of industry or is it normal throughout industry?——*Mr. French*: I should not think it was particularly marked in heavy industry, but I would say that over the range of industry otherwise it is a feature.—*Mr. Carnegie*: I would agree that generally throughout industry people are taking as much credit as they can normally get, and for that reason firms find it very difficult in many ways to extend their fixed assets very often when they would like to.

8893. Who is the net recipient of the credit? If every business were receiving credit at the same time as giving it the net effect might not be very great. Is it the retailer who is receiving the credit in the end?——The retailer is receiving credit in the end, but, as I say, it follows down the line.

8894. *Mr. Jones*: Right to the manufacturers?——In many cases, yes; very much so.

8895. How would you say this extension of credit is shared as between the manufacturer and the wholesaler? Have you got any ideas?——*Mr. Carnegie*: I have no idea.—*Mr. French*: It is difficult to express a ratio; people tend to take what they can get away with.

8896. *Professor Cairncross*: Is it simply the absence of bank credit, or is it the difficulty of raising money at reasonable rates of interest, or the difficulty of making new issues on the Stock Exchange?——The particular problem this arose from was the diversion of funds for capital improvements to the financing of general business. I would imagine that the restrictions on bank credit had fundamentally a good deal to do with it. Take, for example, a retail business that at one time of the year operates on an overdraft. I do not doubt that it still gets an overdraft up to a certain limit, but it has been curtailed and that starts the process.

8897. Have you indications that a large number of people have been refused bank advances that you would normally have expected to get them?——*Mr. French*: We do hear of cases; in conversation with business friends one equally hears of cases where they say: "There is no

use in going to the bank because we know we will not get it."—*Mr. Neil*: In this recent questionnaire the figure for people who said that since September, 1957, they had been refused bank advances or had them drastically reduced was 26 per cent.

8898. *Professor Sayers*: The advances of the Scottish banks have not fallen very much in that period?——*Mr. French*: No, but equally they have not increased.

8899. *Professor Cairncross*: Is it your point that the turnover of business has been expanding but that bank credit has not been keeping pace, and that this has exercised a squeeze on a large number of businesses in the area?——Bank advances are pretty much what they were; but one might expect them to have advanced a bit without the true volume of credit being any greater than it was, due to the effect of inflation.

8900. Is what has been happening in Scotland different from what has been happening in other parts of the country, or is it your view that there has not been any marked difference?——That is a difficult question to answer, because our main basis of information is Scotland. We make the point at the start of our report that we do not think there were many differences between Scotland and other parts of the country, and I would imagine that that applies to this matter also.

8901. *Professor Sayers*: You say specifically in paragraph 16: "projects which would be useful to the economy are having to be cut back because bank finance is not available." Is it that bank finance is not available directly for these purposes or is it that this expansion in trade credit coming back from the retailers who have been denied bank credit is resulting in projects being cut back?——I would say that both these factors have an effect. Paragraph 18, I think, deals more with your second factor.

8902. When you say "projects which would be useful to the economy," are you meaning projects to expand capacity or projects to replace assets which are wearing out?——To expand, no doubt, in certain cases; to renew by a more efficient piece of plant; that sort of thing.

8903. And you have specific instances behind this general statement?——We know of instances, yes.

8904. *Chairman*: You are satisfied that they are projects for which bank finance would normally have been the appropriate form of finance?——That opens up another question. There is no doubt that in the initial stages very often a bank loan is obtained for such a purpose, though I am aware that it is not regarded as a proper method of financing long-term capital expenditure.

8905. *Professor Sayers*: And were the Scottish banks in fact commonly giving credit for these purposes?——Their policy has never been greatly different from the other banks.

8906. I am asking about their practice?——I would not say there is any marked variation in practice; a good many of them are now under English direction.

8907. I am not thinking of any difference between the English banks and the Scottish banks; I am trying to get at the actual practice of the Scottish bankers before and since the credit squeeze?——*Mr. Carnegie*: I think the banker is prepared to try to get round the fact that it is not a fixed asset that he is financing, and that to that extent he is prepared to finance a certain amount of fixed assets expenditure, in the hope that at the end of the day the profits are going to be sufficient to reduce the overdraft over a period, shall we say, of a few years.

8908. Has this practice been curtailed much in the last year or two years?——*Mr. Carnegie*: I would say that the banks, having been given a brief to try to reduce their advances by 10 per cent., have had in some cases to curtail facilities that they might otherwise have given.—*Mr. French*: Where a company has some novel idea, or wants to finance a greater volume of business, it goes in the first instance to its bank; as a result of the directives the banks have had to refuse this kind of thing.

8909. Why in that case has not the volume of advances fallen much?——It may be because there are always industries which are on work of importance to defence or exports, which get rather more favoured treatment. I am not sure that a banker would admit that, but it may be that it is these cases that keep up the volume of advances to what it was. The pattern of the advances may be different from what it was ten or twenty years ago.

8910. Is it different from what it was two years ago in the Scottish banks?——*Mr. French*: I have not seen any recent analysis.—*Mr. Neil*: I would say it was; and I think it is true to say that retail trade is one of the fields in which they have cut down more than others.—*Mr. Carnegie*: With the fall in commodity prices bank advances to persons who deal in commodities have fallen.

8911. That is a factor that has enabled the banks to reduce advances without making life uncomfortable for retailers. Is it not very difficult, when one takes account of such factors as that, to believe that there has been any substantial curtailment of advances in these other directions?——*Mr. French*: I have not seen figures for the Scottish banks, but I have a table here in the Scottish Bankers' Magazine for the British banks as a whole, which shows considerable changes in the make up of the total.

8912. *Professor Cairncross*: You mention in paragraph 18 that there has been some effect on the holding of stocks as well as on plans for capital extension and replacement. So far as there has been such an effect, that must have reduced the need for trade credit; but have you specific evidence in fact on stocks?——Business is, of course, a very flexible thing; but if a manufacturer decided to take in more stocks and went to his banker and said: "This will involve an increase in my overdraft, which I hope to liquidate shortly", he would probably be refused that accommodation.

8913. That is a manufacturer; am I wrong in assuming that stocks here referred also to stocks held by wholesalers and retailers?——In general, unless there has been a change in prices, their object is to hold stocks as small as they reasonably can. I was thinking more of a manufacturer's stock.

8914. *Professor Sayers*: Have you any instances in mind of actual contraction of stocks for financial reasons?——*Mr. Neil*: Not in our committee, but it has been implied in the answers to the questionnaire that we have sent out since then. A number of firms were asked to say what was the general trend of trade in their own particular industry or sphere of commerce, and some of these attributed the contraction which they said they had experienced to the fact that their customers were running down stocks.

8915. It was somebody else, not themselves?——Yes, but it was having an impact on them.

8916. But it was what they thought about somebody else and not certain knowledge?——*Mr. Neil*: Yes, I suppose so.—*Mr. French*: There is, of course, the point that if a wholesaler has sold stocks and his customers take longer to pay, he has not got a fund of money to buy in new stocks. If in these circumstances he went to the bank at the present juncture I doubt if he would get very much in the way of additional advances.

8917. Our talk so far has all been in terms of the availability of bank credit. Has the rate of interest charged by the banks made any difference?——I do not think that anybody in business welcomes a high rate of interest.

8918. But does he act differently when it comes?——*Mr. French*: Probably not; and certainly not in the first instance. We make the point elsewhere that, with the present level of taxation, a raising of the interest rate is not necessarily so keenly felt at the business level.—*Mr. Neil*: That question also was asked in the questionnaire, and of those who replied approximately one-third (I was surprised at the size) said that they had taken steps since September, 1957, to reduce overdrafts because of the cost.—*Mr. French*: That was a sample inquiry.—*Mr. Neil*: And I think has to be treated with reserve. We tend to get replies from those who are feeling sore. It probably does not accurately represent the position.

8919. *Professor Cairncross*: It is a little difficult to reconcile with the move in total advances?——Yes.

8920. *Professor Sayers*: In paragraph 17 you say:—

"Bills of Exchange have been re-introduced or increased in certain trades. . . ."

Which trades?——*Mr. French*: I understand in the timber trade.

8921. But in that trade they have been used continuously since the war. Or do you suggest that for a given volume of trade in timber more bills are now being drawn?——I understand so.

8922. *Lord Harcourt*: Would these be mostly trade bills or bank acceptances?——I would imagine trade bills.

8923. *Professor Sayers*: Are there any other trades?——*Mr. Neil*: That is the only one on which we have specific information, but this comes from Sir John Campbell, who was a member of our committee.—*Mr. French*: Sir John has a wide knowledge of these things, and he said that it extended to several trades.

8924. I wonder if I might be told the meaning of the last sentence in that paragraph 17: "There are, however, indications that this may be so." What is "this"?——The speeches of certain bank chairmen over recent months have indicated that they view with some concern the amount of finance that has been got outside banking channels.

8925. This is nothing within your own knowledge?——No; this is not a peculiarly Scottish point, although it is a fact that one Scottish bank chairman did refer to it specifically.

8926. *Chairman*: While we are on the question of interest rates may we take your paragraphs 24 and 31, and see what you can tell us from your own direct experience about the rates of interest that are referred to there? You say in paragraph 24:

> "Where business is profitable some concerns will be prepared to pay very high rates, and it is understood that some finance companies are offering 10 per cent. for deposits and lending money at 14 per cent. to 16 per cent."

That is gathered from reading?——Yes, that is so.

8927. You go on:

> "It is also reported that bills are being discounted on account of foreign houses at as high a rate as 15 per cent. . . ."

What information have you on that particular point?——*Mr. Neil*: There was a reference in the *Manchester Guardian* of 5th November, 1957: "Business men who have been refused overdrafts to finance new production have been advised to raise money on the secondary market. There they find that money is plentiful, though the cost is shocking. A trade bill can be discounted on the secondary market at 15 or 16 per cent., which compares with 8 or 9 per cent. charged on overdraft."

8928. *Lord Harcourt*: This does not spring from your own experience?——*Mr. French*: We have no particularly Scottish instance in mind.

8929. *Chairman*: Does the reference to Zürich rates in paragraph 31 come from the *Manchester Guardian* too?——*Mr. French*: It is based on the *Manchester Guardian* article, and it is making an assumption from that. Reading these paragraphs again, and recognising that they were written nearly six months ago, one would have to say that the climate has rather changed in these last few months, perhaps even in the last few weeks. I doubt if there would be the same readiness now to get accommodation at such fantastic rates; but that is a development since our committee sat.

8930. *Lord Harcourt*: In your direct personal experience have you seen any of this Zürich finance?——Not in my direct experience.

8931. *Professor Cairncross*: In paragraph 31 at the end of the page you refer to "more selective effects"; that is picked up again and dealt with in the concluding paragraph. When you speak of "more selective effects" do you mean selective between projects rather than between areas?——Yes, although we know that there may be particularly difficult areas.

8932. Is it in your mind that monetary policy does not as a rule exercise any pre-selected impact on particular areas of the country?——I do not think that monetary policy has a particularly adverse effect on any particular sector of the country.

8933. You have noticed nothing happening in consequence of the increase in interest rates and the restriction of bank credit in Scotland that in your view differs substantially from what has happened in other parts of the country?——*Mr. French*: I personally have noticed nothing of that sort.—*Mr. Carnegie*: I agree.

8934. *Chairman*: We come in paragraph 32 to the Capital Issues Committee. Have your members had much direct contact with the organisation of the C.I.C.?——*Mr. French*: I would imagine that certain of them have quite a lot of contact.

8935. Where they have put in applications?——Yes, over a period.

8936. *Professor Cairncross*: You say the absence of reasons for decisions by the C.I.C. is not a matter of grievance? You would prefer that no reasons were given?——I think it would be very dangerous if a case law were built up on that sort of subject.

8937. *Chairman*: Supposing one merely thought of the feelings of the person who has had an application refused and does not know why?——Even if he were only told confidentially why his application had been refused, I think you would find that it would become common knowledge.

8938. I agree, but would there be much harm in the information being given publicly?——*Mr. Carnegie*: We discussed it fairly closely in our committee, and we came to the conclusion that no reasons should be given.

8939. And that was because of the fear of getting a rigid system of precedents built up?——I think that must have been it.

8940. *Lord Harcourt*: Have you noticed any bewilderment amongst your members at having an application refused?——*Mr. French*: I do not myself know of any recent cases. We appreciate that the Committee must operate under governmental policy, and we were rather inclined to leave it at that. It was thought that it had a useful function. It is appreciated that the *ratio* of its decisions must change, depending on the policy laid down for it from time to time. I do not know whether Mr. Carnegie knows of any recent grievances he has heard of personally.—*Mr. Carnegie*: Over a period one has heard a certain amount of groans, but our committee were prepared to accept that that was inevitable.

8941. There is no feeling that the distance between London and Edinburgh or Glasgow places you at a disadvantage?——*Mr. French*: None whatever.

8942. *Sir Oliver Franks*: Really what your committee did was to feel that the C.I.C. was part of Government and therefore you must expect it to behave like the rest of the Government?——To a very large extent that is so.

8943. *Sir Reginald Verdon Smith*: In paragraph 34 you say:—

> "A view was, however, expressed that the smaller business is at a disadvantage when it comes to seeking C.I.C. consent"

and there are several other points where the small business is thought to be at a disadvantage, including the point we were discussing on paragraph 19 about restrictions on bank advances and other sources of credit available. Is there a strong feeling of grievance in your committee that smaller firms are at a disadvantage in a number of respects from the financial point of view; and, if so, would you care to develop that a little?——*Mr. Carnegie*: The committee were to a certain extent divided on this. The bankers said that they would always be prepared to give the smaller man credit for capital assets, but the general feeling round the table was that the smaller man was at a disadvantage when it came to going to the big finance houses to get credit. He was not of the same status. I am talking of projects of up to, say, £20,000.

8944. *Mr. Jones*: Were you thinking in terms of applications to insurance companies and places like that rather than banks?——No, I do not think so. Our feeling was that insurance companies were not really interested in applications under £50,000.

8945. *Professor Cairncross*: Is this the origin of the gap which you refer to later in paragraph 46, where you speak of the problem of providing permanent capital to the smaller company in need of from £5,000 to £25,000? Is it your view that this is a common gap throughout the country, or do you think it is a local one in the area you are most familiar with?——I think that we would have thought that it was not a local gap, but that it applied throughout the country. But the feeling of the committee was that it definitely applied in Scotland.

8946. You are speaking here primarily of the provision of permanent capital. The banks would not generally be

very happy about providing that kind of sum to a small company?——The bankers were inclined to say: "We would help them", but the other members of the committee, the businessmen, thought that when it comes down to hard facts and practice that does not actually take place; the banker says: "No, it is for capital purposes; I cannot help you."

8947. You are speaking here of an investment involving a considerable risk but possibly carrying a proportionately higher return. The small company approaching a bank will have to offer security when it has only limited assets against which to borrow and will pay a rate which is likely to be fixed independently of the type of loan made. Do you think there is scope for loans to a company of that kind on possibly different terms and perhaps at higher rates by a different institution?——Our feeling was that there was a need for such a finance company, providing finance, shall we say, under £50,000.

8948. *Lord Harcourt*: This is the need primarily to replace the old private security holder?——Yes.

8949. *Professor Sayers*: Is this need not being met by the I.C.F.C.?——Further on in the memorandum we say that the I.C.F.C. are becoming too respectable. I think we should qualify that by saying that the I.C.F.C. were limited in the number of projects they could finance, and for that reason they were able to choose the better ones rather than the poorer ones.

8950. *Professor Cairncross*: Do you feel that it is desirable that there should be one institution alone concerned in this work, or do you think some competition might help?——Our committee felt very strongly that some competition would help.

8951. In some countries it is the custom, where development is under consideration, to re-insure part of the bank loan at a central institution. Would you consider that that might be an innovation that would be useful in this context?——Yes; but the Scotsman is always rather chary about paying a high premium, and I am not sure whether the idea of the re-insuring of the loan would catch on.

8952. *Professor Sayers*: These are loans that would bear a rather higher rate than the Scotsman normally pays to his bankers?——Yes.

8953. In fact a higher rate would be appropriate for the risk involved?——Yes.

8954. If the business were undertaken by subsidiaries of the existing banks so that the channel was a ready one, and the Bank of England or some other central institution stood behind the subsidiaries for this business, would the Scotsman take his business of this kind to these institutions readily?——I would have thought so. We discussed in the committee the question whether the banks should not form development companies.

8955. Each bank separately?——Yes, or a consortium. The difficulty with those smaller loans is the supervision of them, and it was felt in the committee that the banks were the people best able to keep in touch with the small man who was getting £20,000, but who probably did not want to pay accountants to the same tune as the bigger firm.

8956. *Professor Cairncross*: The banker is in fact in constant contact with these small people and knows their circumstances?——*Mr. French*: The banking member of the committee, Sir John Campbell, did not regard it as necessarily part of the banks' function to use depositors' money in financing a company of this sort. Whether that is a peculiarly Scottish point of view or not I do not know.

8957. *Lord Harcourt*: Scotland was the home of the investment trust movement. Have any of the Scottish investment trust groups formed subsidiary or associated companies specifically designed to meet this question of the provision of new equity capital?——*Mr. Carnegie*: I think it is generally fair to say that Scottish investment trusts have not. Scottish investment trusts have been built up over the years on the basis that they took into their portfolio marketable securities, and a great many of the groups are not prepared to take a high percentage of unmarketable securities into their portfolios. There are exceptions, but there are not very many.

8958. Have any of the groups sought to get round that difficulty by themselves forming a particularised company to do this business?——The only one that I know of is the Glasgow Industrial Finance Development Company, which takes an interest in smaller private firms, the idea being that they should bring them along until they were able to float them off to the public.

8959. *Professor Sayers*: Has there been a big demand for the services of that company?——No, there has not really been a big demand, I would say because when they come to float the company publicly they feel that if they get a London quotation they will have a better market; so that at the end of the day they would rather go to London.

8960. *Professor Cairncross*: Are you speaking of companies with a capital of £50,000, £100,000, or more?——I think they start as that, and they hope that they will grow.

8961. Is it not true also that there is a problem in floating the companies?——*Mr. French*: I understand that that is so. Of course, if I could make a general point, our committee appreciated that it is a peculiarly difficult problem at the present to provide finance suitable for small but developing businesses. There is always a tremendous risk in the thing, and the forceful personalities who are operating these businesses do not always see the risks; they only see the grand prospects ahead if only they can get that money.

8962. You think that one cannot make large profits unless one has that type of personality?——The whole economy of this country was built up on that sort of business, and it is an unfortunate feature of the times that it is to some extent stifled at the present time.

8963. *Professor Sayers*: You keep stressing "the present time". Is this something which is a passing phase, or is not this a problem which is always with us?——It goes back to 1914.

8964. *Chairman*: That marks the point when the local man with resources to spare which he was prepared to venture began to die out?——That would be the beginning of the process. The problem is less acute, but still in our view rather acute, in the case of the small but well-established business that wishes to expand, to raise, say, an extra £20,000. It may be, as Mr. Carnegie said, that in the past the banks did help for a time, on an understanding that sooner or later more permanent arrangements would be made; just at the moment they do not feel able to do that.

8965. *Lord Harcourt*: Do you think that this gap is due to the fact that the company is trying to raise loan capital, whereas it should perhaps be financing itself with equity capital?——*Mr. Carnegie*: I think that is true.—*Mr. French*: It may be; but I have known cases where people would be prepared to give a share of equity, but that rather increases the capital risk.

8966. *Professor Cairncross*: The kind of person you were speaking of before does not like to part with equity, and naturally takes a more favourable view of his prospects?——I would agree that they do not wish to part with control; I was just saying that there are cases where they would be prepared to give a share of the equity, only that may not be so attractive to the prospective lender.

8967. *Lord Harcourt*: It might be more attractive?——It might be more, it might be less.

8968. *Chairman*: Then you pass to the subject of security over moveables. Suppose that there was a great movement in Scotland to introduce the amenities of the floating charge and the equitable security, and this Committee did not exist; what would you do? Is there a Scottish Law Reform Committee?——Yes, Sir. There is a development since this memorandum was sent to you. The Scottish Law Reform Committee has very recently instituted an inquiry on this very subject, and that is very recent news.

8969. What is the status of that committee? Is it appointed by the Lord Chancellor?——By the Lord Advocate.

8970. And it has had referred to it this particular subject for possible amendment to the law?——Yes.

8971. I think that we ought to leave it in the hands of that Committee?——Possibly so. Could I make one point? Particularly in Glasgow and the West of Scotland a large number of American undertakings have recently set

up very large factories, and they are understood to be doing very well. From these circles surprise and sometimes disappointment is expressed at this particular point, that there is nothing equivalent to a floating charge in Scotland.

8972. Do they rely then partly on local bank or other finance?——I would imagine they would do so if they could. They would probably get it where they find it cheapest.

8973. *Professor Cairncross*: The point is most commonly made to you, I think, by people on the industrial estates, who do not own their own factories?——That is so, and who may in some cases even hire their plant.

8974. *Professor Sayers*: You make a proposal in paragraph 64 about Savings Certificates. Is this a proposal that has been put forward through the National Savings Movement?——I do not know whether it has.

8975. *Mr. Woodcock*: You say that the current issue of Savings Certificates has to be held for ten years to reach maturity; it is actually seven years.——*Mr. Carnegie*: That issue was brought into being since this memorandum was written.

8976. *Chairman*: Have we not had the seven year issue since April, 1956?——*Mr. French*: But we still feel that there might in the present context be advantage in an even shorter Certificate.

8977. In paragraph 63 you are dealing with the Savings Banks.—*Mr. Woodcock*: What you say is not altogether fair. You are speaking only of the Ordinary Departments of the Trustee Savings Banks. Do they not have a higher rate of interest in the Special Investment Departments?——Yes, but not very much higher.

8978. We have been told that some are as high as 4 per cent.; in one case it is 4½ per cent.——That certainly is better, but I do not know whether in these times one would necessarily call that an attractive rate.

8979. *Professor Cairncross*: Do you think there would be any increase in thrift if rates of interest were higher?——Our committee thought that, but I agree it is rather a difficult point to prove.

8980. *Professor Sayers*: And that the shorter term Savings Certificates would also encourage thrift?——The idea of shorter term Savings Certificates was to encourage thrift, and also to discourage indiscriminate spending at the time this memorandum was written. You will recollect that a decrease in consumption was not at that time looked on as a bad thing.

8981. Do you think that the rise in interest rates from their level of, say, six or seven years ago has stimulated thrift?——In so far as the savings movement is concerned I would say no, because the rates have remained the same. It may be that if Savings Banks' interest rates had risen during that period deposits today would be greater.

8982. Savings Certificate interest has risen quite appreciably?——It has not got quite the flexibility of a deposit in a Trustee Savings Bank or in the Post Office Savings Bank either.

8983. *Mr. Woodcock*: Have you any reason to think that a rise in interest rates would increase savings; not just deposits in the Post Office, but savings?——All I can say is that that view was generally held in our committee; we realise that it would have to be put to the test.

8984. *Sir Oliver Franks*: It could be argued that it has been put to the test, and that since interest rates have risen personal saving has risen in a very marked degree. There is no doubt about the fact that the two have marched together; the figures show that. The problem is to know whether the one is the cause of the other.——I agree that saving has risen over the period. Our feeling was that the Savings Banks were perhaps a little bit out of step, and that if their rates had risen that continued increase in total savings might have gone up even more.

8985. *Mr. Woodcock*: The sale of Savings Certificates last week went up by £10 million, with no change in the interest rate?——I agree one cannot always account for these particular movements. I understand from general conversation that people are more inclined to save at the present moment than, perhaps, they were even when this report was written, because there is a little more uncertainty.

8986. The £10 million increase was because the limit on holdings was increased; that is not new saving?——*Mr. Neil*: No, that is a transfer.

8987. *Professor Sayers*: You say that your committee took the quite decided view that thrift would be encouraged by higher interest rates. Could you elaborate the reasoning that led them to that view, or was it just a hunch?——*Mr. French*: It was a hunch, but it was the opinion of a number of fairly well-informed people considering the matter as best they might.

8988. *Chairman*: Is it your impression that over the years the Scottish public generally has become more conscious of the differences and importance of interest rates by a process of general education?——*Mr. French*: It is a difficult question to answer. From 1932 to 1951 rates were low; young people have had to be educated, and older people have had to be re-educated, in interest matters since the change of policy in 1951.—*Mr. Neil*: We had some indication about this, not *à propos* saving but *à propos* hire purchase, which reflects people's spending. We were assured by representatives of retail traders on the committee that interest rates had no effect whatever on hire purchase transactions, and people never looked at them.

8989. *Sir Oliver Franks*: It is a question of the weekly payment?——They looked at the weekly payments; if they could afford them they bought the thing, and if they could not they did not.

8990. *Lord Harcourt*: They did not even look at the number of weekly payments very seriously?——*Mr. Neil*: No, I do not think so; the question was whether it lay within the capacity of the weekly income to take it. I suppose to that extent that rather perhaps undermines what we have been saying.—*Mr. French*: Not necessarily, because this is a large country, and some buy by hire purchase and some do not.

8991. *Mr. Woodcock*: If the rate of interest does not stimulate real saving, will not an increase in the rate on deposits in the Post Office and Trustee Savings Banks accentuate the difficulty we have been dealing with most of the morning? Will it not throw money into these that might otherwise be available for industry?——That is a very difficult question to answer, because one is to some extent in the realm of hypothesis. But we did have the feeling that, if the Savings Banks' rate were more flexible, that might be a way of increasing the total volume of savings.

8992. Would you be interested to know that at the Annual Assembly of the National Savings Movement last Saturday a motion to achieve what you suggest in paragraph 63 was defeated?——I understand the Savings Movement as a whole does not in fact share our view.

Chairman: I think that completes our questions; thank you very much, Mr. French. We are much obliged to you.

(*The witnesses withdrew.*)

(*Adjourned until* 2.00 *p.m.*)

The following witnesses, representing the Trades Union Congress, called and examined:

J. A. BIRCH, ESQ., Chairman, Economic Committee, T.U.C., General Secretary, Union of Shop Distributive and Allied Workers,

H. COLLISON, ESQ., Member, Economic Committee, T.U.C., General Secretary, National Union of Agricultural Workers

L. MURRAY, ESQ., Secretary, Economic Committee, T.U.C.,

F. JONES, ESQ., Assistant, Research Department, T.U.C.

8993. *Chairman*: We have your memorandum* in front of us, Mr. Birch, and we have all read it through carefully. It has been very helpful to us, and contains a great deal of informative material for our work. I am proposing, if you will all have it in front of you, to run through it paragraph by paragraph, and we will see what questions arise on it from members of the Committee. You have a point at the end of paragraph 1 about the position of the Bank of England since nationalisation. You say:—

"This transfer of responsibility has not however been reflected in a more revealing account of the Bank's activities in its published returns and annual reports, and an important task for the Radcliffe Committee will be to remove the air of mystery that still surrounds the operation of monetary policy and the part played in it by the Bank."

What have you in mind particularly there? Is it a question simply of enlarged publication of material that you are talking about in "the air of mystery"?——*Mr. Birch*: Yes, so far as information is concerned, that is what we have in mind. We have always thought that there ought to be a closer link between the Treasury and the Bank, and indeed a greater measure of control over the Bank, but the sort of thing we have in mind here is whether a sort of parallel to the Economic Survey could be produced annually by the Bank: a financial survey, a review of the monetary situation and the policy which has been followed during the year and why it has been followed, with some indication too, which we think would be useful, of details of the Bank's open market operations during the year.

8994. Would it follow from what you are saying, if you envisage anything like a financial review of the year, which would obviously enlarge upon questions of policy and the policies followed, that you would want to be sure that there was a very close relationship between the Bank and the Treasury?——Indeed; closer than there is at present, both in the governmental interconnection and in the actual control of the Bank's operation.

8995. Since you are speaking of what you say as a lack of adequate connection, what is your criticism?——We have not made any pronouncement on the recent Parker Tribunal Report, but we should have thought that there was a case for reviewing the governing body, and for direct representation of the Treasury on it.

8996. *Professor Cairncross*: At the official level?——Yes, indeed.

8997. *Chairman*: Mere representation on the official level might not be sufficient to make very much difference?——The two things would go together. If more information was published, I think that that would reveal if there was not the kind of control being exercised or the close working which we want to see.

8998. *Professor Cairncross*: How do you think it would reveal that? Would not the Bank of England be at special pains to make sure anything they said was endorsed by the Treasury before publication?——Presumably it would only report on what it had actually done. There would be no "cooking" of the report, in the sense of meeting anybody's wishes; it would expose any differences, if there was not a full inter-relationship between what the Treasury thought should be the policy and the actual working of the Bank.

8999. Are you envisaging then that what the Bank of England would normally produce would be something that was fully in line with what the Treasury thought, or are you assuming that the Bank of England might take an independent line from time to time and underline what it thought in its annual report?——*Mr. Birch*: We would not expect the Bank to become a political instrument of the Government any more than the Treasury itself is. After all, the general principles on which the Treasury works whatever Government is in power would be applicable. It would not be a case of political control in that sense.——*Mr. Collison*: Is there not some confusion here? The idea we are mooting is that the report should explain what has been done and why it has been done. It should not seek to make or dictate policy but just to explain the reason for action taken.

9000. *Sir Oliver Franks*: When you say that you have doubts about the existing relationship between the Bank and the Treasury, those doubts might centre on uncertainty about whether the Bank and the Treasury each always know about the other's broad policies or, even if they do, whether they always act on the same broad policies. But one could imagine a situation in which there was a good deal of collaboration and exchange of thought on broad policy but the two institutions each rather went their own way on day-to-day operations; and of course the day-to-day operations would be making policy by accretion, so to speak. When you express the views that you do, is it lack of contact in all the day-to-day workings, or lack of contact in the making of broad policy, that you have primarily in mind?——*Mr. Birch*: Obviously we, and I think the country, would want to be assured that the day-to-day operations of the Bank were in conformity with the long-term policy, or the policy for a given period, that the Treasury had decided upon. We are not accusing the Bank of not being in line; it is just that we do not know whether they are. There is not the information available from time to time. We get the suspicion, which may be quite unfounded, that the Treasury is really being forced into positions of having to accept situations by reason of the Bank's actions, but there is no real evidence at the moment.

9001. If one has doubts and is not sure, there must be some reason for doubting. Presumably over a period of time you have wondered at some things that have happened, and thought it possible that they showed a divergence of initiative?——Yes.

9002. What sort of thing makes you have the doubts?——*Mr. F. Jones*: Perhaps we could give a fairly recent example. In July last year the Chancellor in the House of Commons made a speech on the economic situation in which he referred to what he called the wage-cost inflation; in the course of it he said that deflation alone was not the answer. But in September, by when, it is true, the economic situation had worsened externally, the Chancellor's pronouncements were very different on inflation. He put great emphasis on cutting demand; he put great emphasis on other things, too. From our point of view there was quite a change in the Chancellor's view of what policies were appropriate between July and September; and we feel that the Bank had probably a great deal to do with what happened in September. What we do not know, though at least we have a clearer idea now as a result of the Tribunal, is just what relationship there is between the Bank and the Chancellor, and how far the Bank can, by its views of what should happen to Bank Rate, even precipitate some action on the part of the Government which we might question. These are things about which we cannot in fact be specific, because we are not inside the circle of the Government in which these decisions are taken. But we have doubts.

9003. And that was an occasion for doubting.——That was an occasion for doubting.

9004. *Mr. Woodcock*: Take, for example, today's reduction in the Bank Rate to $5\frac{1}{2}$ per cent.; is your point that it will be left to people to speculate on what is behind this move?——*Mr. Birch*: We may get, some time after the event, perhaps next week, a statement from the Government which may have some relationship to this move. Then we shall wonder whether the move was made knowing that the statement would be made, or whether the statement is made after the event in order to reconcile it with Government policy.

9005. *Professor Cairncross*: May I be quite clear on this? I am not now speaking about the annual financial

* Memoranda of Evidence Part VII No. 15.

survey, where I think what you are asking for is a factual account of the events of the past year, but of the relationship between the Treasury and the Bank of England. Is it your view that, if there is a disagreement between the two, that disagreement should be brought to light and should be made known to the public rather than be hushed up and fought out inside the Government?——That is really the whole point of our suggestion here. These things after all are matters of very important public policy, and the obscurity that sometimes seems to hide them is not a good thing from the point of view of public opinion.

9006. But is it also your view that there should be disagreements from time to time between the Treasury and the Bank of England; that the Bank of England should not be obliged always to accept without question the view of the Government?——That is bound to happen under any kind of system. Presumably there will be differences in the Court of the Bank now. We are not suggesting that every difference of that kind should be the subject of public debate; but on the major course of activity for which the Bank is responsible, which has an important bearing on Government policy, and on which in turn Government policy has an important bearing, if there are differences then I think it is proper that the public should know about them.

9007. *Chairman*: It is sometimes said that in America they have a system under which there are two independent forces, the Federal Reserve on one side and the Government on the other, and that they are both able to report to the public what their views were and what their policies were. That may be a right or a wrong account of America; is it what you think would be healthy in this country?——*Mr. Birch*: No, I do not think so. I would not like this to be the subject of acute political differences. Many organisations are interested in this; we ourselves are interested in this from the point of view of the unions who have to decide their own policy on wages and other matters. I suppose it can be said from the point of view of business itself that it has to speculate; it has to decide what is going to be the line of policy in the coming months. I think it would remove a good deal of speculation if these things were discussed more openly than they are at the present time, and it would be to the advantage of both sides.—*Mr. Murray*: We do not envisage that the Bank on the one hand and the Treasury in its Economic Survey on the other are going to produce radically different reports of what has happened during the year, and disclose radical differences of policy. We think that the Bank itself may be so acutely aware of the danger of this that it will in its own actions tend to conform more to the Government's needs and desires on policy than perhaps it has up to now. If it is conscious that at some stage it will have to make a report, and that those who read between the lines will seek to trace divergences, the Bank will want to avoid that kind of thing and will therefore tend to harmonise its policy with and become more responsible and responsive to Government policy.

9008. *Sir Oliver Franks*: So, turning it the other way round, you do not feel any reason for doubting whether at present or over the past few years the Bank might not be too readily subservient to the Treasury and Government views?——*Mr. Birch*: No, we would not take that view, not on the experience of the last few years; indeed it is very difficult to think back to any time when that could be said.

9009. *Mr. W. E. Jones*: Is not this an appeal to establish clarity and remove mystery?——*Mr. Murray*: There is mystery in another sense: the public at large, including many trade unionists, are only dimly aware of what happens in this field, and we feel that it would be beneficial to them and give them a better general understanding of some of the mystique which surrounds these operations.

9010. *Professor Cairncross*: You would agree that where a change in Bank Rate is under discussion it is rather difficult to have two points of view ventilated in advance?——*Mr. Birch*: Yes indeed; one has to consider the whole position of foreign opinion and so on. It would not be possible to bring all these things into public debate before the event. But even after the event this mystery persists, and we see no advantage to be gained from the point of view of foreign exchange or anything else in perpetuating this once a situation has clearly developed. I think it would help the public (I am talking, of course, of the informed public) and the people who are responsible in various organisations for guiding policy to assess what is happening now and what may happen in the future, if they had some such account as this of what was done last year, why it was done and what the effect was.

9011. Your suggestion earlier was for an annual financial survey. Do you feel that something more frequent than that might be of service?——The statistics that are published now could be very well examined to see whether they are still the ones that are desirable in the context of present conditions, or whether they should be enlarged. I mentioned an annual report because we were trying to draw a comparison between the Economic Survey and a financial survey; the two things would probably help each other.

9012. You do not think a monthly bulletin or report, even a brief one, might help?——We have not considered that as a firm proposition. As I said, we feel that there is a case for reviewing the statistics that are published now, seeing whether they meet the needs of today and whether they should be revised in any way or increased.

9013. *Sir Oliver Franks*: Suppose there was this annual financial report as the sister or brother of the Economic Survey; if the explanation of the background against which an important move in Bank Rate has been made, and therefore the reasons justifying it, are to have the clarifying force which I think you were desiring, then would not that statement have to be made not as part of an annual survey but pretty well concurrently or just after the change? Are you not asking for that too?——*Mr. Birch*: Yes.—*Mr. Murray*: We are rather pushing at an open door, as it appears to have been the intention of the Governor himself to give more publicity to decisions and reasons for decisions. We think this is carrying it one stage further in the same direction as he is desirous of going.

9014. *Chairman*: I take it the instrument chosen must depend on the people using it; but by and large your theme is: "Tell us more what you have done and tell us why you have done it"?——*Mr. Birch*: Yes.

9015. *Professor Sayers*: You are looking for these statements from the Bank of England?——Yes, the Bank would be responsible.

9016. This would not be an agreed Government statement?——No; it would be independent, in the sense that it would be an explanation by the Bank of what it is doing.

9017. These points about the desirability of hearing more from the Bank seem to me to be based on the assumption that you do want a separate Bank of England, separate in the sense of being a body that has its own independent and decided views, although it is working in with the Treasury. Am I right in that?——*Mr. F. Jones*: Certainly not independent in the sense of making policy; but independent in the sense that the Bank has a day-to-day job which is quite different from the day-to-day job of the Treasury, and which will presumably continue. We are anxious that at the policy-making level it should be abundantly clear that the Treasury view, reflecting the Government view, is the one that prevails, and that there should be no separate Bank view of policy. We envisage that the Bank itself will make statements about the Bank's actions, and will explain them very much more clearly than perhaps has been done in the past.—*Mr. Birch*: If I may risk an Irishism, we are saying in effect that we can have a Bank which is still independent to a large extent in its functions but is a good deal more subservient to the Treasury than it is at the present time.

9018. You are in fact drawing a distinction between its technical operations and the decisions on policy?——Yes.

9019. But if these commentaries, these statements on changes in the direction of policy, were to add anything, they would have to be based on the fact that the Bank had not merely the capacity to conduct technical operations but had a mind of its own. Are you prepared to concede that measure of independence of thought?——*Mr. F. Jones*: It would have a mind of its own, but we think that any statement it made should be agreed with the Government. It would have a mind of its own because it would be engaged on specific tasks.

9020. Is there not a real difficulty here?——*Mr. F. Jones*: There is a difficulty, yes.—*Mr. Birch*: It is where

technical operations merge into policy that the difficulty arises. I do not think we would like to be very dogmatic about that point. Indeed one of the difficulties is that to make firm proposals or suggestions in this direction one would have to have the information first, and that is not readily available.—*Mr. F. Jones*: Sometimes we have been confused because of partial explanations. When Bank Rate went down ½ per cent. at the beginning of 1957, the Bank's explanation was that they were following the market, but we know that, if the Bank had wanted the market to do something rather different, it could have had a considerable influence upon it. The Bank said that reducing Bank Rate was a technical matter: but it had policy implications. It is this sort of mystery which we want clarified.

9021. You did not accept the statement that it was a purely technical operation?——No.

9022. *Sir John Woods*: You were not satisfied with the Bank's explanation that it was a technical adjustment following the market. What other form of explanation would have met your views at that time?——*Mr. Collison*: The technical operations of the Bank are in pursuance of a policy which should in our view be Government policy. The technical operation is undertaken by the Bank. The explanation they should give is just as to the detail of the technical operation and how this affects the pursuance of policy.

9023. *Professor Sayers*: You would confine your annual reports and so on to that kind of statement?——No; that is apart from the annual report. I am talking about a statement on such a thing as a change in Bank Rate: a technical operation which has an end of Government policy in mind. The Bank's explanation should be that they have done this as a technical operation in pursuance of a certain policy.

9024. *Sir John Woods*: If you were unhappy about the explanation which did in fact come from the Bank at that time, what sort of other technique would have resolved your troubles?——*Mr. F. Jones*: We should have liked a further explanation than we were given. The one we were given did not seem to stand up completely, because what was not said by the Bank was why in this instance they were prepared to follow the market and were not wanting to influence the market.

9025. *Mr. Woodcock*: Was not this a case where you got what you wanted; you got an explanation?——We got an explanation which we felt was only partial.

9026. *Chairman*: If it was really a technical operation what more could they say to explain it than that it was a technical operation?——*Mr. Birch*: A lot of so-called technical operations these days are really policy, or have an effect on policy, on which there are acute differences of opinion.

9027. *Professor Cairncross*: The more technical this is the more difficult it becomes to distinguish the Bank of England view from the Government view?——We are not here to represent the City in any way, neither are we here to decry the City and its operation; but we feel, and I think a lot of our people do, that the Bank is still too close to the City, and that that is not necessarily a good thing from the point of view of the national interest and Government policy. That is really the underlying point; we are trying to put it quite mildly, without provoking any harsh feeling about it.

9028. *Chairman*: I should have thought you might have said that there is so little general knowledge about what is involved in calling a Bank Rate change a technical operation that it is not enough to explain it by saying it was technical?——Thank you very much, Mr. Chairman.

9029. *Professor Cairncross*: Is it your view that relations between the Bank of England and the Treasury should be very much the same as relations let us say between the National Coal Board and the Ministry of Power, or do you see differences?——It is an interesting line of thought. We have always said that industry should serve the nation, and we think that is equally true of the financial industry. I do not think you could carry the parallel too far; there are so many different forces at work in the City, and it is not the same as a straightforward industrial process. But by and large it is a question of whether the Bank is, and is clearly seen to be, serving the national policy, or whether it is serving some narrow interest in the normal market operations of the City. That is really as far as we can go.

9030. *Sir Reginald Verdon Smith*: I still find it difficult to follow the distinction you are drawing. Is it that you are unhappy about the present relationship because you know of circumstances in which you feel that the Bank of England has acted in a manner contrary to the national interest; or is it that, not having been informed, you fear that there may at some time be such a situation; or is it a conviction that there ought to be a different sort of relationship between the Bank and the Treasury, and the Bank and the City?——*Mr. Birch*: It may be that if we had more information we should not be so suspicious; we should not be saying there is a need for this closer relationship. When we are considering our own statements on economic policy, we have to use the information that is available, and our general feeling at the moment is that we ought to press for this bigger measure of control by the Treasury of the Bank. If more information proved that that was an unnecessary measure, that there is a greater connection and greater control than we suspect, then obviously our point of view would be modified to that extent. That is why the question of more information and the question of control are linked.—*Mr. Murray*: We are in very much the same position as we often are in relation to the activities of industry itself; there we are, perhaps not unnaturally, suspicious and curious, and we wonder whether certain things are happening which eventually we find out are not in fact happening. That is all we are asking for in relation to the Bank.—*Mr. Birch*: As we say at the end of our first paragraph, we are not just asking the Bank to do this; we are hoping that your committee may be able to shed some light on this problem as a result of your deliberations.

9031. *Professor Cairncross*: When you initially introduced the subject of closer relationship between the Bank of England and the Treasury you spoke of Treasury representation on the Court of Governors. Had you thought about the staff of the Bank of England in relation to the staff of the Treasury here? Have you any views about relationships between the two?——*Mr. F. Jones*: Part of the difficulty as we see it is that the Bank is very much a separate body with its own staff. It appoints its own staff, and we have doubts as to whether the Bank staff and the Treasury staff at a policy-making level and even lower down really see eye to eye, and about the sort of training the Bank people are given that the Treasury people do not get, and *vice versa*. One of the questions in our minds is how far it is necessary to have interchange of staffs. But these are not matters on which we have come to definite conclusions, and certainly not matters which we could include in our written evidence. These are matters which we look to you, with your better facilities for getting information and seeing people, to tell us more about.

9032. But you had thought of an interchange between the two as a possibility?——The position of the T.U.C. is that, because of the difficulty of reaching final conclusions, we have not made any recommendations as to what should actually happen; but we are telling you what is in our minds.

9033. *Mr. W. E. Jones*: Does your inquiry go to the extent of consultation within the two departments as well?——Yes. Part of the difficulty is that we do not know how much consultation already takes place; but again we feel on the whole from what we hear that very little does take place, and certainly not enough.

9034. *Mr. Woodcock*: But you would be a good deal more satisfied, if not happier, if you knew just exactly what happens?——Precisely.

9035. *Chairman*: These are points which you are directing our attention to rather than trying to solve for us?——*Mr. Birch*: If you please.

9036. Perhaps we ought to pass on.——*Sir John Woods*: At the end of paragraph 4 you say: "interest rates were kept low". The short rate was kept low; but did the long rate remain stable?——*Mr. F. Jones*: The long rate was not stable; it did in fact reach about 3½ per cent. before the Labour Government went out of office; but we would certainly consider that low compared with the present.

9037. *Professor Sayers*: There was a rise?——Yes; once the Dalton "cheap money" policy had been given up, then the long-term rate tended to reflect market forces.

9038. Would you say that it was raised?——No; it was allowed to go up. The Government had been trying to keep it down and gave up the attempt, really from the time of Sir Stafford Cripps. I do not think there is much doubt as to the quite clear change in Government policy from an attempt to force the long-term rate down when Dalton was Chancellor to one of allowing the long-term rate to go up once that policy was abandoned.

9039. That indicates that there was a choice here?——*Mr. Birch*: It is a matter of speculation as to how far this would have gone. Whether the Labour Government, if it had continued in office, would have felt it desirable to take some special steps to recover the position one cannot say.

9040. I am not thinking of what would have happened if the Labour Government had continued in office; I am thinking of what did happen during their period of office. I think you said it was allowed to rise?——*Mr. F. Jones*: It must be said that the market ceased to believe that the Government had the power to force the long-term rate down to 2½ per cent. and keep it down. There was a moment when 2½ per cent. was achieved by Mr. Dalton, but afterwards the long-term rate moved up. The question is one of great difficulty, and I do not think any economists or financial people have really decided how far the Government could have gone on and how far in fact it was forced to stop; but there was a change in policy. There was a Government decision no longer to try to compel the market to accept 2½ per cent. You are asking whether the Government was forced to do that or whether the Government could have continued to force the market. Perhaps the answer would be that the market could not be driven too far without other things having to happen; and one of the factors was the external situation, which of course was deteriorating. We recognise that there are limits to how far the Government can go in manipulating the long-term rate of interest, but on the whole we are inclined to think that the Government can do very much more with the long-term rate of interest than allow the market to determine it; we think the Government can play quite an important part.

9041. And you think it could have done during this period?——You are asking us to answer a question which I do not think can be answered. I do not think there was any real agreement at the time amongst Government advisers and other economists as to what should happen.

9042. *Chairman*: That brings us to the point in paragraph 29, where you are dealing not with what might have happened in the past but what should happen in the future. Are there any questions on that?—*Professor Cairncross*: As I understand it you are putting two propositions to us: (1) that movements in the rate of interest do not have the effect on investment that perhaps at one time they may have had, and (2) that movements in the rate of interest are subject to a measure of control by the Government. What precisely is this measure of control? In the last sentence of paragraph 29 you refer to "direct open market operations designed to influence long-term rates". What kind of operations have you in mind there?——We envisage that it would not be necessary for the Government to do more than sell long-term stocks, to have the effect of keeping the medium and long-term rates of interest up; or buy, to keep the rates down. That is the sort of operation the Government is able to follow if it wishes.

9043. You would have the Government operate in its own debt?——I see no reason why it should not do that.

9044. *Chairman*: Have you considered the effect upon those who deal in the market, and their confidence in the market, if the Government were known to be operating for this purpose?——We feel that the situation would not be so very different from the one at the present time. If the Government moves the Bank Rate with the intention of affecting other interest rates, then it seems to us that the market is bound to know the view the Government is taking. In the same way, if the Government operated in its debt, the market would be bound to know what view the Government was taking.

9045. *Professor Sayers*: If the Government tried by this means to keep rates down, but the market broadly took the view that this position the Government was taking up was not likely to be tenable for any considerable length of time, would it not have the purely technical consequence that the Government would have to buy an enormous amount of long-term securities? They would have to monetize the debt, as we say, on a very big scale indeed?——*Mr. Birch*: This would not be happening on its own; there would be other actions by the Government in other fields.

9046. We will assume that Bank Rate would be kept down at a very low level and so on; but you might still have the position which monetization of the debt had to proceed a very long way?——Yes, that is conceivable.

9047. Did not the Dalton episode underline that?——Yes.

9048. Would you see any disadvantage in monetization on a very big scale?——*Mr. F. Jones*: It is linked up with the Government's Budget policy and the question how far the Government should maintain an overall surplus, and how far economic circumstances were such that that sort of action was appropriate. We see that the Government cannot necessarily state and enforce what rates of interest should operate, because the market does have a definite influence; but if the Government can create a climate in which the market thinks that certain interest rates are appropriate because of other things that the Government is doing, or perhaps because of what the Government is doing itself in the field of interest rates, then it seems to us that there is no difficulty, and no reason why the Government should not do this.

9049. Are you not assuming the problem away in saying that the climate of opinion has been produced? I am envisaging a situation in which people are unconvinced. Monetization of the debt only occurs because the market is unconvinced. Would you not accept that as a possibility?——Indeed yes. We do not only make the point in paragraph 29 that all rates of interest in addition to the short-term rate should be brought down; we can also envisage circumstances in which it would probably be impossible to bring medium and long-term rates down. We think the short-term rate can always be brought down, but we can see conditions in which it will be impossible to bring medium and long-term rates down, and in which indeed it might be necessary for the Government to keep medium and long-term rates up.

9050. *Professor Cairncross*: You attach more importance to the short-term rate being low in practically all circumstances than to the long-term rate being low; is that fair?——*Mr. Birch*: Within limits.

9051. You can visualise circumstances in which it might be appropriate for the long-term rate to be rather higher. Is it also one of your contentions to us that, if there is inflation in the system, and if the inflation is tending to react on long-term rates of interest, you would prefer to try and put an end to the inflation by other means, and hope that that would then stabilise the rate of interest, rather than to use the rate of interest itself to put an end to inflation?——That is the main burden of our paper.

9052. *Professor Sayers*: You would seek to avoid this position of monetization of debt by Budget surpluses and so on, on such a scale that there would be no upward pull on the rate of interest?——*Mr. F. Jones*: I think we would like to put it this way: in such a way that there would not be too much pressure on physical resources.

9053. Because it is the pressure on physical resources that is really at the back of the long interest rates?——Yes.

9054. You are really saying not that the rate of interest should be kept down as a matter of policy, but that the kind of conditions in which the rate of interest is liable to rise should be prevented by other methods?——*Mr. Birch*: Yes.

9055. *Chairman*: Is it inherent in the position you reach by paragraph 29 that in the modern economic and financial conditions there never can be any good reason for a high short-term interest rate? You have disposed of the idea that it is useful to attract foreign funds on any scale, and you say that it is primarily the Government which is affected by the cost of borrowing today; and therefore you are arguing that really there never can be a good purpose for maintaining a high short-term interest rate?——It is the absence of what we consider to be the other available methods of controlling the economy that makes the consideration of this necessary. We were in some little difficulty in preparing our evidence because we could not

consider monetary policy in isolation; there are all the other factors and influences at work. The emphasis we have tried to put in our paper is on the relationship between monetary policy and these other weapons of control. Therefore a question as to long-term interest rate policy without reference to what else is happening in the economy is really almost impossible to answer. If the Government do not do certain things, then they have to fall back on this policy of monetary manipulation. We think that it is not necessarily going to produce the results, or that, when it does produce the results, it produces other things as well which create other problems for the Government to solve. That is why we are trying to keep these in balance with the other measures we think should be taken.

9056. *Professor Cairncross*: But you see value in it as a long stop; you see circumstances in which other measures might not have been taken in time?——It is really a confession of failure in other directions if that has to happen.

9057. *Professor Sayers*: You do envisage the possibility of raising medium and long-term rates sometimes; but if that occurred you would regard it as evidence that the Government had failed in its other measures?——Yes.

9058. *Sir Oliver Franks*: Or perhaps that the world had failed us?——One cannot treat this in isolation from the general movement. That raises the whole question of what we should do in the international field, and what kind of agreements we should try to get. This continually widens out from one aspect of policy to another.

9059. I quite agree; the only point I wanted to make then was one with which I think you would not want to differ: that for good or ill this country is very exposed to external influences, and they in turn set a limit to the extent to which we can get our own affairs the way we want them independently of the way of the world outside?——*Mr. Collison*: And the effect on the attitude of the world outside if we control our own affairs; they might not let us down.

9060. *Professor Cairncross*: If we were in a period, as we may be now, in which pressure on capital was very intense and the opportunities for employment of capital were particularly remunerative, would you think it right to give way in part to that pressure by letting long-term rates go up, even though you might throw the main burden on the Budget and on public savings?——*Mr. Birch*: We do not see anything wrong in using some discrimination. We think there are certain projects of such importance nationally, in regard both to industrial production and to welfare, that the Government itself ought even to fix a rate of interest in order to ensure that the policy is going to be successful. One of the things we are very much concerned about in the present situation is the way in which the use of interest rates and the general trend of Government policy is non-discriminatory. It could even be said that it is encouraging or allowing things which we think are less essential at the expense of things which are essential. Therefore, as we say in dealing with the Public Works Loan Board and Government financing in this paper, we see no reason why there should not be some discrimination shown at certain times in interest rates themselves.

9061. That is discrimination between different types of borrower. I had in mind rather that you might be prepared to visualise some rise in the price of capital when the shortage of capital was particularly acute. I was asking whether you would rule that out, and rely entirely on trying to adjust the supply of savings?——*Mr. Murray*: We should be prepared to admit that there may be circumstances in which the pressure is so high that the Government have to give a little bit on the interest rate so that it will move more quickly than the attempts to stimulate savings. We recognise also that, for example, if there is very great pressure of overseas demand on the London capital market, this may be one of the ways, possibly in addition to exchange control, in which the Government might try to stem this down. This is not the only way to do it; there are other techniques. But this can help in a situation which suddenly emerges.

9062. *Sir Oliver Franks*: Are you not saying that we are in a mixed economy, and it is a matter of opinion what part the market should play and what part administrative decision; that you feel there is room for both, but that on the whole the important role should be played by administrative decision, the balance being the play of the market, rather than letting the market take care of it, with administrative decision only where it is necessary?——*Mr. Birch*: Yes.

9063. *Professor Cairncross*: Are you not going further than that? Are you not introducing not only administrative decision but political decision? Is not the size of the Budget surplus something that has to be decided by Parliament?——*Mr. Birch*: We go further in this respect too: we very much doubt the efficacy of market operations to do the job they are intended to do.—*Mr. Murray*: In any event political decisions allow the use of all three sets of techniques; administrative controls involve political attitudes.

9064. *Sir Oliver Franks*: You mean a judgment of the social value of the political and economic ends pursued?——Certainly.

9065. *Professor Cairncross*: A decision on the size of the Budget surplus is not one decision but one of a set of decisions about what is to happen to taxation or public expenditure and involves squaring a great many people once a year. It is a form of decision that may be rather more difficult to take, as a means of control, than other types of administrative decision or market operations. There are limitations, in other words, to the use of the Budget surplus?——*Mr. Birch*: That is democracy.—*Mr. Murray*: There is a deceptive simplicity in the use of interest rates which might not on occasion outweigh the disadvantages.

9066. *Sir Oliver Franks*: How clear are you that in peacetime one can mark out with certainty essential from inessential projects? I do not mean, say, a new strip mill on the one hand and an addition to a cosmetics factory on the other; I mean more broadly and seriously than that. In wartime there is an obvious yardstick; one can relate everything to the one purpose. In peacetime it is much more difficult to define the purpose and therefore to define essentiality. One cannot say that it is only primary industry which is essential because without the manufactured product one cannot export; and so on. Yet a good deal of the argument for weighting the role of administrative decision turns on the ability safely to distinguish between essential and inessential over a fairly long term for the general welfare of the country and its economy. Could you develop that a little bit?——*Mr. Birch*: That is the biggest problem of any Government today; and we think it should be a Government problem. There are certain criteria the Government can adopt; there is the need for more exports, always taking into account what has to be imported in order to provide those additional exports; there may be complications, but that is the sort of thing that can be ascertained. The Government must have very close contact with industry, and with the general picture of overseas markets: where exporters are meeting competition, where we are falling down on export markets and so on. Then there are certain welfare services to which we attach the greatest importance, not just from the social point of view but because of the effect of maintaining those services on the general level of demand; the position in industry, relations between unions and employers; and so on. Then another criterion, and a very important one, is the extent to which for a given amount of investment we are going to get a return in production. These are things which are calculable. Certain basic industries are capable of being "automated" to a greater extent than they have been up to now, with immense results in increased productivity and production. There is a feeling on our side that in some respects we are falling behind in that direction, and not really getting the kind of investment we want that is going to produce the best results in the quickest time. I agree that those are very broad criteria, but nevertheless it is not impossible on that basis to begin to formulate priorities. We think that that is a job for the Government, not in the sense of a job for bureaucracy but a job for some overriding control after taking into account all the methods of consultation and advice from industry which can be obtained. Mistakes may very well be made in trying to do that; but are the mistakes that are likely to be made any worse than just leaving this thing to the market, with the results that we have had in the last few years alternate credit squeezes and investment booms, and yet at the same time no increase in production?

9067. *Chairman*: I follow the point that you must not mind mistakes being made because they may not be as bad as a system which does not even recognise the possibility of making them. But I find that your answer does not deal with this aspect of it: if the Government are going to control credit by distinction between essential and inessential, they cannot, I imagine,

hope to do that centrally. They can have central definitions of the kind we have seen in the directives to the C.I.C. and the banks, but in the end, as your own paragraph 22 envisages, it is the bank manager who is left to interpret a series of phrases in his actual recommendations that credit should be given to one and not to another. He is left to try to choose between what he thinks, with what help can be given to him, is essential or not essential, what is likely to help exports in our complicated economy and what is not. Is it not very difficult to rely upon that system for effective distinction between essential and inessential, because it breaks down into so many people with rather vague instructions?——*Mr. Murray*: Bank credit would not be the only technique that was operating; there is the possibility of fiscal discrimination, as the Millard Tucker Committee themselves recommended; and the C.I.C. on a much smaller scale has been able to differentiate between different kinds of operation for the purposes of advances of credit, and to do it quite effectively.

9068. Bank credit is quite a large element; but I really wanted to illustrate the difficulty by speaking in terms of bank credit?——We are conscious of that difficulty, but, if we are asked what the alternative is, given the starting assumption of scarce resources and increasing needs, we are almost driven to this point.

9069. *Sir Oliver Franks*: What is the fundamental objection to the market in your view? Is it in the end an ethical objection, that the "play of the market" in the end reduces to a play of forces in which human quality and decision play little part, whereas in administrative decisions human purpose and human decision do play a part and are effective, so that the one is ethically justifiable and the other not; or is it a belief, which you think could be proved by experience, that the fruits of the one are good, the fruits of the other bad?——*Mr. Collison*: That one system is better, or more effective.—*Mr. Birch*: This has been a changing situation over the years. At the present time the attitude of the trade union movement towards a free market is mainly that it is inefficient in serving the public interest. After all, we have not for very many years had in this country eastern bazaar trading conditions, which are the ultimate expression of the market. That has had to be modified down the years, and I do not think anyone advocates that sort of indiscipline at the present time. These things are questions of degree; our attempt all the time has been to try and assess the best way of serving the public interest. We are quite convinced that what may be a profitable exercise in the market is not necessarily in the best interests of the general public and its social purposes. It is a mixture of the ethical argument and the argument strictly on the basis of efficiency. We think that it is perhaps a good sign that in many parts of the country now (and this is not something that is confined to political parties or trade unions) there is a realisation that these things cannot just be left to every individual to make his own decision and then play according to his hunch or his expectation of profit and so on.—*Mr. Collison*: The Chairman pointed out that the method of administrative decision cannot be 100 per cent. perfect in operation; but we feel very strongly that that is no reason for relinquishing the principle. We know this is an imperfect world, and one cannot be absolutely sure; but one can be sufficiently sure to make it possible to get much better results in this way than by relying on the commercial market.

9070. I agree that these things are in the end matters of degree as well as of principle, and that the extreme of the market is not the model for all; but what happens if you turn the argument round the other way? You have what must inevitably be a very small group of men, removed from any direct acquaintance or knowledge of the things they would be deciding about; almost inevitably, in fact, civil servants, because these are not things that Ministers really cope with, though they accept the recommendations. How secure are you going to be, again talking in terms of degree and not principle, from large and spreading errors of judgment? This small group of people, with the best will in the world, might choose the wrong main road to go down. Is that an equal and opposite risk to the risk you are describing with the market? Can there be any security against error?——*Mr. Birch*: A good deal depends on the approach of the Government and Government departments to this. It is a welcome sign that there has been a closer working in recent years between the civil service and industry; I am not speaking just of consultative machinery but of a general realisation that these are not things which can be dealt with in water-tight compartments. That is in addition to the fact that in a democracy one has people raising views in Parliament and public opinion.

9071. You want checks on wise decisions?——*Mr. Birch*. Yes, I think so. We would wish to develop them in the proper way. There is a growing realisation of the dangers that occur if the state does not, at the same time as it centralises these matters, provide for proper consultation and for representatives of consumer organisations as well as manufacturing organisations and labour organisations to have a part in understanding the decisions that are made, and an opportunity of being able to ventilate their views if they feel that a thing is going the wrong way. I think the biggest safeguard against the dangers you point out is the knowledge that they exist. —*Mr. Collison*: If one has to choose, would not one always choose responsible judgment, provided it is the judgment of integrity, accepting the fact that mistakes can be made? Is it not better to accept judgment rather than chance, though perhaps when I say "chance" I am exaggerating slightly?—*Sir Oliver Franks*: In the most perfect society of all, ancient Athens, they chose their chief officers by lot in order to make sure of fairness.

9072. *Professor Sayers*: Is not Mr. Collison misrepresenting just a little, if I may say so, what happens when things are left to the market? What happens in the market is not a matter of chance; it follows from human decisions, or the decision of the man who wants something. He wants it sufficiently to offer a price. Now we know that, in various ways and in certain directions, we do not want that offer to have the consequence that he gets the something, and we see to it that he does not get it. But, if a great many of the activities of the economy are allowed to follow that guide, that is so much the less for any governmental body to have to decide, to have to consult others about, and so on. Is it not essentially a matter of the economy of time, how far you allow the individual's decision to offer a price to determine the economy in certain directions? It is a matter of degree?——*Mr. Collison*: Yes. I said that I was exaggerating when I compared judgment with chance; but the comparison can still be made, and, as Mr. Birch says, you get cases, when things are left to the open credit market, where mistakes of direction are made. —*Mr. Birch*: I think, too, that this argument has to be placed in the context of modern conditions. Obviously no one is going to prescribe that we should have some national machinery to determine the colour of the socks which shall be sold in shops and things of that kind. But so many of the decisions that have to be taken in industry today are of immense significance one way or another, and the cost of a mistake now is much more than it was fifty years ago, when there is such a concentration of manufacturing capacity in a few large hands. This is part of the general development which is going on, which has been very much accelerated, and which has to be even more accelerated in the future if we are to keep pace with the general development of the world, even if it is on different lines from the pure economists' theory of the market. I say that with the utmost respect. I might put it this way: I would not mind, as an ordinary citizen dependent for my standard of living on what business is doing, leaving to the play of the market the small things such as the provisions of my little essentials; but when it comes to deciding on steel production and coal production and the services of major transport undertakings, I prefer to have some say in that; I am not prepared to leave it to the forces of the market and to the decisions of different businesses, knowing full well that if they make the wrong decisions the consequences are very much greater than ever they were in the past. No one is suggesting that we should have an economy regimented to the extent that every particular aspect and facet of our lives and every particular commodity we use has to be determined by some national plan; but on the other hand, when it comes to the basic fundamental questions, to those things on which we all depend, fuel, power, lighting, heating and all such things, including transport, I am sure that I would rather take the risk of national planning and have some national governmental authority's decision rather than have the decisions of some individual undertakings.

9073. You say no one has thought of suggesting that we should all be regimented; that is true. Equally no one has suggested that the market should be left free all the way. I may very well be more on the side of regimentation than you are. These are matters of degree: that is all I am suggesting to you; and it is a matter for opinion and argument as to how far, in a set of markets, you push the decisions on to a central machine and how far you leave them to the pull of the market. Would you agree about that?——Yes, it is a question of degree.

9074. *Sir John Woods*: Accepting that one does not try to regiment everything, but just the important sectors of the economy, from the centre, bave you given consideration to one, as I think, entirely practical point? I had some experience of this when I was one of the "gentlemen in Whitehall", and it appears to me that one can only come to views and decisions about these things on the basis of a really very considerable mass of information. That information has to be collected, and my experience is that in the process of collecting it one invariably gets at least three months out of date. The result is that decisions are delayed and, because the situation has changed in the meantime, they may be wrong: they may even be badly wrong. There is a possibility that if one carries this idea of central determination as between essential and non-essential, desirable and less desirable, too far, one is very liable in fact to be wrong in a rapidly-changing world and in a very complex economy; and not only to be wrong, but in the process to delay decisions which really ought to be taken. Do you consider that to be an important point or not?——Yes. With any national planning there must be provision for the most up-to-date statistics to be available that it is possible to obtain. In a sense they never will be up-to-date; at a meeting held today one cannot know what the position is today for the whole range of operations one has to discuss. There is room for improvement in our statistics; Sir Reginald Verdon Smith and I sat on a committee on the census of production statistics for eighteen months, and we found some of the problems that arise in collecting statistics and verifying them. But when all is said and done, the best possible statistics that one can get are better than what is after all playing a hunch. That is really what the market is doing.

9075. I was thinking in terms of decisions about capital investment; and in taking its decision an individual company is not, on the whole, playing a hunch. It is exactly the same with exports. Things can change in the export field so rapidly that it is an abortive effort to get this information in time.——But if we need more motor cars for export, and we plan our economy to encourage this amount of production, surely that kind of trend would not change so rapidly as to render the information abortive?

9076. That particular one might not; I do not know. But circumstances do change very rapidly. To come back to an historical instance, we got into difficulties several times over the steel allocation. I am only trying to suggest to you that this is an important practical factor limiting the degree to which this can be done?——*Mr. Murray*: That is perfectly true; but there are two different sides to it. First of all the purely technical side: I am satisfied that our own Government statistical service is very much less perfect than it could be, as indeed Ministers recognise. The second side of it is the importance of keeping clear the two different kinds of objectives, the objective of the businessman and the objective of the Government. The Government's objective is a social one which they have defined and proceed to secure; the other is that of making a profit on a certain transaction. That is a very different one; I am not decrying it, but when one talks about "playing a hunch" that distinction needs to be remembered.—*Mr. Birch*: That brings in another point which we have made in this memorandum. The individual company is capable of making investment plans for a fairly long term ahead; it makes an assessment of the need and the likely profitability or otherwise. What the individual undertaking cannot do is to assess its own plans in relation to those of others. That is something which has to be done centrally.

9077. *Chairman*: Mr. Murray, you criticised Government statistics just now. Is your main criticism directed to the lack of volume and detail, or to the lack of ready and rapid availability?——*Mr. Murray*: Both.

9078. Do not fullness and speed tend to conflict with each other?——Most certainly; but look at the American picture. This is a stock example, but it is a good one. There one sees much greater information, for instance on this question of investment, and also on such other matters as trends of earnings, wage rates, hours of work, and so on, brought forward at remarkable speed and turning out to be remarkably accurate with a very small margin of error. One can only welcome the improvements that have been made here over the past two or three years and go on to believe that further improvements can be made for this purpose. The problem that Sir John Woods raises is a very real one, but I think we can get a little nearer to making an accurate and quick judgment upon trends.

9079. *Professor Cairncross*: Were you thinking of financial statistics to any extent?——*Mr. Murray*: I have not looked into this question of financial statistics.—*Mr. F. Jones*: We think that improvements could be made in financial statistics, but not with particular hearing on the point that is being discussed, i.e. the pressure on resources. Obviously forecasts of investment intentions would be more interesting if we could have them for something more than twelve months ahead. I recognise that the limit on that is the difficulty of getting the business man to look further than twelve months ahead. We should like to see a forecast of investment in the private sector made on the basis of the next five years. But on the financial side I do not think that at this moment there is any specific thing which would reveal the pressure on resources.—*Mr. Murray*: Except on the savings figures which we mention here, where the gap in our knowledge is deplorable.

9080. *Professor Sayers*: You refer in paragraph 34 to your proposal for a National Investment Board, which would "obtain information on all schemes of capital expenditure, both public and private." Are you thinking primarily of information about investment intentions?——*Mr. Birch*: Yes.—*Mr. Murray*: And also realised investment, actual investment, as well as investment intentions.

9081. Clearly it would not be necessary to set up a national body for this, because this is information which is collected, however imperfectly, now. Could we ask just what you had envisaged?—*Chairman*: Could we come rather later to that, because as we go through the paper there is quite a lot which leads up to that?—*Professor Sayers*: Of course, Mr. Chairman. Mr. Murray, you mentioned the gap in savings statistics; have you any positive suggestions as to how savings could be more accurately estimated?——*Mr. Murray*: I would have thought that the social survey technique which the Oxford Institute of Statistics have been using over the last few years might be useful. It could be done on a sample basis.—*Mr. F. Jones*: We understand that the Central Statistical Office have conducted at least one survey, if not two. We do not know how fruitful those surveys were; and we understand they are no longer being conducted by the Government. We are sorry about that, and we hope that you will look into it. Apart from social surveys, we think the institutions themselves could publish more information. We have in mind the building societies, the banks, hire purchase houses, and so on. We think that these financial institutions should make available every month a statement of their deposits so that we can follow the changes in deposits; and we also think that deposits should be classified according to whether they are deposits of persons or companies. The T.U.C. have not produced a blueprint of the sort of surveys we want, but they are things for which we see the need.

9082. You are aware that there are very considerable theoretical difficulties about all these measures, and that this is really one of the toughest nuts to crack?——Yes.

9083. *Chairman*: We had leaped forward from paragraph 4 on interest rates; may we go on from there and see what questions there are?—*Sir Oliver Franks*: In paragraph 12 you are talking about the external situation. I agree that the history of the last few years shows that confidence is a dominating factor as regards capital movements; but the impression I have of the paragraph is that you consider that other factors, for example the Bank Rate, do not come to very much. If we look at the external side only with these thoughts in mind, what

account should be given of the period from last September to now? There has been a considerable change from a high rate of outflow of reserves to a good rate of inflow; one might say that the Bank Rate had nothing to do with it, or one might say that it bad quite a lot to do with it. It is not, I think, simply a matter of confidence; it is a question of whether the Bank Rate itself, either by its direct action or by what it suggested to foreigners, had some effect. Would you be willing to elaborate on your remarks here in the light of the period since last September?——*Mr. Birch*: We agreed last September, on behalf of the General Council, that some emergency measures had to be taken to meet the exchange crisis. It is really a question of speculation as to whether confidence could have been built up without such a high Bank Rate or without maintaining it after the first shock bad been administered.

9084. I happened to be at a meeting of the International Bank and the International Monetary Fund very shortly after it bad changed, as was Lord Harcourt; and I gained the impression that the movement in the Bank Rate, leaving aside entirely the domestic repercussions, had a relevance to the attitude which foreigners took of us and our prospects.——We were of the opinion that foreign opinion was very much more influenced by the statement defining the domestic situation and so on; but we were not inside and we have not the advantage of the knowledge that you had.

9085. I am not wishing to argue at the moment that these other factors were not relevant; but I did have the impression that the Bank Rate did count.——It also put quite a burden on the balance of payments for the service of our own foreign debt. That has to be offset.

9086. *Chairman*: In paragraph 12 you take the view that the main contributions were the firm denials by the German and U.K. Governments on exchange parities and the declaration of the Chancellor of the Exchequer. I personally find it difficult to think that Government statements by themselves, if unaccompanied by actions, could have the marked effect that has been noticed in the last few months?——*Mr. Murray*: They were accompanied by actions. I am sure that the foreigner waited to see what the Government did, and that has had some effect on the flow backwards into the reserves; but I am equally sure that they have also been hedging their sterling purchases by forward sales, and we may see the trend reversed. There has been a very rapid improvement in the reserves and a change in the balance of payments situation. We cannot believe that either the mere change in the Bank Rate by itself or even the change in the Bank Rate accompanied by the declaration and some Government actions is totally responsible. We cannot be sure how the minds of these people do work, but we cannot believe that they are so irrational as merely to believe that a change in any level of Bank Rate in itself is enough to restore the previous sterling position.

9087. I do not want to press the Bank Rate as an instrument at all, but I could not leave it just as a view that declarations of policy could be the cause. I think we agree thus far that some Government actions, which are of a visible order and demand attention, are required; and then, as you say, it is difficult to see which the essential form of action is, the more so when they all come together?——Yes, they all come together, to the point at which they convince people that they are of value.

9088. *Sir Oliver Franks*: You rather suggested that it would be unreasonable in foreign opinion to regard movement of the Bank Rate as a primary factor. I am not sure that we are dealing with a domain here in which reason is altogether master. I am inclined to think that foreign opinion does take movements of the Bank Rate into account, at least as an earnest of a certain attitude or policy of Government. That perhaps is not capable of wholly rational determination; it may be more a matter of history, that within the past things have been like that, so they are now taken to be like that. But I would suggest to you that on a certain number of occasions, of which I believe September 19th, 1957, was one, this quality of a decisive movement of Bank Rate to affect foreign opinion had a quite powerful significance, which produced certain results. I am not in any sense arguing for one particular thing doing all the work, but I think that that is one of the things that perhaps one ought to take into account when one is looking at the external side. Would you agree with me on that?——Yes, I think so, I would say that it is certainly true historically. Probably the main new factor in the situation is the new sensitivity of sterling, because of the large amount of it that is floating around the world. We make the point in paragraph 20 that the Government may have to consider methods of trying to eliminate some of this irrationality by taking specific measures to reduce the sensitiveness of sterling. There are other methods than the ones we have described which can be used, but the Government has allowed the country to be so wholly dependent upon what the T.U.C. thinks are irrational decisions. That is why we were subjected to very violent forces which were unleashed by the Government in September last.

9089. Yes, but this is not a rational world?——No, but we try to make it as rational as we can.

9090. You say in paragraph 12: "This is not the way the Bank Rate works in present circumstances. Short-term capital movements are affected much more by 'confidence' than by interest rates. . . ." Is it not perhaps a little rash to assume that confidence is not there?——*Mr. Murray*: It is indirectly.—*Mr. Collison*: The situation was that for a long time we had been suffering from inflation, which people outside had observed, and that had led to lack of confidence. We would argue that that was happening precisely because previous measures were not taken. Having reached that emergency, the Government had to show that it really did intend to do something about it. The 2 per cent. increase in the Bank Rate may, as you say, have had that kind of effect; but we would not accept the argument in itself, on the point alone, except in relation to the general background and context of the situation. It obviously helped; but we should not have reached that stage.—*Mr. F. Jones*: We should, in fact, put more emphasis on the other measures apart from the Bank Rate. At the beginning of 1955 the Bank Rate went up 1½ per cent.; that did not prevent a run on sterling in the autumn.

9091. I am sticking to this recent ease, because it is relatively fresh in our memories. Do you think the other things the Government were able to announce at the time, a promise about Government expenditure and an arithmetical averaging of bank advances which would be judged over the year, were powerful in relation to this other thing, which was an accomplished fact? I think that in a way you are being very rational and "eighteenth century" about this, and not quite taking account of the dramatic effect that some things have. I am not concerned for the moment to argue whether this is good or bad, but only that these things exist; and I am putting to you that these facts were sufficiently noticeable and powerful to be things which one has to take account of when dealing with this rather complex set of circumstances?——*Mr. Murray*: Are you suggesting that if the Bank Rate had been altered to 7 per cent. without being accompanied by these declarations and, to some extent, these actions, that would have brought back sterling and restored our sterling position?

9092. *Lord Harcourt*: I do not think Sir Oliver was suggesting that the Bank Rate movement would do that. I was at the meeting where he was, and I took the opportunity of talking to an enormous number of people who were concerned very closely with these matters; and I certainly came away from those meetings with the definite impression that, of the items in the package deal, the one to which they ascribed the greatest importance was the raising of the Bank Rate.—*Mr. Woodcock*: I do not want to stop your discussion on the situation of last September, but as I read this it is related to paragraph 11, where you say:

"Traditionally monetary policy affected the external situation in two main ways. A rise in Bank Rate attracted short-term capital to London to take advantage of the higher interest rates, and discouraged overseas borrowers from raising funds in London."

You go on to say that that aspect of the Bank Rate is no longer relevant, and that therefore, if the Bank Rate has to be used, it has to be used in a different context as one of the instruments that give confidence, not of offering better terms for lending here and discouraging borrowing by making it more difficult here than elsewhere. So you want at least to put the Bank Rate in this new situation.——Precisely; that is why I asked whether the Bank Rate itself would have stabilised the sterling position.

9093. *Lord Harcourt*: Are you saying that the rise in Bank Rate at this moment is not attracting any funds to London?——I am not saying that: I would not know. There may well be funds that are being attracted. I would also suspect that those funds are being hedged, and in any event that they are short-term and we cannot depend upon them to restore our position. If I was a foreigner, I would hedge and then wait and see whether the Government is going to carry out its intentions, which I believe in but which I am not entirely certain about.

9094. But there are still certain financial benefits in moving long-term capital to London?——Yes.

9095. And that is a product of the high Bank Rate?——*Mr. F. Jones*: But they do not solve our problems in any fundamental way.

9096. *Mr. W. E. Jones*: You are saying that this movement in these circumstances is too insecure to benefit the economy for any permanent period of time?——In August there seemed a real possibility that the pound might be devalued; at any rate there was a great deal of talk about it, and the franc had been devalued, at any rate *de facto*; if one had been holding sterling and had been able to get rid of it in the market one would have done so. At least, that is the natural way in which people in that position would behave. The important thing, we feel, was the statement made by the German Minister of Economics and by the British Government that there was no intention to vary the exchange rates. This is the way we think speculators, or people who held sterling, reacted when they were reassured that there was to be no revaluation of the mark and that the British Government were determined to retain the existing parity.

9097. *Chairman*: Have not such things been said by Governments before, and followed immediately by contrary action?——That is the second thing we should look at: how far the Government would really take measures to reduce pressure internally; and the measures that it would take internally would have to be something more than an increase in the Bank Rate to be satisfying, because the movement in Bank Rate in 1955 had not really done very much at all. The statement we listened to very carefully in the trade union movement was the Chancellor of the Exchequer's statement that further pressure on prices would be taken by the level of employment or the level of internal demand rather than by the pound itself. That seemed to us to be a very important statement, and it was made emphatically and firmly, in a way that previous Chancellors in Conservative Governments had not made statements. Bank Rate had been moving up from 1951 onwards; had we been in this position of being able to speculate against the pound, the fact that the Bank Rate had been moved up from 5 to 7 per cent. would not have created a new situation.

9098. *Professor Cairncross*: What would your view be if this autumn exactly the same combination of circumstances recurred, as it very well may? Do you not really put your money, not on what we have been discussing just now, internally, but on the action described by Mr. Murray earlier? You do not rely on the movement of Bank Rate or any statement made by the British Government, as such, but on an attempt to bring into play the operations of the International Monetary Fund?——I do not want Professor Cairncross to misunderstand what I said. I was putting myself in the position of the speculator, and what we thought would be in the speculator's mind. Now you are asking what the T.U.C. think to be the way out. We do not advocate internal deflation in order to maintain the value of the pound when the run on it does not emanate from the balance of payments of this country. The position of the T.U.C. is the one you have mentioned: international action. We feel that that is more appropriate than individual Governments, through monetary policy, deflating their own economies sufficiently to restore the value of their currency.

9099. *Sir John Woods*: You are suggesting international reflation instead of internal deflation. Suppose we cannot get it: what then? Do we give up?——*Mr. F. Jones*: If there is pressure on resources, we recognise that that will have some effect, and may have an important effect, on the value of the pound. If we cannot get assistance from overseas we have to make internal adjustments. It is at that point that the T.U.C. say that more attention should be paid to techniques other than monetary policy. We recognise that there may be circumstances in which it would be necessary to reduce demand.—*Mr. Murray*: In that sense the Bank Rate is very much like a stimulant: it can be administered, but it will lose its effect over a period of time, and if the circumstances that Professor Cairncross mentioned should re-emerge, given the present set of policies in London, one sees no alternative but devaluation.

9100. *Professor Sayers*: But this is quite a different view of Bank Rate, that it is a stimulant. I thought you regarded it as the ghost of Hamlet's father?——Yes, but if he reappears too often we will not believe in him.

9101. Many people thought it was the ghost of Hamlet's father; but in an irrational world many people took fright last Septmeber at the sight of this ghost. But again, since this is irrational, could one rely on the same effect another time?——People get used to ghosts in time. We are saying here that the Bank Rate was not changed just for the sake of change; it was to restore the confidence of foreigners that the pound was not going to go on sliding and sliding in value. If, on the hypothesis very often put forward, the pound goes on sliding and sliding and if there is a further run on reserves, and if confidence is going to seep away, the effect of Hamlet's father's ghost on the second occasion will be that people are going to begin to doubt that it really was a ghost, and they will cease to have any confidence.

9102. But surely that is the argument against using Bank Rate at all. The fact that it has to be used with other measures to do anything does not mean that it is not useful at all. The real argument against using it is that it is unreliable: that, if people's reactions are irrational, it may just as easily react the wrong way as the right way?—*Chairman*: I thought that that was what was meant originally: that the effect was irrational or unpredictable?——*Mr. Collison*: Had it been taken that it was an indication that we were in fact going to deal with the situation and that this was one of the ways, it might be that the opposite would have happened.

9103. *Professor Sayers*: Surely that is the argument against using the Bank Rate in this contingency: that its effect is completely unreliable and may be perverse?—*Chairman*: In paragraph 15 of your memorandum you have said: "Abroad a rise in Bank Rate has often been interpreted as a sign of weakness rather than as a prelude to strong deflationary action". What occasions had you in mind of what Professor Sayers has just called the "perverse" effect?——*Mr. Birch*: We should qualify that a little; perhaps we over-stated it in saying it was interpreted as a sign of weakness. But the Government cannot just announce a rise in Bank Rate and then sit back and expect everything to go right. The Chancellor must accompany that with some kind of statement or other which puts it into perspective and indicates that fundamentally the economy is sound; otherwise it would, or could, be taken as a panic measure, and that might have the opposite effect. Underlying the whole of this discussion is our very strong feeling that in the short-term confidence may be affected by these manoeuvres, but in the long-term it is the economic situation of the country, our industrial capacity and the extent to which we are using it, which will finally determine the confidence of the world in Britain. One of the difficulties of using short-term specifics to deal with a situation is that that may mean creating economic conditions which, in the long-term, are going to be greatly to our disadvantage. It is very difficult for the ordinary member of a trade union to appreciate the point that a deflationary measure which leads to unemployment, or to less employment than there has been, can in the long run give a lead as to how strong Britain is. It is irrational; and therefore it is necessary always to have an eye on the internal effects of these measures and on the fundamental way in which we can maintain our position in the world.

9104. I would not have thought that there would really be a discussion about whether it could be a long-term corrective: I should have thought that even traditionally it was used as a short-term corrective only. But I was wondering about your statement that it has "often been interpreted abroad as a sign of weakness". Had you any particular occasions in mind that we could put our fingers on?——*Mr. F. Jones*: We were thinking of the period at the beginning of 1955; there was a crisis and a run on

sterling in the autumn of 1955, which did not abate until an assurance had been given by the Chancellor at the International Monetary Fund Conference. 1956 was difficult because of Suez. But we think 1955 was probably an occasion when foreign opinion was not reassured.

9105. *Sir John Woods*: That is not quite the same thing as saying that it was interpreted as a sign of weakness?——That is true. We agree that this is an overstatement. We had in mind that it is a possibility that foreign governments could regard it as a last ditch defence.

9106. You go through the various factors and indicate that the use of the high Bank Rate has very little effect on consumption, on investment in stocks or on investment in fixed assets, and not all that much effect on the external situation. But in paragraph 12 you say: "A bigher Bank Rate may still be a portent of deflationary action at home, but general credit restraint would have to be pressed very far before it markedly improved the balance of payments." I get the impression, reading this through, that you begin by saying that a high Bank Rate has very little effect anyway, except on the cost of the national debt, but that for some obscure reason it is implied later on that it has very bad effects internally, that it creates a deflationary spiral and threatens unemployment. Is that a quite unfair impression?——*Mr. Murray*: We are distinguishing here between Bank Rate pure and simple and Bank Rate plus the package deal that emerged last September. That probably explains the apparent inconsistency.

9107. *Sir Reginald Verdon Smith*: You mean no level of Bank Rate, as such, could create deflation?——We do not say no level, but we say no level that we have experienced since the war.

9108. *Sir John Woods*: Would 7 per cent. by itself have been enough, or would you say that it needs Bank Rate plus the ceiling on the nationalised industries plus the freeze on bank advances, and so on?——It would be possible to push interest rates to some level at which they would have serious effects by themselves; but I should not have thought that the 7 per cent. Bank Rate, in itself, would have precipitated a major deflation in the country.

9109. *Professor Sayers*: In paragraph 18 you say: ". . . it has apparently not been possible to reduce it to its former level when an improvement has taken place because such a reduction might be misinterpreted by public and foreign opinion." What reason have you for supposing that the Bank's delay in reducing rates is based on that reasoning?——*Mr. F. Jones*: We have no certain information as to exactly why the Bank of England reduces Bank Rate, but this is the impression that we have formed by studying it, and by reading the statements made by Ministers at various times. We have thought that one important reason for not reducing Bank Rate would be if it was thought that it would create the impression that the economy could go ahead and be allowed to run at higher pressure. That would be the most important reason why the Government would hesitate before it reduced Bank Rate; it would have to make sure that it was not going to have that result.—*Mr. Birch*: This ties up with the previous discussion; if one accepts the thesis that an increase in Bank Rate by itself will not do the trick, but has to be accompanied by statements and other measures, then the implication is that, if the Government reduce Bank Rate, they are back pedalling on all these other measures as well.

9110. *Sir Oliver Franks*: I am not going to put this in quite a fair way, just to bring out the point: you spend a good deal of time arguing that any level of Bank Rate that we have seen is not very effective; but what you have now said suggests that lowering the Bank Rate might be so effective that the Government would hesitate to do so. If this is so, does no one have to shade one's views about the possible power of the weapon? Whether it is a power for good or for bad, this seems to admit that it may have quite a powerful effect?——*Mr. Birch*: The people who put Bank Rate up put it up because they felt that that was so; so if they put it down it is on the same basis, that some consequences may ensue. Perhaps the real answer to this is that it is connected with other measures; the reversing of the Bank Rate is assumed to be a reversal of the other measures as well. We have not denied that in the context of what happened the raising of Bank Rate had an effect. What we have said is that the raising of the Bank Rate alone would not have had that effect, and therefore the rest of our arguments about the possible effect of a reduction are based on that assumption.—*Mr. Murray*: I think that leads to the conclusion that Bank Rate has at least two probably important effects: one effect is on confidence; and the other effect is the effect upon the cost of the Government debt. We regard it as desirable from the point of view of reducing the cost of servicing the Government debt to bring it down, but the Government may be reluctant to do so because of the other unpredictable consequences of a reduction of Bank Rate on confidence.

9111. Whether it should only be used as part of the package, or can be used by itself, and whether it is taken as indicating the fate of other measures or not, does it not still remain that this view means that as such it has a potency? Did you not say that the effect of bringing it down might be so powerful that one would hesitate to bring it down for that reason?——*Mr. Collison*: We are not saying that. We have said that the raising of Bank Rate alone does not usually have a very strong effect, save in respect of foreign opinion, where the confidence element is important and the effect of the raising of Bank Rate is unpredictable. On the other hand when Bank Rate is reduced the effect may be very much more serious. —*Mr. F. Jones*: The Government has thought Bank Rate sufficiently important to raise it. We are saying that foreign opinion, which is very important, has been the main reason why Bank Rate has been put up. Naturally foreign opinion assumes, if Bank Rate is put down, that the circumstances have changed; and if they feel that circumstances have changed, then obviously they put the opposite construction on the move to that which the Government intends. We are really saying here that when the Government use the Bank Rate they create expectations, and that there is, as it were, a psychological effect of Bank Rate. When we analyse what Bank Rate actually does, we do not feel that it does very much; but we are bound to say, as we do in this next paragraph, that, just because the Government attaches the importance that it does to Bank Rate, and does in fact raise it, when the Government brings it down it will have some effect on expectations. The fact that the Government uses it as a regulator means that it can only be brought down by the Government if the circumstances have improved sufficiently; and on the whole the circumstances have not improved sufficiently over the years since the Bank Rate has been put up. Consequently there has been no opportunity for the Government to bring it down.

9112. There remains the point that it does have some effect?——The fact that the Government uses it does create expectations; it has an effect in the minds of people. From the T.U.C. point of view we would emphasise other weapons; and we think that other effects than those intended can be created in people's minds when this rather clumsy instrument is used.

9113. *Professor Cairncross*: You envisage in paragraph 20 action to increase international liquidity through the International Monetary Fund, and you appear to make this conditional on co-operation with other members of the Fund, especially the United States. If the United States were unwilling to participate in this kind of action, have you any other kind of suggestion about what might be done to increase international liquidity?——This is not a matter on which the T.U.C. feels it is necessary to produce a blue-print. We are emphasising in this paragraph the need for international action. If something was not possible at the level of the I.M.F., there is the possibility (which we have mentioned) of doing something within the E.P.U. and with the rest of the Commonwealth. These are ways in which there could be collective action to ease a shortage of foreign currency and so to prevent an imbalance of trade occurring. For example, if the American recession goes very much deeper than at present, and it begins really to reduce the level of world trade, then the T.U.C. view would be that the rest of the world so far as possible should get together; we might take collective action within the Commonwealth to discriminate against dollar imports, and E.P.U. itself could be used for that purpose.

9114. *Chairman*: We are not looking for a blue-print necessarily; but, accepting a good deal of the criticism you make about the existing instruments, we have to try to test out the validity of alternatives.—*Professor Cairncross*: Do you regard this as something immediate, about which action should be taken in any event, or conditional

on something longer term of the international kind?——*Mr. Birch*: We think the Government ought to have given attention to this long ago. It is not something to be kept in reserve. It is necessary to try and deal on a longer term basis with this problem of international exchange.

9115. *Sir Oliver Franks*: There are certain evidences of interest at the moment?——*Mr. Murray*: I certainly would not be too pessimistic. The United States in the last two or three years has shown a good deal of willingness to recognise these problems; and we feel we might spur them on a little more, and it might have a good effect.

9116. *Professor Cairncross*: There are alternative courses of action which are open to the Government; this paragraph, as I see it, is not intended to pronounce between these alternatives, but to say that some action in this direction is needed?—*Professor Sayers*: Will you give your reason for suggesting at the end of the paragraph the withdrawal of official support for the transferable sterling exchange rate?——*Mr. Birch*: It is a question, if we are going to continue to pay for certain things, whether that price becomes too excessive.

9117. The price in what form?——*Mr. Birch*: The burdens which we accept in regard to the sterling area. Many of our problems are much wider than those this country's own economy produces, as a result of the position of sterling.—*Mr. Murray*: There is the additional factor that we are in effect putting our hands into our dollar pockets to provide dollars indefinitely not only on official sterling-dollar business but on transferable sterling-dollar business. It is causing a dollar drain in this country.

9118. Official support for transferable sterling costs dollars; but so does its absence, because certain imports into the non-sterling area from the sterling area bring in less dollars. What evidence is there that the one costs more dollars than the other?——*Mr. F. Jones*: Perhaps we should go back to early 1955, when commodity shunting was taking place, and this measure was taken to support transferable sterling. We are suggesting that the cost of supporting transferable sterling might well be greater than the cost of commodity shunting; but we have no evidence for that. We are wondering whether this may not be an important fact.

9119. It is a pure guess?——*Mr. Birch*: We say that serious consideration should be given to it.—*Mr. Murray*: The figures are not there.

9120. *Chairman*: You want an answer from us?——*Mr. F. Jones*: Indeed, yes.

9121. *Sir Reginald Verdon Smith*: In paragraph 21 in the second sentence there is the phrase: ". . . direct controls, including direct control of credit." Does "direct control of credit" mean the sort of controls which you refer to in the ensuing paragraph covering bank credit?——Yes; we develop that in paragraphs 22 and 23.

9122. *Chairman*: Then you come on to your suggestions of alternative methods of control of the banks and their credit-giving power. You criticise the existing system in paragraph 23 by pointing out that, if the Bank of England starts open market operations, under our existing system the banks can always restore their cash reserves by calling in money from the discount market or by allowing their Treasury Bills to run off without renewing them, and therefore it is not an effective control. As one of the possible alternative methods of control you notice the compulsory liquidity ratios. Would not the same arrangements which enable the banks to restore their position under the present system enable them to do much the same thing if they were subject to compulsory liquidity ratios?——*Mr. F. Jones*: Yes.—*Mr. Birch*: It would be in that case a very clear flouting of the intention to a far greater extent.

9123. If the Government were to impose a system under which they were given this power and would so be able to control the banking system in its credit-giving power, and if the banks merely responded to the operation of that system by doing what they could to protect themselves, would you regard them as flouting the system? Would they not just be playing the game according to the rules the Government had chosen?——*Mr. F. Jones*: We do not deny that there are always ways in which the banks could take action which would make the Government measures completely ineffective. But, after all, this problem arises partly because the banks have said that it is unreasonable to expect them to control, or even reduce their advances, when in fact they are in a very liquid position. The argument is that if their liquidity could be reduced to the conventional minimum, and there was a speedy and effective way of doing it, they would find it easier to carry out the wishes of the Government. These alternative methods that we are putting forward to reduce bank liquidity to the required level are put forward as examples of what could be done. We agree at the end of paragraph 24 that the banks themselves could always frustrate the authorities' intentions, and that ultimately, if the banks were doing things which appeared to the Government to be against the public interest, they would have to be directed.

9124. Ultimately the Government would have to find some form of compulsory direction which insisted that the banks should do what the Government thought they ought to do; and that looks like providing a compulsory ceiling for advances?——Yes indeed. We are not asserting that these alternative methods are absolutely necessary.

9125. *Professor Cairncross*: In your thinking about this you seem to lay special stress on advances. Do you regard advances as a type of bank asset of particular importance, or do you think that other assets are equally important?——This is quite a difficult question on which there is no certain answer; but the distinction we want to make is between active money and idle money. Advances are on the whole what we would regard as active money, and therefore the main emphasis of Government pressure should be on advances.

9126. You regard it as undesirable that the banks should be free to switch from holding investments to making advances, if the total of advances seems to you to be increasing in the wrong set of circumstances?——Yes; we would think it was more important to restrict advances.

9127. *Sir Oliver Franks*: You prefer that the customers of the banks should withdraw their deposits and build up the finance houses to do the work which you prefer that the banks should be doing?——*Mr. Birch*: We come to finance houses later on.

9128. *Professor Cairncross*: In the past five or six years there has been very little increase in bank deposits; so the problem has not been one of increase in the money supply. Would you think it appropriate, however, looking at what has happened over that period, to take action to reduce the money supply? Or are you only suggesting that action should be taken to reduce the level of bank advances?——*Mr. F. Jones*: This really arises because the banks have complained that they have been put in an invidious position. We are saying that these are methods by which they would not be in the position of withholding credit when they are in a very liquid position; by these methods they would no longer be liquid, and to that extent they would be able to withhold credit with a clear banking conscience. This was the consideration which made us put these alternatives forward. If you are asking us whether the amount of money in the system in recent years has been responsible for inflationary pressure, then I think our answer would be no; this is one important reason why we would put less emphasis on monetary policy than Conservative Governments have done.

9129. You would not dispute that a reduction in bank liquidity over the past few years would have limited demand and limited inflation at the same time, but you would hold that it could only have done it at the cost of a rise in interest rates which you did not feel desirable on other grounds?——There are two prongs to our views: (1) if the Government use Bank Rate they operate *via* interest rates, and on the whole we would prefer interest rates to be low rather than high; (2) we also believe that the important point to look at all the time is the pressure on real resources, and that the ways of reducing pressure ought to be more through fiscal policy, and if necessary physical controls, than through monetary policy. If, as an alternative to manipulated interest rates, credit was directly controlled in the ways we have suggested, we agree that that would have some effect on the pressure on resources, but on the whole we are not inclined to think that it would have an important effect. We do not see direct control of credit as a main regulator of the economy.

9130. You would agree that, if action was taken along the lines of your paragraph 24 to take control over bank liquidity, that would drive the banks' customers into other

channels where they could be satisfied at higher rates of interest (as in fact happens), and that higher rates of interest would exhibit themselves, but in a different way?——*Mr. F. Jones*: We are not denying that there would be consequences flowing from the policy, but again I want to emphasise, as we do emphasise at the beginning of our evidence, that we think that manipulation of credit should play a minor rôle as compared with other weapons.—*Mr. Birch*: In all this we are looking all the time for more selective ways of control than interest rates.

9131. This may be played down as a subsidiary element or weapon in a series of controls, but it is a definite control, and it can take effect only in the long run through a rise in the cost of credit provided by the banking system, or alternatively through the non-availability of credit from the system. Is that not right?——*Mr. Murray*: We go on to discuss control of non-banking credit.

9132. *Sir Oliver Franks*: The stream of money as it circulates faster or slower is very like water, and these are dams that are put in its course at certain places. If a dam is erected on advances, the water rises up and seeps round and goes out, and another dam must be erected. Is not that in the end a process which tends to be self-defeating, that the level always rises and finds its other way through? Is not that a criticism of this particular way of trying to deal with the problems of credit? Not arguing at all for the moment whether or not monetary policy and control is, or can be temporarily, an important weapon, is there any limit to the amount of direct control you may be involved in once you start it?——*Mr. Birch*: If I may say so, your analogy of the dam is a very good one, because, after all, the purpose of these exercises is not to dam up the supply for all time. We would hope that the dams would be so used that the water would be pouring into the economy in the right direction.

9133. Collecting the winter rains and using it in the dry summer?——It is not a question of sitting on it for all time. Our own basis of thinking is one of expansion in the economy and ensuring that power is there at the right time in the right direction.

9134. *Professor Sayers*: I find it difficult to reconcile the resort to this kind of control with your dislike of rising rates of interest, because this is in the main a control by rates of interest. It is a long way round of doing it, but it does not get you far unless by increasing rates of interest. Is this another part of the contention that possibly budgetary pressures will not be enough sometimes, and monetary measures have to be resorted to?——*Mr. F. Jones*: These alternative methods of reducing liquidity that we have put forward are alternatives to Government funding operations, at any rate to the extent that they secure the liquidity level in the banking system which the Government wishes. It is in that sense that we think these are alternative methods to movement in interest rates.

9135. I would agree only that they are different routes by which the Government can produce some check to borrowing, and that, whichever way they do it, the check to borrowing becomes effective in the main by people finding that it is more difficult and more expensive to borrow?——You say "more difficult and more expensive"; our emphasis is on "more difficult" rather than "more expensive".

9136. The experience of the last few years has shown, on Sir Oliver's analogy of the dam that had to be erected, that it is very difficult indeed to maintain. People get round the dam: they got the money at higher interest rates. Does not the control become an interest rate control: that is my difficulty?——*Mr. Birch*: Interest rates have always to be looked at from different directions, in the sense of restricting borrowing, and reducing the pressure on demand, and so on.

9137. Which you do not believe on the whole that they do?——*Mr. Birch*: They can have that effect if they go high enough, but not necessarily a good effect or in the right direction. One has to look at interest rates from the other side too. Housing is an immense factor in the economy; and the increased cost of housing, whether it is for owner-building or for local authorities, has been caused by interest rates far more than by any other factor: labour, costs of materials, or anything else. It is a staggering thing. If one can achieve the same object of reducing the pressure without putting on these additional burdens, then it seems to me that overall this is a better approach to the problem.—*Mr. Murray*: I do not think the alternative will have the effect that Professor Sayers suggests. It will tend to raise interest rates; but we are not suggesting in this evidence that interest rates within limits may not be used for purposes of controlling the economy. We can see that they have a part to play.

9138. Your thesis is really that there may be times when you have to resort to monetary measures to reduce pressure, but the effect is mainly by interest rates?——*Mr. Murray*: I think so. We recognise that, and we do not object to some advances in less essential categories being squeezed out by interest rates in this way.—*Mr. F. Jones*: It seems to me that Professor Sayers is saying that if there is a squeeze on advances through the banks, borrowers will go elsewhere, and that, if they are prepared to pay the price they will eventually get the money. We are saying that the Government should erect some more dams, and the dams which are referred to in paragraph 33 would make it more difficult. You can make the point that, if this was the only method of regulating the economy, then it would be defeating itself. Again I want to remind the Committee that our main emphasis is that other methods apart from monetary policy are required to regulate the economy. In so far as we recognise that monetary policy must play a part, our emphasis would be less on interest rates and more upon influencing the channels.

9139. Erecting barriers?——Yes.

Chairman: We have a certain amount of material ahead, on the National Investment Board, the control of the use of funds in institutions and other banks, the provision of finance for industry, gaps in the capital market, and so on. Perhaps we ought to try and take that on another day so that we do not hurry it now. I wonder if we could find an hour another time in which you could meet us?——*Mr. Birch*: We will do our best to accommodate you. We can ask the secretaries to try and find a convenient date.—*Chairman*: Then let us continue later.*

* See *infra*, 41st Day, Qns. 10142 to 10189.

(Adjourned until Tuesday, 3rd June, 1958, at 2.15 p.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-FIFTH DAY

Tuesday, 3rd June, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

PROFESSOR A. J. BROWN, Professor of Economics, University of Leeds, called and examined.

9140. *Chairman* : We are very grateful to you for the memorandum* you have prepared for us; we have all read it, and we were able to have a discussion amongst ourselves this morning about the points that were involved in it. There are two or three points on which we should like you to enlarge.—*Professor Sayers*: In the concluding paragraph of your first section you make the point that monetary stringency may have the effect of increasing the gold reserves of the country, but it may have this effect partly because it has the effect of reducing stocks of primary commodities You assume that it does have the effect of reducing stocks of primary commodities?——*Professor Brown*: Yes. I use monetary stringency there in the widest sense. If I were pressed about what I mean by monetary stringency, I would say that the rationing of credit seems to me to be more effective, in doing this particular thing, than high interest rates.

9141. What kind of evidence would you use in support of that?——The fact that it seems to be generally accepted among people in, for instance, the wool trade who are concerned with holding imported stocks on credit. I must confess that I have not looked at the statistical evidence very carefully to see if it seems to be generally true. What is very clearly true on the statistical evidence of the last ten years or so, is that stocks in general (not just of imported things) vary extremely closely with the balance of payments on current account. About half the year-to-year change in total inventories, as shown in the Blue Books on National Income and Expenditure, can be accounted for by year-to-year changes in imports; and I think that if one looked at it, one would see that the points when imports have been cut rather sharply and stocks have fallen rather sharply at the same time are the points following the crises of 1947, 1951 and 1955; that is to say, they are the points when a stringent monetary policy was applied.

9142. You say 1947? Other things happened then, but not monetary stringency, surely?——I am not quite sure about 1947; I am quite sure about 1951 and 1955.

9143. It would be easy enough to recognise in the published facts that there has been this alternation between building up of stocks and building up of reserves, but if one is to relate the movement of stocks to the movement of monetary conditions, then is not the task very much more difficult?——Yes.

9144. What you said about the wool trade I found interesting. Is this information you have picked up in the course of conversation with the wool trade people in the last few years?——Yes; it is what seems to be generally held by people who import wool.

9145. How far back does this kind of evidence go? Have you heard it said many times over the last five years, or two years, or one year?——I have heard it said as a general fact of life in the wool trade by people who are in it and have been in it since the 1920s. I do not think I have heard them refer particularly to the events of any one recent year, but there does seem to be a disposition among people in that trade to believe that holdings of wool are sensitive to credit conditions.

9146. When you say there is a "disposition to believe" that, you are putting it at second remove?——Yes; it is all second remove.

9147. *Professor Cairncross* : The figures are available; stocks of wool have not in fact shown tremendous fluctuations during the last few years?——They went down very much in 1950 and 1951.

9148. I am talking about the last five years?——In the last five years they have been pretty steady.

9149. In spite of very substantial increases in interest rates?——Yes. I think people in the trade would probably say that stocks were reduced to a low level at the beginning of the fifties and that it was not practicable to reduce them further.

9150. *Sir John Woods* : In 1950-51 was it not more a question of price than of interest rates?——It may have been good speculation, but I am not sure that I can give the trade as much credit as that; I am not sure that I want to give them the credit of being so right when the Americans were so wrong about it. They had, I suppose, as much reason as anybody else in other parts of the world to think that there might be a major war coming and that it was a good time to lay in stocks; but in fact they ran them down. I wish I knew more about their motives. After the event they were inclined to say: "Look, we were right. We held off when prices were high and we did well out of it." But I think that, at any rate in 1951, the credit conditions may have had something to do with it.

9151. *Professor Cairncross* : You say in the second sentence under the heading "Prices of Primary Products" that British demand is only a fraction of world demand, varying between ten and fifty per cent. for different commodities. Where it is as high as fifty per cent., surely credit restrictions in this country would affect the world price?——They would. I have been thinking about those proportions; I think I have pitched them a bit too high. It is very difficult to know just what to relate British demand to. If one relates it to the total amount of commodities moving in international trade, and one takes a fair sample of commodities for which there is information, it goes all the way from five per cent. to ninety per cent., but it probably averages round about twenty per cent. If one relates it to a rather vague concept, the amount of the commodities which in principle is available to move in world trade, or the price of which moves closely with the things that flow internationally, my guess is that one would get an average of round about ten per cent. But it is a difficult sort of guess to make.

9152. The important thing is whether you think from the evidence that credit restrictions and high interest rates in this country are likely to have much influence on world prices; you discount that?——Yes.

9153. You do not think that any of the reduction in commodity prices over the past year is to be attributed to high interest rates?——I would not say not any; but it seems fairly plain that what the Americans do will matter about five times as much as what we do, and what other people do will matter as well, so that we cannot be respon-

* Memoranda of Evidence Part XIII No. 3.

sible for a very big part of what happens. Obviously, if we have very stringent measures, this will have some effect; but a very much less marked action in the opposite direction by the Americans would offset that.

9154. Are you taking account of the way in which interest rates in London might determine other interest rates in other producing countries?——Taking account of that, I would still hold this to be true.

9155. *Professor Sayers*: In the first half of 1952 the relative depression in primary products was on the face of it associated in some measure with tighter credit throughout the world; was not that tighter credit at any rate encouraged by British policy?——Yes; I put the emphasis on tighter credit throughout the world there. One must allow, too, that there were a good many other things at work besides credit policy and traders' policies about stock-holding. There was a very marked change in consumers' behaviour in 1952, which must have been important.

9156. Coming to another stage in that same part of your paper, supposing that one accepted the view that tighter credit conditions made an appreciable difference to the holding of stocks of primary commodities, and that an accumulation of gold reserves by the country in response to dearer money were largely offset by running down of stocks of primary commodities, would you accept the view that in spite of this offsetting there may be times when it is important to attract gold to the reserves even at the expense of running down stocks of commodities?——Yes, I would accept that. I mean to concede that in what I say here.

9157. But you would argue that, if the country is not in a desperate position from the point of view of maintenance of its exchange rate, this offsetting point in the stocks position is to be reckoned quite seriously against any gain in reserves?——Very much. I would say that the improvement that you get through an increase in the gold holding is in some degree illusory. It is an illusion that may be very convenient to us.

9158. It may be important on occasions?——It may be important, like a lot of other illusions connected with money; but it is only part of the picture, and one has to recognise that.

9159. Is not all this on the assumption that the stocks position is almost as closely controlled as the gold position by the monetary stringency?——It is on the assumption that they are at any rate negatively correlated.

9160. *Chairman*: I would like to go back to what you said about the wool trade. Have you had personal contacts in Yorkshire and Lancashire with those who operate the wool trade?——I have some slight contacts in Yorkshire.

9161. I think you spoke of them as treating it as one of the facts of life that stockholdings of wool were sensitive to credit conditions. Could you enlarge on that a little? Do they in fact behave, according to your observation, so as to respond to the sensitiveness, or is it a sort of general theory which they communicate to you?——Perhaps I put the emphasis in the wrong place in saying that they talked as if stock positions are sensitive to credit. What I think they are inclined to say more is that the price is sensitive to credit. This is, after all, one of the commodities for which British demand is a high proportion of world demand. I am thinking on the whole of people who have been in the wool trade since before the statistics of stockholdings, and who live by having hunches about the price of wool. I think that, in so far as they are aware of what economists say at all, they tend to accept Sir Ralph Hawtrey's position about this. They tend to say that ultimately the price (which is what they are interested in rather than stockholdings) is sensitive to monetary policy, and that, if the price of wool goes bad on them, it is because of monetary stringency.

9162. *Sir Oliver Franks*: It is like the dinner at Bradford when I heard people say: "If only we had not got to reckon with London we would be all right."?——Yes!

9163. *Professor Cairncross*: Would you agree that the policy of holding stocks is governed more by the expectation of how prices would move than by the rates of interest on the money required to finance the stocks?——Yes; but a lot of them are dependent on getting credit, and it is not so much the rate of interest they have to pay but how much credit they can get. I think they recognise that.

9164. Your account of 1951 rather gave one to understand that, although the finance required then might be perhaps four times as great, it was not the difficulty of getting finance that prevented them from buying wool but their view of what was happening to prices?——I did not mean to say that. I cannot really pretend that I have very close knowledge of what people were thinking in the wool trade in 1950, but my general impression is that in the last part of 1950 and the beginning of 1951, when wool prices were rising, there was no great disposition in the wool trade to think that this was wrong, or against the order of nature, or something that they ought to speculate against. I do not know of any sentiment of that kind that would entirely account for their not having joined in the general speculation on a permanent rise in wool prices. Of course, some people did speculate, and got very badly caught.

9165. But were they in difficulty because of a lack of finance at all at that time?——That is not a thing I want to be positive about; but they talked as if finance was important.

9166. *Professor Sayers*: Has the restriction of bank overdrafts in the last year or two been alleged as a serious reason of difficulty in buying wool?——I have not heard it much talked about.

9167. Have you noticed any change in the wool trade alleged to be connected with monetary changes since September, 1957?——I have not heard it particularly connected with monetary changes, but I have not in fact talked much to wool people in the last year or so.

9168. *Professor Cairncross*: In the next section where you are dealing with restriction of profit margins, your main point, as I understand it, is that a reduction in demand brought about by monetary policy or in any other way would be likely to react on profits chiefly by its impact on the utilisation of capacity, and that the change in profit margins reckoned in relation to prime costs might be expected to be rather small?——Yes.

9169. You appear to draw from this the deduction that depression of profit margins is not a very promising method of attacking inflation. Would you agree that there have been times in the post-war period when there has been a change in the general atmosphere of inflation without much change either in profit margins or in activity? Was there not a fairly remarkable change between 1947 and 1949 in the degree of inflation in the system, without much change in activity or unemployment?——There was indeed. Various reasons can be given for that. There was a cessation in the rise in primary product prices for a time after the autumn of 1948; and there was an agreement to hold wages and salaries to some extent.

9170. But was that not itself facilitated a little by the relative stability in the cost of living, and by a change in public feeling about the amount of inflation?——There was certainly a change in general feeling which made possible the check of the increase in incomes, and that was helped by the halt in the cost of living which, in turn, was due to some extent, I suppose, to the cessation of the rise in world commodity prices.

9171. If you take the view that profit margins are rather inflexible downwards, you would presumably also agree that they are a little inflexible upwards nowadays, and that therefore the impact of an increase in demand tends to be in longer order books. May it not be a matter of some importance whether you apply pressure to demand so as to reduce the length of order books without necessarily affecting the profit margins or the degree of activity?——It may be a matter of great importance in various ways; it may affect exports and all sorts of things. Is that what you had in mind?

9172. Not just that, but also what you say in your section on wages and salaries. If order books are shrinking does that not have an effect on the negotiating position of employers and employed?—*Lord Harcourt*: Even though there is at that stage no reduction in activity?——I think it might, but how much it is very difficult to say. I do not see a lot of indication that there has been any very strong influence. It seems to me that the range over which the pressure of demand, however it is measured, has varied since the war has not really been enough to show any very great effect on the rate of wage and salary inflation. Some people claim to be able to see some sort of relation between the pressure of demand measured in some way and the rate of inflation, but I must confess I cannot; perhaps I have not tried hard

enough, but I just do not see any clear relation at all. It seems to me that, if one takes this absence of any very clear relation since the war along with such evidence as there is before the war, one probably would not expect the wage and salary inflation to be checked to any great extent, unless the slackening of effective demand is very much greater than anything we have had since the war.

9173. *Professor Cairncross*: You are putting two propositions now. One is that you judge from the post-war record that the pressure of demand has not had much effect on price inflation; and the other is that it has not had much effect on costs, and there you are thinking particularly of wages and salaries. These two propositions are not quite the same?——I am not sure that I really meant the first one. I really meant to refer to costs, and labour costs in particular.

9174. *Professor Sayers*: When you say towards the end of your third section:—

> "Nevertheless, making what seem to be reasonable allowances for this the lesson of inter-war experience seems to be that with the present wage fixing machinery it takes a level of unemployment far above anything we have experienced since the war to bring the rate of increase of money wages to equality with the rate of increase of physical productivity per man"

what level of unemployment would seem to you to be necessary to bring about this equality?——This is all horribly speculative. If one looks at the record before the war it seems that rates of earnings rose faster than labour productivity roughly speaking whenever the unemployment rate was less than about 10 or 12 per cent. A lot of the unemployment at that time was concentrated in particular industries and particular areas, where labour was, so to speak, trapped, and labour mobility between these industries and other industries was in the short run very low; so the position was not the same as it would have been if unemployment had been spread fairly evenly over the whole of the economy. One can only guess what the effect of that is; one might perhaps discount 4 per cent. out of that 10 or 12 per cent. for the extent to which unemployment was local rather than general, and get 6 or 8 per cent. as the effective level of unemployment which was critical in this sense, and which went with a rate of wage inflation about equal to the rate of increase of productivity. Since the war the rate of increase of productivity has been higher; something rather over 2 per cent. as against something rather over 1 per cent. per annum before the war. That means that we can tolerate a higher rate of wage increase without having inflation of unit costs. So it seems to me that one might arrive at something like 4 to 6 per cent. as the range in which one might expect to find the critical level now, judging from pre-war events and making these allowances. This is on the assumption that other things that make for wage inflation are not stronger. It is making no allowance, for instance, for any change in the strength or attitude or expectations of trade unions. I should have thought it was therefore a minimum estimate rather than a best estimate.

9175. *Professor Cairncross*: On the other hand you are working on the basis of pre-war percentages of a group of insured workers which has been expanded by about 50 per cent.; and the expansion has been in groups of labour where unemployment is normally very low. So the 4 to 6 per cent. you have suggested would in present day terms represent something like 3 to 5 per cent.?——One would certainly have to make some allowance for that.

9176. *Professor Sayers*: I think that is over-estimating the degree of unemployment in this respect. If, for the reasons you rightly bring forward, we look upon the years from 1935 to 1939 as rather odd, we have experience of a very long period, before 1914, between the wars and after 1945, from which it seems that a level of unemployment of more like 5 per cent. is compatible with no rise in wage rates at all, and a level of unemployment of about 2 per cent. is compatible with wage increases of $2\frac{1}{2}$ per cent. or so. Is not that sort of range very different from the range of 6 to 8 per cent.?——You are going back a long time.

9177. I am going back a long time; but I am also fitting it to post-war experience?——Can one?

9178. I agree that there are special points about post-war experience: Professor Cairncross mentioned that one would expect the unemployment percentages to be rather lower today, if they represented the same sort of degree of unemployment over the whole system as before the war. But I wondered whether it was just those special circumstances of the thirties that made wages rise more than one would have expected at that time. A great deal of this argument depends on the interpretation one puts on the events of 1934 to 1939?——The wage changes between the wars are odd in all sorts of ways. For one thing they are negatively correlated with the growth of industry; that is very strange and seems to me to suggest that they have more to do with bargaining power, union activity and so on, than with the level of effective demand for labour in a particular industry. This seems to me to be rather symptomatic on the whole of the changes that have happened since before 1914.

9179. So your position really is not just that it takes a level of unemployment far above anything we have experienced to bring the rate of increase in money wages to equality with the rate of increase in productivity, but that the level of unemployment cannot be related to greater wage changes in any predictable way at all?——I have not been able to relate it for the post-war period. For the inter-war period there is something more like a relation. For the period before 1914 there is some sort of relation, though not terribly good. Since the war another variable has probably been more important than the level of unemployment: the change in the cost of living, and particularly the changes in the prices of imports. These have been relatively enormous as compared with most inter-war experience.

9180. Looking at the post-war period, if one abstracts from the years in which those changes in import prices were having most effect, one finds that in 1955 and 1956 (the boom years) wage rates increased by 7 to $7\frac{1}{2}$ per cent.; in 1953 and 1954 the changes were 3 to $4\frac{1}{2}$ per cent. Does it not rather suggest that the pressure of employment opportunities has some effect?——The biggest increase of all in wages was in 1951 and 1952; that is obviously related to the price rise. 1952 was fairly high; then it got down to about 3 per cent. That was due to the quite important influence of rather a big fall in import prices. The fall in import prices reduced the cost of the national output by something like one-third or one-quarter as much as the increase in British incomes put it up by; it is quite substantial.

9181. But on the whole you are rather sceptical about the existence of an interesting relation? You have put it here that it would take a level of unemployment far higher than anything we would tolerate; but you are in fact rather more sceptical?——I am sceptical about it. I do not think that there is enough evidence to establish anything like confidence on the matter, but it seems to me that what indications there are point the way I said.

9182. *Professor Cairncross*: If you think that unemployment is going to rise next year as compared with this year, does that modify your expectation of the general rise in wages to be anticipated over the year?——I would not regard it as strong compared with other factors that I might be aware of, unless I thought that the rise of unemployment was going to be really rather substantial.

9183. You think that there is some alternative way of approaching the movement of wages and salaries; that is referred to in your last sentence, but you leave it rather vague. Have you any idea how you could predict what might happen to wages and salaries?——I was not intending to refer there to prediction. I was referring to policy.

9184. But if you have control you have a better chance of predicting?——I hope there may be a method of controlling the rate of increase in wages and salaries but this is not a thing that I claim to have any strong views on. I do not claim to have any confidence that there is a beautiful solution to be found through some acceptable method of control. I do not take the optimistic view that all problems are soluble.

9185. Your emphasis is on "it is to be hoped"?——Yes.

9186. *Professor Sayers*: Your scepticism relates to the possibility of holding back costs by a relatively slight degree of unemployment; you have not any serious doubts about the possibility of depressing the total of monetary demand by monetary policy?——I have not really questioned that very much here. I was not meaning to assert, and I hope I have not given that impression from what I have said

this afternoon, that monetary policy is a very powerful instrument in controlling the effective level of demand. It seems to be that it has many weaknesses.

9187. In your section about the effect on increase of productivity you envisage monetary policy as having the effect of reducing investment quite seriously?——Yes. I am not so much intending to assert that monetary policy can easily depress investment; I was merely intending to say that, if monetary policy is applied sufficiently vigorously it will do something, and that one thing it will probably do is to depress investment.

9188. But is that true if it does not have to be carried to the point of producing a great deal of idle capacity? If it does not produce idle capacity on a large scale, if, that is to say, national income is very nearly maintained, then should not the result of monetary stringency and high level interest rates be that the level of investment is higher than it was before, not lower; that it is merely investment plans that are cut and that realised investment is higher than before?——I am not quite clear that I follow you, but I think that, unless monetary policy is pushed to the point where it does do something considerable to the level of investment, it is probably not doing much at all.

9189. *Professor Cairncross*: Much at all to control the movement of wages?——Or indeed to control the level of total effective demand. It is true that there are points at which it is effective. It is to some degree effective on consumers' expenditure now if it is applied the right way.

9190. *Professor Sayers*: The effect is likely to be a depression of consumers' expenditure, in so far as it has any effect?——Yes.

9191. And the effect on the investment side is in the first place to cut investment plans?——Yes.

9192. And these two effects together, if they are not carried so far as to produce a substantial reduction of national income, will mean that there are not as many bottlenecks as before, that the total level of production is almost maintained, while the level of consumption falls the level of investment has risen; is that not right?——You seem to me to assume that there are a lot of bottlenecks; more bottlenecks than I think we have really had.

9193. I am assuming that total demand is not compressed to such an extent as to produce idle capacity; that is to say, that the level of production remains almost as high as before. You have agreed that in so far as it has any effect on consumption, the effect is a reduction; is not the rest absolutely convenient?——Yes; but then you have assumed that nothing much happens to income.

9194. But this is on the assumption that there is excessive total demand at the beginning?——I do not really think that excessive total demand is our trouble. If we were in a situation of the sort that we were in at the end of the war, then I think that the case you make might be a very solid one, but I do not think we have been in that sort of situation since about 1948 or 1949.

9195. This is a description of the situation in which people were saying that too much investment was being started, and too little investment being accomplished?——Yes.

9196. *Professor Cairncross*: When you say you do not think we have been in that situation, what do you think then is the explanation of the inflation since 1952?——I think that it is mostly an inflation of wages and salaries. I think it arises from the fact that there is not equilibrium in the market for labour, but there is equilibrium by ordinary standards in the market for finished goods. Conditions in the two groups of markets are not the same.

9197. But if there is a high demand for goods surely that becomes automatically reflected in higher earnings?——Yes.

9198. Does that not react on the willingness of employers to grant increases in wage rates?——I should agree that inflation in the market for finished goods will produce inflation all along the line. One will probably be able to see what is happening by looking at profits; there will probably be an increase in profits.

9199. Even though profit margins are being held fixed by custom or for some other reason?——I do not claim that profit margins are absolutely fixed, though I think that they are relatively insensitive. There would probably be some indication of an increase in profit margins if there was a substantial amount of excess demand in the market for finished goods. In those circumstances wages, with the kind of wage-fixing system that we have, would certainly follow suit. They might lag behind, but there would be a rise in wages. But it seems to me that we were too hopeful. We thought, perhaps not unreasonably, that if we suppressed all excess demand for finished goods, we should then have steady prices. The fact seems to be that we do not. We have an upward creep of wages and salaries, which gets financed in various ways, partly by the creation of credit in which the banking system is largely passive, though we have seen in recent years to what a very large extent it can be financed just by fuller use of the existing stock of money, the velocity of circulation being a highly variable thing. If one has that situation, and one has the kinds of rigidity that I think existed, one cannot stop this upward creep of wages and salaries by monetary means without doing something fairly drastic, something which will reflect fairly drastically on the level of employment and on the degree of utilisation of capacity. This seems to me to be the nature of our difficulty.

9200. Would you find it inconsistent with your explanation that the pressure of demand has been successful in drawing into the labour market very large numbers of people over the last few years who before the war, or even immediately after the war, did not find employment?——I do not think that is inconsistent with the picture. It is a mitigating factor, and a very important one.

9201. *Professor Sayers*: Surely it is a symptom of the increasing pressure of total demand that has been created by this continuing rise in the prices of finished goods. There has been incentive to go on producing more and more, and produce machines for making more and more, and there has been this bottleneck of plans which has resulted in putting up of labour prices by more and more earnings being paid out. More and more people have been drawn into the labour market at high cost. Is that not a situation in which a rise in investment may well have been compatible with rising interest rates, and a situation in which investment might be raised even further by a further rise in interest rates?——It is true that if there had not been so much demand for finished goods there would not have been so much bidding up for wages. I think there is some connection between the two. In particular I think there is a connection between the amount of effective demand and the extent to which earnings creep up in relation to wage rates. One can see that that is rather sensitive; since the war it has shown itself to be rather sensitive to changes in the pressure of effective demand. But that does not seem to me to be a very big part of the picture. The push of wages and salaries from below, so to speak, seems to me to be on the evidence we have discussed (perhaps rather slight evidence, but still such evidence as there is) fairly insensitive to the precise level of effective demand, unless effective demand has really become very low; but that push seems to me to be more important than the pull which is clearly relatable to the variations in the level of effective demand.

9202. *Professor Cairncross*: Let us take the extreme case in which profit margins are absolutely fixed. Is there any distinction in your mind between the two situations? Any movement in prices must be reflected in costs and wages, and I would have thought that it then becomes almost meaningless to distinguish between the push and the pull? You lay a lot of emphasis on profit inflation?——I think that is the only indication you will get of a "pull" as distinct from a "push".

9203. But if a change in demand shows itself primarily in the movement of order books and not in profit margins, then the distinction we are drawing seems to me to become rather metaphysical?——I am not sure that I would agree that that is so. The question is whether wages and salaries can go on pushing up even if order books are not very long. My suspicion is that they would go on pushing up even if order books were not very long, in fact even if there was very appreciable excess capacity.

9204. In section 4 you lay emphasis on the way in which a reduction in the rate of investment may slow down the rate of increase in productivity. You take this as a positive relationship where you speak about the delay in the application of technical improvement. Else-

where you do not take this necessarily as a positive relationship. You refer to the experience of the United States, and suggest that there have been periods of high unemployment when there have been quite high rates of productivity growth. How seriously do you take the positive relationship between the two factors?——I think that in the last resort it is bound to be a positive relationship, but it seems to me there must be a fairly wide range over which other things are more important in affecting productivity than the amount of investment.

9205. You agree that there are many forms of technical progress that do not involve capital investment?——Indeed yes.

9206. And these may be accelerated in conditions of stable prices, or even falling prices?——Some of them seem to be. It seems that one source of increase of productivity is at work in depression, because there is a great incentive to cut costs, and inefficient firms go out of business, and quite another source at work in times of what is generally called a shortage of labour. It may be that somewhere in between there is just the minimum tendency towards technical progress. One can quote instances that seem to support all this; but in the last resort, if there is very little investment, the amount of technical progress one can have is very strictly limited. If there is a lot of investment there can hardly help being a considerable increase, at any rate, in productivity. The picture seems to me to be one where periods of labour shortage and high investment are on the whole the periods of the fastest increase in output per man; but about the other periods the findings are not quite so clear. The relation is not so simple positive when you compare depressions with periods of moderate prosperity.

9207. May I put the alternative suggestion? Would you agree that in periods when in any given industry output is rising rapidly productivity is also rising, irrespective of whether investment is still occurring as rapidly, or not quite so rapidly?——I am not sure about the "irrespective" clause, though I can see that productivity can go up either when one is working towards the fuller use of capacity or when one has an increase of investment.

9208. *Sir Oliver Franks*: I have just one general point I would like to follow up. There have been a number of rises in the rate of interest in the last three and a half years. I think it would follow from a good part of your paper that, if we were looking simply at the internal effects on the economy, we should at least have grave doubts whether they were rightly designed, or whether they would have the required effects. If you look instead at the external scene and the problems which have arisen there, would you say that the movements of the rate of interest have been reasonable and justified, or would you say that the same condemnation holds for both aspects?——I suppose on the whole they have been motivated much more by external than internal considerations, in so far as the two can be separated; and they seem to have had some effectiveness externally, although I would still say that it is a pity that we have to do this. It may be inevitable, but it is a pity.

9209. You mean that it may be inevitable on external grounds, but we have to pay a price in going without desirable things at home?——It is inevitable in the circumstances that exist. One can imagine circumstances being changed.

Chairman: I think that brings us to the end of our questions. Thank you very much, Professor Brown. We are very much obliged to you.

(*The witness withdrew.*)

SIR RALPH HAWTREY, C.B., F.B.A., called and examined.

9210. *Chairman*: Sir Ralph, thank you very much for your memorandum*. We have all read it, and there are one or two questions arising out of it which we would like to put to you, if we may. We should like to start in the reverse order, as it were, by going through a theme upon which you elaborate from paragraph 62 onwards, under your heading of Foreign Exchange Value of the Money Unit. I know it is a theme with which you have been very much associated, and we would like you to enlarge upon some aspects of it for us. Professor Cairncross, would you like to begin with one or two questions on that?—*Professor Cairncross*: Sir Ralph, is it still your view, as put to us in paragraph 71, that British exports are substantially under-priced?——*Sir Ralph Hawtrey*: Yes.

9211. You would argue that that has been true all along in the 1950s?——It has been true ever since 1949, but to a gradually and slowly diminishing extent, because British costs have been rising a little faster than American costs.

9212. You make the comparison with American costs; but would you hold that they are under-priced in relation to the exports from other countries as well?——No, I think that the German money unit is practically as much under-valued as the pound sterling. In many ways I think it is more correct to say that it is the American dollar which is over-valued, rather than that the German and British money units are under-valued. That is why it is possible to have 7½ per cent. unemployment in America and 2 per cent. unemployment in England and Germany.

9213. I am not clear from your exposition here what you think to be the appropriate action to take in those circumstances. Are you advocating in this memorandum that we should have a fluctuating rate of exchange?——A fluctuating rate of exchange is absolutely unavoidable unless our money unit is tied up with the American dollar and with gold. If it is absolutely tied up by a fixed rate of exchange, then we must face the subsequent fluctuations in money values and unemployment. If, on the other hand, there is to be a policy of stabilising wages or stabilising prices, for example by limiting the rise in wages to the rise in productivity, in that case we must have a fluctuating rate of exchange with the currency of any country which does not adopt a similar system.

* Memoranda of Evidence Part XIII No. 13.

9214. Supposing other policies continued as they have in the past few years, would you expect the pound to hold to a fairly fixed relationship to the dollar, or what kind of variation in its value would you think permissible?——One cannot forecast the fluctuations to be allowed for. It is a matter of guesswork what the equilibrium level of the pound sterling would be. One would have to make suitable assumptions about the movement of British wages and prices in order to make the comparison, and any calculation of that kind is purely hypothetical.

9215. Would you have the Bank of England or the Exchange Equalisation Account intervening to limit the range of fluctuations?——Not necessarily to limit them at all. I think the right procedure would be for the Bank of England to consider daily if necessary, or at any rate at sufficiently short intervals, having regard to wages and cost conditions at home and abroad, exactly what rate of exchange for the moment was consistent with the policy which had been adopted. Having arrived at a figure for today, or this week or this month, which would not necessarily be a published figure, they would adhere to it in purchases and sales of foreign money and gold, and they would vary it as often as might be; but the ultimate effect of that would be that the pound sterling would be the stable currency in terms of wealth, and any foreign money that wanted to be stable on its own account could attain stability by merely having a fixed rate of exchange with Great Britain.

9216. You appear to assume that if prices were held steady in this country and held steady in, let us say, the United States, the sterling rate ought then to remain unchanged?——Substantially I think that is true, subject to certain reservations and corrections. There are various economic forces at work which may alter the proper relation of one money unit to another; but given that we adopt an internal stabilisation policy, which is apparently the policy of the Government, then we must adapt the rate of exchange to that policy.

9217. Suppose that the policy is to convert what was before the war an unfavourable balance of payments into a substantially favourable balance of payments, and that in the meantime there has been a great reduction in our holdings of foreign assets. May that not imply a very

substantial change in the terms on which and the rates of exchange at which this country can conduct trade with the rest of the world?——That has to be allowed for. It is rather an intricate problem. I have just completed a paper about that for the Council on Prices, Productivity and Incomes. The Council, in their first report, criticised my view that the pound is under-valued, on the ground that the loss of external income has been so heavy that a very large adjustment in the rate of exchange ought to be necessary. Against that, in the first place I think that, in a country whose exports are mainly manufactured goods, the important thing, in order to increase exports, is usually to get a footing in the export markets. Of course it is essential to suit the needs of your export markets, to have goods of good quality, and to sell the goods at competitive prices. But I do not think there is any reason to suppose that, provided we have adequate time to adjust our industry to our export markets, any large adjustment in our rate of exchange is necessary. We started off adapting our export markets after 1945 and we have been expanding our exports pretty steadily ever since; they are now double what they were in 1946. I should say we have had plenty of time to adapt our production to the export markets. Then you will observe that the argument about the under-pricing of exports is based upon a comparison of the price index of British manufacturers and the price index of the American manufacturers back to 1938. Substantially, the under-valuation amounts to 19 per cent.; I think the statistics support that figure. In that calculation all the figures are the actual prices at which manufacturers are selling; if the effect of this enormous expansion of exports has been to attract into the export trade producers of high cost, that will be reflected in the statistical calculation.

9218. Is it not almost inevitably reflected? You are not trying to suggest to us that our competitive position in foreign markets is quite independent of the price we charge for our manufactures?——No. I say that we are charging something far below a competitive price. I am now arguing that the calculation that arrives at this 19 per cent. allows for the special effort that has been made to bring high cost manufacturers into the export market. If you suppose that a rise in the rate of exchange or a rise in wages had the effect of excluding the high cost manufacturer, then the extent to which the prices of the rest can be raised is all the greater: if you exclude the high cost manufacturer from this 19 per cent., the under-valuation for all the rest is not 19 per cent. but perhaps 20 per cent. or 21 per cent. on the assumption that there are a substantial number of high cost producers involved. I am not at all sure that there are; I think it is quite likely that British manufacturers, as a whole, have adapted themselves so successfully that a rise of costs, within this limit of 19 per cent., would not cause any great loss of exports.

9219. Are you suggesting to us, as I think is implied in your memorandum, that our exports are very insensitive to cost, and that our competitive position is not very likely to be altered by increases of export prices?——I am not saying that; they are highly sensitive. That is why industry is so much over-employed, and there is a shortage of labour and excessive overtime. Export business is so sensitive to price that it gets over-loaded with orders when its cost is 19 per cent. too low. The effect of raising British costs in due proportion would be simply to relieve industry of this state of over-employment and scarcity of labour and the excessive use of overtime.

9220. Are you suggesting that an increase of 20 per cent. in the price of British exports would currently have very little effect on the volume of exports?——I must make a reservation there. Since this was written the American recession has developed. If American costs were in equilibrium with the flow of money between the dollar area and the rest of the world, then I would say that the costs of British exports could be raised by the full 20 per cent. without any appreciable loss of business. But the situation in America now is very different, and it is quite possible that the increase in costs would reach its limit at 15 per cent. or even 10 per cent. One could only tell by trying.

9221. May I go back to an earlier point which you were making to us? I had the impression that you thought that the Bank of England's appropriate criterion in seeking to regulate the rate of exchange was to compare the movement either of domestic prices here with domestic prices abroad or to compare our export prices with the export prices of other countries, and that it should maintain that relationship. Is that correct?——The important thing is costs, not prices. The key figure is the wage index; I think the average hourly earnings figure is the best to go by. I would also say that the immediate aim of credit regulation should be just maintaining full employment, so that with our existing wage level our credit system should be such that the price level, the profit level and the flow of money should all be consistent with full employment at that wage level. That does not absolutely secure stable wages or stable prices. Under that system wages may be rising, though so long as there is nothing in the monetary system that directly encourages the rise of wages, I should think that the rise of wages would not be very great or very rapid. But those are the considerations which the Bank should have in mind in determining both its credit policy and the rate of exchange to be allotted.

9222. Does not this leave the balance of payments completely out of the picture?——The balance of payments is secured automatically. The balance of payments depends on preventing excess spending. So long as there is no excess spending there will be no excess imports. In spending I include capital outlay as well as consumption spending.

9223. You are putting to us that the balance of payments will very soon become adjusted to the relationship between wages and other costs here to wages and costs abroad?——So long as a tight hold is kept on the supply of money a favourable balance of payments can be secured. When I say "a tight hold on the supply of money", I do not mean by that necessarily dear money or a high Bank Rate, but quantitatively a tight hold on the supply of money. If the total of bank assets is kept down, if necessary by funding operations or by budget surpluses, so that the total supply of money is not sufficient to carry on business otherwise, there will be a favourable balance of payments, and gold and dollars will be acquired. The money reserves will automatically increase if there is a scarcity of money, as they have in Germany at the present time; the favourable balance of payments in Germany is, in my opinion, due to the fact that the supply of money in Germany has been kept down ever since the monetary reform of 1948. I should perhaps say since 1950, because their bank advances rose immediately after the reform. The result has been the accumulation of a very big monetary reserve.

9224. *Chairman*: Sir Ralph, you have told us that in your view the pound is under-valued in relation to the dollar. I think you added that you did not think it was under-valued in relation to other currencies, such as that of Western Germany?——I cannot say that I have studied the cost position of countries other than Western Germany.

9225. If we had a position in which the pound was tied to the dollar, would not our position be very dependent upon whether other currencies, which might be under-valued, were also tied to the dollar? Would not our balance of payments be in great danger?——I think not, because the increase in exports which a country can gain by under-valuing its exports is limited. When there is a general state of unemployment as in 1930, a country which heavily under-values its money, as Japan did, takes away a lot of business from the rest of the world; but when there is a general position of full employment, or at any rate when countries with under-valued money units are fully employed or indeed over-employed, the threat to production in other countries ceases. Now Germany has recently reached that position. Apart from the periods of seasonal unemployment, unemployment in Germany has fallen, as it has here, below 2 per cent. That means that, whatever prices the German exporters sell at and however low their cost, there is a limit to the extent to which the quantitative threat to their exports can be serious. I can imagine a state of things in which the standard by which to determine whether our money was over-valued or under-valued would cease to be gold or American dollars; they could be left on one side to make what they could of the situation, and the standard of measurement would automatically be other industrial countries such as Germany. That is a perfectly possible situation.

9226. *Sir John Woods*: I look at this purely from a worm's eye view, in relation to one industry which you may or may not regard as being a high cost industry.

America is easy as far as I am concerned, and Germany is very difficult; but there is a great deal of competition of a very severe kind from Switzerland, Sweden, Belgium, Italy and France. I think the Chairman's point is very relevant in relation to those other continental countries which, in heavy engineering anyway, are serious competitors of this country. I do not observe that their currencies are over-valued by reference to sterling; therefore, would we not, in that very important sector of British exports, tend to lose a great deal if we re-valued sterling upwards and those other countries did not?——I think that is quite possible. I have thought for some time past that a proper solution would be for the Americans to devalue their dollar. As I say, I have not really studied the cost situation in these other countries: the statistics are not so easily available. The principle, I think, remains perfectly clear: that we are suffering from all the symptoms of a heavily under-valued money. Exactly what the position with other countries may be requires to be investigated. I would not dispute your point; I do not pretend to have all the statistical information at my disposal to give a fully reasoned answer.

9227. *Professor Cairncross*: If the pound was free and the Bank of England were asked whether action was needed to support the rate or to allow it to fall, your view appears to be that the Bank should look to what I should regard as long-term factors; that is, the current cost relationship between this country and other countries. Would you hold to that, even though the movement of the balance of payments might be very strongly in the opposite direction?——I would not regard any arbitrary change in rates of exchange as a proper way of dealing with the balance of payments. If an adverse balance of payments is caused by excessive costs, then of course the right remedy is devaluation; but if it is not due to that but to something else, then the right remedy is probably some monetary measure to stop excess spending.

9228. Suppose there are structural changes. Suppose, for instance, we were to become more dependent on exports or to become less capable of sustaining the balance between exports and imports which is needed to maintain our stability; how then would you expect the rate of exchange to behave?——A structural change like that is in essence a rise of costs, which is properly dealt with by a depreciation of the exchange.

9229. *Professor Sayers*: Surely that would not show itself in the sort of figures you have been looking at? ——I contemplate a Bank of England that continues always on the alert, in very close touch with industrial conditions at home and abroad. It is for them to diagnose the situation and to say what the proper remedy is when things go wrong in any way. I do not think that one can provide any rule of thumb, or any simple statistical test, by which one can say exactly what measures ought to be adopted.

9230. *Professor Cairncross*: But, to put the proposition to you in those terms, if the Chancellor of the Exchequer is under pressure as to what to alter in order to gain a much more favourable balance of payments so as to have capital to employ abroad on a larger scale than in the past, and if at the same time this is likely to mean a marked change in our exports, is it sufficient to put pressure through the monetary system on domestic demand, or do you not think it might be necessary to have some adjustment in the exchange rate to improve the position of British exports?——Not necessarily. I think that if the Government want to stimulate investment abroad the essential condition is to increase savings so as to provide a margin available for investment abroad; otherwise they can only provide a margin for investment abroad by reducing investment at home.

9231. That might be one of the pre-conditions, but would it be sufficient to ensure that British exports underwent the expansion which was called for?——No, it might be wasted at home; but I suppose if the Government are trying to direct and plan industry in the economic system they may have to discriminate in some way between two channels of investment. If they want particularly to encourage investment abroad and the investor is not doing what they want, I suppose they have to take measures to discourage investment at home.

9232. If the foreign situation was to move, it might imply an extension in our share of the world market in manufactured goods from 20 per cent. to 22 or 23 per cent. Do you think that could be brought about without a relative change in the price of British exports?——Yes; I think there is a parallel, on a smaller scale, to the situation which I referred to at the beginning, about a loss of external income. An increase in external investment has to be met in the same sort of way as a loss of external income. I pointed out earlier that it was extremely likely that the process of adapting export trade to the new situation with the increased export surplus would involve a certain amount of time in which traders had to adapt themselves to new markets and to find out how to use productive resources in the most suitable manner, which is the same point as with the loss of external investments. There might then be an interval running to quite a few years, in which substantially one might say that our costs were excessive, because the effect of the situation that I have described would be that we had to draw excess cost or high cost producers into our export markets. But whenever one gets that kind of dislocation one always has to be on the look out for the kind of trouble we have been suffering from in the last ten years; that is to say, we may be losing more from the under-pricing of exports than we are gaining from the increase in volume. At the present time I suppose we are subsidising foreign consumers to the tune of hundreds of millions a year through our under-pricing of exports.

9233. It would be your view that, if the pound were left free, it would undergo considerable appreciation?——"Left free" is a dangerous expression. At the present time we are still suffering from the official view, accepted in all circles, that the pound is not under-valued and that therefore any increase in wages will cause either unemployment or a devaluation. There has therefore been underlying the exchange markets and financial markets all over the world an assumption that it is possible that the British Government and their advisers may be right, and speculation against the pound is for this reason likely to be profitable. That has suffered a set-back by the rise in Bank Rate last year. One may say that a free pound would probably rise. It is very odd that the persistent official view that we cannot afford any rise of wages, when everybody knows that there is going to be a rise of wages, has not carried more weight.

9234. Are you saying that the rate of exchange is governed not just by real factors, such as cost relationships, but also by the weight of propaganda that a Government can bring to bear in its favour?——I do not call it propaganda: it is what the Government regard as an ascertainment of the economic facts, and as sufficiently based for them to base their whole wages policy upon it. That carries weight in the calculations of the people who have to deal in foreign exchange. They give weight to the Government's warnings that we are on the verge of a devaluation of the pound.

9235. *Professor Sayers*: When the International Monetary Fund was set up, it was intended that it should include among its officers people whose business it should be to study the relationships between various currencies and who should, by their objective and international enquiries, help to form international opinion on an objective basis on these questions. On your view has not the I.M.F. failed grievously in not having formed world opinion correctly on the value of sterling?——It is very sad, but I have been almost a lone voice for many years on this subject; all the expert opinion that the Government could rally would be in favour of their present view. Mr. Harrod has taken a similar view to mine; the only other supporter that I could name is the Governor of the Bank of England, who announced a couple of years ago that the pound was still under-valued; but apart from that, any kind of advice that any international body or department could ask for would probably have been just what all governments have been thinking over the last ten years: that the pound has been on the verge of another de-valuation.

9236. Would you not agree that it was one of the purposes of the I.M.F. to form world opinion on just such questions as these?——I do not know. That may have been announced as part of their intentions. If so, I should put very great faith in their proceedings, since they now have Dr. Per Jacobsson in charge of their affairs. I should think that his guidance would be entirely on the right lines.

9237. *Professor Cairncross*: In paragraph 88 you say that, if world deflation on the scale of the early 1930s were repeated at some future time, there would be no hesitation in devaluing the pound at an early stage. Would you agree that if there was to be a resumption of a world depression at would be appropriate to devalue?——Yes; there is no doubt that the authorities would do that if anything like the situation of 1931 recurred.

9238. Would you approve or not?——It would be a disastrous blunder to let the situation recur. If the authorities adopted the kind of plan of stabilisation that I recommend, it never could recur, at least in this country. Of course, if the recession in the United States developed into that kind of horror I should be all in favour of eventually devaluing the pound. It would be necessary in order to maintain full employment.

9239. Even though no change took place in cost relationships?——American costs might become enormously excessive in relation to the flow of money, as at the present time they are evidently no longer in equilibrium.

9240. If America entered a depression, what would be your principal reason for devaluing the pound?——The avoidance of unemployment. If we found our employment going up to 7½ per cent., like the Americans, or even a great deal less than that, even to 4 per cent., I would take drastic measures. This is hypothetical: I could not say exactly what calculations of the rate of exchange would be appropriate. It is one thing to have an instrument of stabilisation in full operation with the necessary close observation of the rate of exchange day by day and week by week; it is quite another thing to have a rate of exchange tied fixedly to the American dollar, and then suddenly to wake up to the fact that that is going to let us in for a depression of enormous magnitude.

9241. So that in extreme circumstances you would break the normal relationship with costs?——Yes, if you take costs as the test; that is, of course, on the assumption that the foreign costs are in equilibrium. Substantially that has been so until recently in America, apart from the set-back in 1949. But as soon as the costs in the country that is being taken as a standard are themselves out of equilibrium, the calculation has to be revised.

9242. Not necessarily, however, proportionate to the reduction in costs in that country?——It is very difficult to say, from the purely statistical point of view, exactly what the disparity is. In 1932, for example, it was possible to say that prices, in terms of gold, had fallen by more than half and that the world depression was due to that fact; but in point of fact that is a very unsatisfactory calculation, because the index includes prices of manufactures, which cannot fall appreciably below costs (indeed can hardly fall as low as costs) along with prices of primary products, which may fall to one-tenth of what they were under the influence of a drop in demand and inelastic supply.

9243. *Chairman*: There is another point on which we wanted some help from you, Sir Ralph: what is your attitude towards the budgetary instrument? In paragraph 56 you introduce the view that for the purpose of stopping inflation budgetary action is not easily made effective. You say that a budget surplus does not necessarily have any deflationary effect; and you go on to give possible uses of the budget surplus. In paragraph 57 you say that it cannot be relied upon to stop inflation because it cannot work its effect in a short period. Professor Cairncross, would you like to put one or two points on this?—*Professor Cairncross*: It is not apparent to me why you do not treat a budget surplus as reacting on demand in the way in which I think most economists assume it does. You say that, if the budget surplus is used to redeem debt in the hands of investors, it merely adds to the resources of the investment market. If you chose to redeem debt, might that not go to finance outlay that would have taken place in any event?——A country cannot have capital outlay in excess of available savings. If it does, there is excess spending and inflation and an unfavourable balance.

9244. *Professor Sayers*: But that is just what we may have at some times. Suppose that in that situation a budget surplus is created by an act of policy, would that budget surplus help to reduce the level of internal demand and so to restore these various equilibriums?——Yes; but if the surplus is used to redeem investments in the hands of the public, that adds to the resources of the public for capital outlay just what has been taken away, and there is no need for reduction in their outlays.

9245. *Professor Cairncross*: But without a surplus you would add still more, because then the capital outlay would have to be financed by the Government out of additional money?—*Professor Sayers*: We are concerned not with the fact that we have a surplus, but with the decision that was taken to create a surplus; this act of creating a surplus removes from some people their capacity to demand goods and services to a certain extent?——Then the surplus is used to redeem debt in the hands of investors, and the investors receive the spending power that the consumers gave up. The effect may be to reduce consumption and increase capital outlay, but on balance the total amount of spending is not altered.

9246. The total amount of spending is not altered, as you have described the procedure; but I thought it was of the essence of your case that it is not so much the stock of money as the flow of money that matters, that it is the effective demand for goods and services that determines the inflationary pressure. If some people find that their income after tax is reduced by the amount which totals up to the budget surplus created by a decision of the Chancellor, then is not the flow of money demanding goods and services in exchange reduced by that act?——Yes, but when the money comes into the hands of the investors it starts on its course again, so the flow of money remains undiminished. I agree that there might be a short interval in which the money is held idle, and intervals are often very important.

9247. Is not that absolutely critical?——It seems to me that, particularly at the time at which its purpose is to stop inflation, one effect of inflation is to create an unsatisfied demand for capital outlay. There is inflated demand and therefore a desire on the part of producers to extend their productive capacity, and a consequential pressure on the capital market. If at a time like that resources in the hands of investors are increased, the money is likely to be immediately devoted to capital outlay.

9248. *Professor Cairncross*: There is no increase in the resources, surely, in the hands of the investors? They are being given money in place of debt; they could get that money by selling the debt at any time?——Yes, but then somebody has to buy it.

9249. That may affect the rate of interest, but it is an operation in which it would be possible for them to indulge freely?——The total resources available to the capital market are increased by the amount.

9250. *Professor Sayers*: But the outlay of the capital market was not being constricted by the stock of money. You have agreed that it is the flow that matters, not the stock?——But this money is flowing from the Government to the investors, and the investors do not want to hold it idle.

9251. *Professor Cairncross*: Can they not go and buy a debt?——Provided they can find a seller, but the seller will then have the money and want to do something with that.

9252. *Professor Sayers*: But nothing has altered to give them any incentive to spend the total amount that was knocked off consumption spending by the act of redemption?——I agree that it reduces capital outlay or consumption spending; but I would like to proceed to another point which I think may help to clear this up. The alternative to redeeming debt in the hands of investors is redeeming debt in the hands of the banks. If the Government redeem debt in the hands of the banks, and the banks are not disposed to encourage credit expansion (if, that is to say, the banks are not at cross purposes with the Government when it is time to stop inflation), in that case the surplus is used to extinguish money, and the flow of money is to that extent stopped. I have been laying stress on the contrast between that procedure, where the Government uses its taxing power to extinguish money, and the other case where it simply passes all its money to a different class of spenders.

9253. *Professor Cairncross*: May we take it in conjunction with what you say in paragraph 50: "It is when a part of Government expenditure is financed by the banks through increased holdings of Treasury bills or other Government securities that excess spending occurs". This seems, to me at any rate, to mean that you lay all your emphasis in this passage on an increase in the

money supply as being inflationary. It seems to me equally that in the passage we are looking at in paragraph 56 the distinction which you draw is based on the fact that in one case the money supply expands, whereas in the other case it does not. But you have already in an earlier passage told us that it was not just the money supply that mattered, but the flow of money; that is, it is open to the Government, by redeeming debt in whatever form it chooses, to keep the money supply constant. If it does, then would you agree that a budget surplus does exercise a deflationary effect?——A budget surplus which is applied to extinguishing money does have a deflationary effect provided that the banks are not acting at cross purposes and stimulating the creation of money to fill the gap.

9254. Or if the public's attitude towards money and debt is calculated to preserve constancy of spending?——I am not supposing anything to alter the public's attitude towards money and debt by the act of redemption; investments are not all in the form of debt. I have been assuming that the investor is somebody who likes to draw an income from his capital. When debt is redeemed he ceases to draw an income from it; therefore be is immediately on the look out for an alternative means of drawing an income.

9255. *Chairman*: But the Government can only redeem its own debt?——Yes, that is true; still, there are plenty of Government securities in the bands of a very wide variety of investors.

9256. *Professor Cairncross*: The reason for pressing you on this is that as you put it in your memorandum you seem to be drawing a distinction between what the Government can do through the budget and what it can do through monetary policy; but I am not clear, after listening to the discussion in the last few minutes, whether you think this is an important distinction or not?——I think that what is important is what I say in paragraph 57: "The principal reason why a budget surplus cannot be relied on to stop inflation is that it cannot work its effect in a short period. Nor can it be promptly stopped when inflation is yielding place to deflation". That brings my account of this into relation with one of the principal recommendations of Bank Rate policy: that Bank Rate can be altered to any extent at short intervals, can be used as a weapon in a very short period, and can stop in the initial stages any undesirable tendency towards inflation or deflation. Fiscal policy cannot do that.

9257. *Professor Sayers*: I thought you argued that a Budget surplus does have an immediate effect in reducing the flow of money in exchange for goods and services. You went on to argue that this will subsequently be offset by an expansion of capital spending, and so on; but did you not agree that the effect of a budget surplus was to reduce the flow, that is to say, to produce a quick effect?——May I suggest that we take a more realistic view of what a budget surplus is? Suppose a budget surplus of round about £500 million a year; the immediate impact is to withdraw £1½ million a day from the public. I spoke of an interval possibly being important; the interval may be just a separate interval for each day's surplus spread over several months. The budget surplus starts some time in the financial year, and it only has a serious effect on the amount of outlays in the course of months. The whole thing is a gradual process.

9258. *Professor Cairncross*: Your principal emphasis, however is on paragraph 57, where you are taking the view that Government can do very little through taxation or expenditure in the short period? In fact I think you went further, and said that they could not do anything inside the year?——Of course, they could have an interim budget; and there have been various proposals put forward for using taxes that can be adjusted at short intervals, though I do not think any of them get over my objection in paragraph 57. One is to have a sales tax that can be adjusted at short intervals; another is to adjust the "Pay As You Earn" deductions; or again to adjust the national insurance contributions. Many things of that kind can be done at pretty short intervals without seriously contravening constitutional procedure for finance.

9259. Why do you not think that would have an effect in the short period?——None of them would be anything like Bank Rate in the delicacy of action. Incidentally, I do not think that the public can be relied upon to accept a big increase in the fiscal burden, whatever form it takes, merely because the Governor of the Bank of England thinks that the tendency is towards inflation, and that in the course of two or three years' time there may be such a rise in prices that the consumer will be very much annoyed by it; I do not think in a situation like that you would be able to get a Government to make the necessary increases, whereas Bank Rate can be put up without consulting anybody, and kept up just long enough, with no serious detriment to anybody concerned.

9260. *Chairman*: Does not that imply a freedom in the central bank to take its measures for an economic purpose which it foresees, independently of the political action which the Government itself would support?——That is the system we are working under at the present time. Of course the Governor is a servant of the Government, and presumably the Government could overrule him when be recommends a rise of Bank Rate; but it is not as if a rise of Bank Rate was going to evoke popular opposition in the same way as a rise of sales tax or "Pay As You Earn."

9261. Is not the operation of the Bank Rate very much a subject of public controversy today?——Yes; it is very much a matter of controversy because it is believed that the effect of a high Bank Rate is to reduce demand. If it is a purpose of high policy to reduce demand, then the complaints of a high Bank Rate ought not to weigh very much. I think that, whereas Bank Rate was under a cloud until last September, most people would now admit that it does do its job and that we have got a favourable balance of payments and a favourable rate of exchange.

9262. We have touched on a topic which is not dealt with in your paper. With all your experience inside the Treasury, and observing the monetary field, have you any views about the right relation, in the kind of state we live in, between the Government on one side and the central bank on the other? You have seen two systems at least in operation, I suppose, at any rate in form; what would you say about the way to work the relationship?——It is important to have a clear policy, so that the Bank of England knows what it is aiming at. Given that policy, it should be given a free hand, as a general in the field. I do not think that the Government ought to bother about technicalities of credit control, just as a Government does not bother about the technicalities of the Inland Revenue. The Inland Revenue knows all the intricacies of the law and administration of income tax, and goes ahead with it; things only come up to the Government where some grievance arises and someone is suffering from something which is alleged to be against policy. If the Bank of England were given a perfectly free hand in credit policy, there might be occasions on which there would be complaints to the Government; but if the Bank knows its job it would have a good answer to them, just as in general the Inland Revenue has a good answer to complaints.

9263. Do you think that credit policy can be separated from the operation of the credit instruments as clearly as your answer is rather suggesting? Once the Bank has been given its political directive, such as a general in the field is sometimes allowed to receive, can the Bank be left on its own responsibility to choose the instruments and how they are to be worked?——Yes; but of course it is absolutely essential that the Government should also play the game. If the Government starts some inflationary or deflationary policy, it must do that at any rate in consultation with the Bank, so that they shall not be at cross purposes. An example of that is the relation of funding operations to the 30 per cent. liquidity ratio which the banks are at present more or less committed to following. Funding may have the effect of reducing the supply of Treasury Bills and making it difficult or perhaps impossible for the banks to adhere to the 30 per cent. liquidity ratio. If there are not enough Treasury Bills to go round, they may fail to attain it. Whenever the Government is engaging in funding operations or in the redemption of Treasury Bills or any similar operation, or even in a policy of budget surplus or deficit, in all those things it would undoubtedly have to consult with the Bank of England and see to it that it was not putting difficulties in the Bank's way. To that extent there would have to be very intimate relations between the Bank and the Treasury. That is largely a realm with which Parliament does not interfere; Parliament never has very much interest

in funding and debt policy. The Treasury as a department would have a pretty free hand to make arrangements with the Bank. Sometimes there might be a conflict of interest, in the sense that payment of a high rate of interest on Treasury Bills might be inconvenient for budgetary purposes. Matters of that kind would arise, and in the last resort that kind of question would have to come up before the Chancellor of the Exchequer and the Cabinet. But, given a well understood and wise policy, I think all such questions could be settled without any very great difficulty.

9264. *Sir John Woods*: Let us suppose that the Bank has been given a directive that all policy is to be directed towards attaining stability of prices, but without the risk of severe unemployment. Would it be your view that the Bank of England should then be entirely free to do what it liked with Bank Rate, even without consultation with the Government?——I think that in practice consultation would be a matter of course, but I do not think consultation ought to mean interference with the discretion of the Bank, unless some real point of difficulty turns up.

9265. Might there not be a real point of difficulty in that context? A number of people in this country might think that having a Bank Rate as high as the one we had in September does seriously threaten employment?——I think that the price stabilisation you suggest would on the whole secure full employment, but I should quite agree that there are cases in which it would not. For that reason I have for a long time advocated not a stabilisation of prices but a stabilisation of the wage level; that is to say, monetary policy should be such that it never by itself requires any change in the wage level.

9266. I was not meaning to raise that question on its merits; I was merely saying that from the Government's point of view there are many people who distrust the use of high interest rates as being a threat to employment. Therefore it seems to me politically difficult for a Government in that area to leave the carrying out of policy entirely to the Bank's discretion?——I was suggesting, by way of reply to that, that in preference to a stabilisation of prices, which might involve unemployment, I would have stabilisation of wages, which would mean that monetary policy was so framed as to keep the flow of money just at the point of securing full employment with the existing wage level. If that were the instruction to the Bank of England, there could only be unemployment through failing to carry the instructions out. I do not mean to say that that would not sometimes occur; after all, unemployment is sometimes brought about by other causes than money.

9267. *Professor Cairncross*: Sir Ralph, you refer several times to excess spending, and the discussion of it runs right through your memorandum; how do you judge when there is excess spending?——There are various symptoms. One is the adverse balance; if there is an adverse balance, that in one form or another necessarily means excess spending.

9268. Even if there is a depression abroad? Are there not exceptions to this?——Excess spending in a sense is rather a relative term. If there is a depression abroad and our policy is to adjust conditions here to conditions abroad, then so long as there is excess spending delaying the appearance of the depression here, that is a fault in the carrying out of the policy.

9269. I am not putting the question to you as a matter of terminology, but rather to find out what symptoms you would regard as calling for action. You seem to identify excess spending with inflation, very largely?——Yes.

9270. What are the symptoms that you would have the Bank of England look at carefully in deciding when to modify credit policy?——As I say, the balance of payments is one of them; and the other would be the state of employment. A state of over-employment, an abnormally low unemployment ratio, excessive hours, an actual scarcity of labour, difficulty of procuring labour needed by industry: those are clear symptoms of over-spending, and in order to remedy that tight credit is needed.

9271. You do not regard a reduction in stocks, which I should have thought was the first thing you would have mentioned, as being a symptom?——Yes; but it is difficult to interpret stocks statistically. For one thing, when traders are endeavouring to decrease their stocks the effect is felt to a great extent in diminished activity, diminished incomes and diminished outlay, and the decrease of stocks fails to be effective. Also the question of what total of stocks is excessive depends on what traders expect to happen to prices, the cost of credit and so on. In order to interpret any given statistical position of stocks one has to apply all those different qualifications. But I should entirely agree that the state of stocks is in itself highly important.

9272. You do not make any reference to the movement of prices?——Of course the movement of prices counts for a great deal, but I do not think one can lay down any simple rules relating excess spending to prices. For instance, the price level depends among other things very much upon the state of the markets in primary products. A rise or fall in prices may be due to scarcity or abundance of various primary products. In the case of manufactured products there are many fluctuations of prices which are not really very relevant to the primary situation of an excess or deficiency of spending. But I think a well-conducted central bank would be in close touch with all the available symptoms, statistical and other, just as the I.M.F. should for world conditions.

Chairman: I think that exhausts the questions we wanted to draw you on, Sir Ralph. We are very much obliged to you for your help to us.

(Adjourned until Friday, 13th June, 1958, at 11 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-SIXTH DAY

Friday, 13th June, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.B., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E. (Questions 9273 to 9348 only)
W. E. JONES, ESQ., O.B.E. (Questions 9273 to 9360 only)

PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

M. H. DE KOCK, ESQ., Governor of the South African Reserve Bank, called and examined.

9273. *Chairman*: Mr. de Kock, we are all very grateful to you for your memorandum*; you can take it we have all read it through thoroughly. Will you have it in front of you so that we can run through it paragraph by paragraph? The first section is devoted to an analytical account of the set-up of the Reserve Bank. You say in paragraph 3 that three of the stockholders' representatives are required "to be, or to have been, actively engaged in commerce or finance, one in agriculture and two in other industrial pursuits." What has been the pattern? Do you normally have people who have outside activities as well?——*Mr. de Kock*: Yes. The original Act, I assume, was intended to cover a person who is actively engaged in, say, finance or commerce when elected by the stockholders and subsequently retires from his other activities but is asked to remain on the Board for a certain period. We have no age limit or understanding, as you have in Britain. I think it was just to cover that, but normally it is followed very closely. At some times we have, as at present, a representative falling under the first group of finance, but who at the same time sits on the boards of various manufacturing companies and has a big ranch, so that strictly speaking he can fall under any one of the three groups. Should we have a very good man in finance when a vacancy occurs in the industrial group, we could shift this representative into the industrial group and appoint someone else in finance. But usually the practice has been that we want men who are actively engaged in any of these fields.

9274. From your experience would you attach importance to the fact that they had at the same time as their directorships of the Bank active outside interests as well?——Yes. We have found it very useful as a source of information on how things are going currently or what the prospects are. We also rely upon any one particular representative consulting others in his particular line of activity. There are, for example, the industrial representatives; we have one in manufacturing and one in mining. They are expected to consult their colleagues before attending a Board meeting, or at times the Governor may ask in between Board meetings for certain information on their particular activities.

9275. Does this consultation with colleagues outside and with points of contact in their own industries produce any difficulties, from the point of view of advance information becoming available or Bank propositions being discussed or becoming known outside the Bank?——Individually they would not. They are able to discuss anything of a serious nature with the Deputy Governor or Governor, not always at the Board meetings. Usually our experience has been that we act as a family; traditions have grown up, even in a young bank like ours, and directors are expected to maintain secrecy not only regarding the activities of the Bank itself but also about any information which other directors may have submitted at the Board meetings.

9276. That being the basis, how is it possible, let us say, for the man who represents commerce to have talks about matters coming up for decision by the Bank with people outside? Does he not find his hands rather tied?——We expect them to keep in touch with commerce generally, and to be better informed, but not to discuss matters which have been submitted at the Board meetings. It was of course a matter of great interest to our directors as to what happened here at the Parker Tribunal; it was probably an eye-opener to them, to show how complications can arise. But we do not have the same degree of interconnection of financial companies that you have in London, so that we have less chance of a director finding himself in a difficult position and making a decision after he knows that Bank Rate may be changed. We have one director who is chairman of the biggest insurance company in South Africa; he particularly was very interested in what had happened here, as he had tried very hard not to disclose any information he might get from the Bank. As he is our senior director with the longest service, I consult him more frequently than the others, so that he has been in a difficult position off and on; but he claims that his attempts to avoid discussing rates have not really created great difficulties for him with his officials. But I can quite imagine the position is much more difficult here.

9277. *Lord Harcourt*: How often does your Board meet?——The normal procedure is that the full Board meets four times a year only, as members come from various parts of the country, which is a fair size. We have territorial representation, not under the Act but by agreement. The quarterly meeting is a meeting that goes into great detail and tries to anticipate what will happen in the next quarter. But we can have either full meetings or smaller meetings in between. Sometimes I telephone to Cape Town to the senior director who lives there, and I may consult him or I may say what is in my mind. Others in Johannesburg and Pretoria are of course more near by, but except in times of crisis we have not found it necessary to hold more than four meetings a year.

9278. *Sir John Woods*: You do not have any sort of standing committee of the Board?——We have sometimes thought about it, and I think it would be a big improvement, but so far nothing has been done. Sometimes we have committees for particular purposes. At the Board meeting I may submit that something is about to happen, and I suggest that a committee of three or four be appointed for that purpose; but there is not a regular executive committee to cover any particular point of importance.

9279. *Lord Harcourt*: How many of your directors are executive directors?——We have no executive directors as the Bank of England has; only the Governor and Deputy Governor are full-time, and the others are all part-time.

9280. *Professor Cairncross*: How do the Government-appointed directors, other than the Governor and Deputy Governor, differ from the others? Are they chosen also from industry and commerce?——They may be, but the Act does not lay down any particular qualification. The Government at present has a professor of economics as one of the three; then there is one in commerce, and

* Memoranda of Evidence Part V No. 7.

the other one is a general representative; he was our High Commissioner in London before the war. But they have changed from time to time, and the Government just considers supplementing the other six, who are known to them.

9281. *Chairman*: It is a statutory requirement that the Governor should have banking experience, but apart from that your system works without the other directors on the Board coming from the banking world?——That is so.

9282. I know it excludes people actively concerned, but apart from that it is not the normal practice that they should have past banking experience?——No. We find it is enough for the Governor and Deputy Governor to have the technical knowledge of banking. We want to know more about what happens in the other economic activities of the country. Not only the Governor and Deputy Governor but our chief executives and staff command all the necessary knowledge of banking. In the first three years of the Reserve Bank, as in the American system on which our Act was based, three of the seats on the Board were reserved for bankers. After two years the first Governor, who was an old Bank of England man, represented to the Government that it was a complication for him to have commercial banking representatives on the Board. That was sufficient for the Government to introduce an amendment in 1923 to exclude commercial bankers from the Board and so it has remained. As regards the banks, of course, although bankers are excluded from the Board we have frequent contact with them. There is no real reason for representatives of the banks being on the Board. We have them on our doorstep most of the time.

9283. *Sir Oliver Franks*: Would you say that the fact that the membership of the Board is to an extent representative of the different States of the Union, that it brings in people who live in the different parts of the Union, is a strength to the Board in relation to public opinion, or do you think that it is not very important in that regard? Do you think that it gives the citizens of the Union generally a feeling of breadth of base in the Bank's Board, or do you think this is not a thought which plays any part?——I would say that both from the point of view of public opinion and from the point of view of the Government as well it has been a source of strength; that in arguments with the Government, and the Treasury in particular, we have always found the existence of a Board constituted in this way a source of strength in making our points clearer. In the course of years we have observed some inclination on the part of Government representatives, whether in the Cabinet or officials in the Treasury, to attach some importance to what I have to say about the views or the attitude our Board would take up on a given matter *vis-à-vis* the Government. In public opinion, too, I think there is an inclination to place a greater value on the status of the Bank by virtue of the composition of its Board.

9284. *Professor Sayers*: In speaking of these representative directors you have talked of them as funnels through which you can draw information and advice from the various sectors of the economy. Are they of importance to you at all in helping to get the Bank's attitude understood by these various sectors? Do they serve the purpose of helping to keep public opinion in touch with and understanding the thought of the Bank?——Yes, I think they perform a useful function in that way. In their communities they are bound to discuss some of these matters of common concern, and in that way they help to interpret the policy of the Bank and give the reasons for acts which may be regarded as unpopular by a certain section of the community. We find that to that extent they are, as it were, agents of the Bank in their communities.

9285. And do you therefore encourage them to discuss the motives of the Bank outside?——We never encourage them to discuss basic policies of the Bank, because they may say more than we would like them to say or they may not interpret the technical details correctly; but in a general way they do discuss the matter. If questions are followed up by a particular person who is well informed, say an economist, in that area, the director would normally say: "I suggest you go and see the Governor yourself." The moment he gets into deep water he would pass him on to the Bank.

9286. And do you attach importance to commanding this acceptance by informed opinion through whatever channel? Do you think it important to see that the Bank is understood?——Yes. In one way or another we help the Press, the financial editors, to understand the position better, if we notice from their comments that they have got the wrong angle. The Governor or Deputy Governor himself would not do it except in very special cases, but we always have one official or another who is told to contact the party concerned and show him where he took the wrong turning. We do not have a special official like in the Bank of England; we do not do things on such a big scale.

9287. *Mr. Jones*: Is there any significance in the circumstance that six members of the Board are representatives of stockholders and five are nominated by the Government, in that it is six to five?——That arose at the beginning in 1920, when the Act was passed. From what I can remember of the proceedings in Parliament of the Select Committee, it was the idea that there should just be a majority for the stockholders. That six to five makes it very close; it does not look as if the Bank will be run by the private stockholders. I think that it is one of those things that just happens; some decision had to be taken and instead of making it seven to four they made it closer. There was one time when the National Party while in opposition proposed that an additional member be appointed by the Government so as to make it six to six, with the Governor having the casting vote. That was after the Second Reading of the new Act, the 1944 Act which took the place of the old Act and included all the amendments made in the meantime. I was Deputy Governor at the time; the Governor told me to say that we would agree, and when it got to the Committee stage the Minister then proposed the appointment of an additional member by the Government, but the Chairman of the Committee rejected the amendment on the ground that it was a material amendment. As Parliament had already given the Bill a Second Reading as it was, they would have had to return to the Second Reading stage; it was towards the end of Parliament, and so the Minister gave it up. But instead of that he reduced the maximum stockholding from £10,000 to £5,000 as a compromise; that was the second point the Opposition had pressed for. That was in 1944. Since 1948 the National Party has been in power, and still is; they have not raised that point again, because they find that the system works well as it is.

9288. *Chairman*: The position is this that by the constitution the majority on the Board of the Bank are the directors appointed by the outside stockholders; on the other hand the Minister of Finance can say in Parliament that "the Treasury, the State, has all the power behind the scenes", and that he shares responsibility with you for decisions taken in the monetary field. There must be some constitutional practice under which the independence of the Board is reconciled with those Parliamentary statements. What happens in fact?——In practice our Board acts as one unit. The Government representatives and the stockholders' representatives are intermingled and no one ever says: "Speaking as a Government representative (or as a stockholders' representative) I say so-and-so". Throughout the period I have been connected with the Bank (I have been on the Board since 1932) that question has never come up. I think that is why the present Government, knowing how it works, have not raised the issue again since they came to power. There was one time when the Labour Party had made an important point of it. But the practice has been that the six stockholders' representatives do not regard matters from the point of view of their own particular economic activity, but that of the country as a whole. Newly appointed directors very soon learn that the central bank has to look at matters from the national point of view, and that they must not come with all their selfish interests. In practice it could all be men nominated by the Government, provided the Government nominated from commerce, finance, industry and agriculture; it would have exactly the same effect. We do not make a big feature of it, but psychologically it helps. The public particularly feel that the Bank is not an institution that is at the whim of the Government, and that therefore politics do not enter into the decisions and activities of the central bank.

9289. Accepting that the directors do approach their position and their duties as directors of the central bank regardless of who put them there, when there is a conflict

of view, as there must sometimes be, between their decisions as a Board and the Government represented by the Treasury, how is this conflict resolved?——Yes. The Government is not directly represented on the Board. The Government has always appointed men from outside, so that if there is any conflict it is left to the Governor to resolve the issue. The Board as such will never send a deputation to the Government about any matter. It has become a tradition that the Governor is the only one who may speak for the Bank and that, whenever the Governor feels very strongly about a matter, the directors who have spoken against it have, up to now anyway, given up. They have been satisfied to state their point of view, and if they cannot shake the Governor they are content to agree.

9290. You have then a working convention that in the last resort on the Board the Governor's view is the one that should prevail?——Yes. In practice as Governor for thirteen years I can testify that the Board has influenced me in the course of years; so there is less opportunity for disagreement. They get to understand the Governor better, and the Governor gets to understand them better, and frequently his proposals are framed in such a way that they will not necessarily meet their wishes, but avoid the points of dissension. But the Board has accepted that the Governor is the regular contact with the Government, with the banks, and with central banks in all parts of the world, and if he feels very strongly about a matter they are not prepared to press their point against him.

9291. I have still not quite understood the interpretation of the phrase: "The Treasury has all the power behind the scenes". It has no formal power under your constitution; it cannot give directions or control decisions about the level of interest rates or the volume of credit. How does it work then? You consult the Minister before you take any effective decision in the name of the Board. Is there never a conflict of view that has to be resolved?——So far we have not had anything serious. I have sometimes been influenced by the Treasury bringing up a point which I had not fully considered; or they may suggest some delay.

9292. According to your experience the ultimate decision is accepted as lying with the Governor on behalf of the Board, but you would expect to weigh all that is put to you?——Yes. When the Minister said, at the time when the 1944 Act was passed, that the Treasury has all the power behind the scenes, it was one of those statements that tend to come in the course of a speech made out of hand. He was a very reasonable Minister; during the nine years of his office he never once tried to use any pressure with the Bank. I think that it was just a way of overstating the case. They have the power behind the scenes; but they still have their responsibility towards the country if they do not follow the advice of the central bank. We have a tradition that at the annual meeting of stockholders the Governor gives a comprehensive review of the whole economic and financial position with explanations of the Bank's policies. That gives him the opportunity of stating any disagreement with the Government, and our Government has never seen fit to have that happen. Just as our directors accept the view of the Governor if he feels strongly, so the Government has up to now accepted the Bank's view, for fear of the matter being ventilated in the Governor's address to stockholders, which gets full publicity. The Bank sees that every word of it is published; it pays as for a company advertisement like any other company, without it being said to be a company advertisement. Every newspaper in South Africa gets it and comments are made. I regard that tradition as a very important factor in strengthening the position of the Reserve Bank *vis-à-vis* the Government. Theoretically the Minister has the power behind the scenes, but practically he is limited by the publicity given to what the Bank does and the comments made by the Press and by members of Parliament.

9293. *Professor Cairncross*: In the specific example you gave us about supplementary reserve requirements, did the initiative rest with the Treasury? Was it their function to bring this into force, or did it rest with you?——The initiative rests with the Bank according to law, but the Treasury has to agree to the implementation of it.

9294. This is a statutory requirement?——Yes. The initiative in all those matters lies with the Bank; the Government can agree or otherwise. If the Government disagreed on this question of supplementary reserve requirements, the Reserve Bank would have let the country know that there was a problem of an over-expansion of bank credit which was leading to imports increasing beyond the means of the country, and that our proposals were not accepted by the Government.

9295. Is the Government also statutorily required to agree to an increase in Bank Rate?——No, that is just an arrangement; we feel that the Treasury has to be consulted. It is for the Minister of Finance to tell his colleagues in the Cabinet about it if he wishes to, but we have always discussed it with the Treasury. That is a position we have to accept, although there is no mention of it in the Act. The Act just says that the Bank must publish the rates at which it is prepared to discount various classes of bills, whether Treasury or commercial or agricultural bills. That is an obligation, and also a source of strength for us. We cannot shirk that issue. We must publish the rates; and, having to publish the rates, naturally we take the initiative.

9296. But if the Minister of Finance wanted you to delay raising rates for a time, and put that to you, you might be prepared to accept this view, even though you had the support of your Board?——Yes.

9297. *Mr. Jones*: You indicated that, where the Bank was at variance with Government policy, you would go and hammer it out with the Minister or the Treasury. As the Government, the Minister and the Bank are responsible for the economic and financial wellbeing of the country, are there circumstances where the Bank, through yourself as Governor, and the Government, through the Finance Committee, discuss financial and economic policy in the Union?——Yes, we have opportunities for doing that. It is not a regular feature for the Governor to appear before the Public Accounts Committee of Parliament. That has happened only a few times. There is no standing arrangement, but there are opportunities for consultation with the finance leaders of the Opposition. When we have had amending legislation for the Reserve Bank, and when the National Finance Corporation, which was sponsored by the Reserve Bank, was set up, there were arguments in Parliament, and I suggested to the Minister of Finance that I should see the Opposition and explain the matter to them and arrive at a compromise. In all such cases we have been able to arrange a suitable compromise.

9298. In circumstances where the Treasury has a point of view on finance, would that lead the Treasury to come to you in those circumstances, in the same way as you go to the Treasury when you are at variance or where you are apprehensive of the policy of the Treasury?——Yes, Sir, the head of the Treasury and the Governor meet frequently. The Treasury has sometimes mentioned the question of Bank Rate, but always in the sense of suggesting that there is perhaps a case for considering a change in view of these and those conditions; there is never any pressure. It so happens that we have had a good working arrangement, and the head of the Reserve Bank and the head of the Treasury have always been friends.

9299. How intimate is your association in carrying out this work in the Union? Have you regular meetings, for instance, to discuss policy?——Not anything regular. It just happens. Sometimes we talk on the telephone, or sometimes we have lunch together; or I go to the Treasury on my way to the Bank. I have to pass the Government buildings on my way to the Bank, and it suits them if I do that, rather than that they should come down to town to the Bank. There has never been any occasion for regular meetings; it just happens all the time. We are close together.

9300. *Chairman*: Would you say that this works very well because of happy personal relations and that there might be more difficulty if the relations were not easy and friendly?——That is quite possible, but I consider that, if the appointments are of the kind they should be, no difficulty should arise. I think that both the Governor and the Secretary for Finance, as we call him, should be economists, as things are today. I cannot imagine anyone else being able to cope with the situation if he wants to be a really active Governor; it is not enough to have economic advice; he has to act on his own on so many occasions when he alone is present with the Minister in secret discussions. The same Minister selects the Governor and the Secretary for Finance, and the chances are that

he is not going to appoint two people who he knows have differed greatly, as of course happens in the field of economics.

9301. *Professor Cairncross*: Do the staff of the Reserve Bank and the staff of the Treasury have much contact with each other? Do you ever take into the Reserve Bank someone whose career normally is in the Treasury?——That has never been done, nor *vice versa*. I do not say that we should object to it but so far we have rather looked at it that we train our men and the Treasury have to train their men. There is a slight difference of outlook: we are like a private institution, and they are part of the Civil Service and subject to all the regulations of the Service.

9302. But they do have contact with one another?——Yes.

9303. *Professor Sayers*: When you recruit them initially, do you recruit from the same field? Are they the same kind of people? Do they have the same background? Do they have the same sort of education?——Yes, I think that would be very much the same, because we train our own people now, with the exception, say, of bringing an economist or a statistician in from outside.

9304. *Sir Oliver Franks*: If one takes the higher administrative staff in the South African Treasury and in your Bank, are most of them in fact recruited from university graduates?——Most of the senior men today are university people, but the great majority of entrants are just out of high school, of matriculation standard. Many of them continue their education after that. There are facilities in our big towns, in the extra-mural faculties of universities, for people to take a B.Com. degree. That is done to quite a large extent. Then there are the bankers' examinations; we have an Institute of Bankers similar to yours, and we encourage people to take courses in order to be able to pass these examinations. Years ago it was not the practice to do so, when the Bank started. There were not so many opportunities for advanced education in economics and so on. When I was a young man there was not anything like that in South Africa; I went abroad for it. Today there are still people going abroad for advanced study in economics, but at least we can in our universities give them a fairly good grounding today.

9305. *Professor Sayers*: Has there been any suggestion or discussion of the possibility of interchange of personnel between the Treasury and the Bank on the way up, so to speak?——No, we have never discussed that.

9306. *Professor Cairncross*: Do you see anything objectionable in that?——Not if it suits both parties. We may have a desire to get a certain man from the Treasury whom we like into the Bank, but we feel the Treasury needs him perhaps more than we need him, so we leave it alone.

9307. You have a lot of problems on debt management in South Africa, I take it, as most other countries have. These problems are probably better understood in the Treasury, where the normal authority is likely to lie, than perhaps in banking. Have you thought of some interchange that would extend the experience of your own staff in that way?——No, we have not considered that. The problems of debt management are not so complicated for us as they are in the U.K. and U.S.

9308. *Sir John Woods*: You have been talking about the relations between the Reserve Bank and the Treasury in monetary matters; what is the relationship in fiscal and budget matters? Does the Bank know about the budget beforehand? Is it consulted?——Just as the Bank consults the Treasury on purely monetary matters and tells them what is in their mind, so it has come about in the course of years, not from the start, but particularly since I have been Governor, that the Treasury consults the Bank on fiscal matters. That is not just because I am Governor; it is because in the world as a whole fiscal policy has come to play a bigger part. The Treasury have come to see that budget policy is a very important factor in economic policy generally, and that has caused them to discuss possible repercussions of any decision or measures with the Bank. They cannot consult others, but they regard the Governor of the Reserve Bank as a party concerned in the matter. His advice might be valuable to them, and he at least could be expected to keep a secret. So in recent years they have discussed their policy beforehand, and from our side we have made suggestions to them as to what they should do. We have a friendly discussion on fiscal matters as well as on monetary matters; the two are discussed together because they belong together. But those matters are never discussed with our Board. That is purely a matter between the Governor and the Treasury.

9309. *Chairman*: Now we ought to move on to what you say about the instruments of control. The first one that you draw attention to is the use of "moral suasion". It looks from what you say as if recently you have not found that you can rely upon that particular weapon for all purposes. Would you enlarge a little as to why, when you have only four main commercial banks to deal with, you have found that recently it has not been capable of being relied upon? I understand that they have varying conditions of business, but I would have thought that your requests to them might be adapted to their variations, which would be known to you and known to them among themselves. What has gone wrong in this?——In the first place the competition between the banks has come to play a bigger part than it did before. Secondly, I would blame the system, which is the British system, of extending facilities on the overdraft basis and laying down limits. In the course of years, affected by competition, limits have been laid down in excess of what the bank regarded as the needs of the customer; but the customer came to look upon this limit as an assessment of his status and if he did not get it from his banker he might go to another banker. That did happen; there was a new bank that had come along very fast. It was a local bank, and on sentimental grounds also it attracted a lot of business away from the three older banks. As far as I can judge the Government and the Bank thought that there was no danger, because according to their past experience all the customers would not make full use of their facilities and in any case not at the same time; but we have now had the experience that for various reasons business customers of the banks on this occasion did make use of the facilities. I consider that the business community was over-optimistic on the prospects of business in the country. They had seen the rising curve for many years. They took no note of the economic recession in North America, of the big decline in many of our export prices and the smaller purchasing power for imports; at least, they were not as much influenced by these facts as we had hoped. We had considered that these matters would bring an automatic brake on both the business community and the commercial banking system, but for the first time, at any rate during my period in the Bank, neither of the two was affected as we expected by these trends. The business community remained over-optimistic, and the banks did not reduce the limits althought we had called a bankers' conference early in November and another later on. We are a small community in Pretoria; we meet them at parties, we meet them at the club, at lunch, and so on; and wherever I met them I tried to ram it down their throats. But it just did not work; they claimed that it was not out of disrespect for my views, but that they were just victims of circumstances. They gave me to understand that they fully appreciated what I meant and would give serious attention to the views of the Reserve Bank; but in practice they found businessmen drawing on the unused portion of their limits. Another factor that influenced the business community was the fear of reimposition of the import control. Each one tried to be clever and beat the ban. The more our reserves showed a tendency to decline the more they felt they were on safe grounds in placing orders abroad. We have had an extraordinary concurrence of circumstances in the past twelve months which has changed our views completely on the matter. Moral suasion now comes in only in the direction of the selective control of credit. We meet with them and tell them our opinion. We say: "If you act differently it is on your own responsibility; you have over-expanded credit for imports and hire purchase transactions and that is where there has got to be a contraction. The current production of the country must go on; you have to get the contraction in the areas where the excesses have taken place". As far as I am concerned, the supplementary reserve requirements will remain in existence. They will go up and down according to circumstances, but I am no longer relying on the commercial banks being able to carry out our requests on the quantitative side. They may find it necessary to change their system.

They have administered the system of overdrafts like a line of credit for a period. Previously advances were legally repayable on demand, but in practice the banks have given their customers to understand that they have a line of credit for six or twelve months. I have suggested to them that they should charge, say, a half per cent. commitment fee for the unused portion of a line of credit, so that customers will not be so keen to ask for excessive limits. They can always come to the bank later on, if their requirements grow. I think that that would be a big improvement for forcing their customers to come and see them more frequently.

9310. *Professor Sayers*: May I be quite sure what are the critical points in this process? Competition between banks is one of their sources of difficulty; they are careful to preserve good relations with their customers, and they are fearful of custom shifting to another bank. For this reason a bank feels unable to go back on its undertaking to its customer about an overdraft limit just under pressure of moral suasion from you. Is that right?——Yes.

9311. And the gap between the actual overdraft and the overdraft limits has normally been a pretty wide one in total?——Yes.

9312. And a situation has arisen in which the business world has chosen to run up its overdrafts towards the limits?——Yes.

9313. And the banks have felt unable to resist this simply under pressure of moral suasion from you? Is that right?——Yes. I may say that the banks actually welcome the application of the supplementary reserve requirements. As Professor Sayers says, they could not face telling a customer: "We have over-extended credit. We must now give you two or three months' notice to bring down your overdraft limit. You have got to do with less." They now use this measure of the central bank as the reason for their being tough with their import customers, for example, or their hire purchase customers. We do not mind taking the blame if that pleases them; but it does show that difficulty, that if competition is strong the banks feel that the authorities are demanding too much of them, if they rely on moral suasion alone for their requests to restrict credit. The banks now take the line towards their customers: "The Reserve Bank has given us two months' notice of introducing the supplementary reserve requirement; therefore I have no option but to do to you what they are doing to me."

9314. *Professor Cairncross*: If there were a ceiling on overdrafts that would have had much the same effect?——The overdrafts themselves, the outstanding loans, cannot be controlled, because the banks themselves cannot control them. It is very difficult to lay down ceilings for individual customers.

9315. *Professor Sayers*: Would it not be practicable to set a limit to the total overdrafts of the banks?—*Professor Cairncross*: In this country we have opted for a method, first of requesting a reduction in advances, and subsequently and in addition of imposing a ceiling on advances. You have taken a quite different line: you have relied on supplementary reserve requirements?——Because the other one could not be carried out. We asked them on a previous occasion not to allow any net increase in their advances and discounts, taking the two together. In 1955 we were in circumstances where they could not carry it out, but the margin by which they failed to do so was not such as to induce me to apply supplementary reserve requirements although it did cause me to ask the Government to give us the power to do so, which they did in 1956. Even then I thought it would be sufficient for the banks to know that we had the power. The point is that the overdrafts in existence cannot be held at a given point under the system we have, which is largely what it is in Britain. I can see that myself now, because of the unused limits; a bank does not know what its customers are going to do; they are really in the commanding position. For the authorities to make statements to the Press and to the business community as a whole telling them not to go above their present borrowing would have no effect.

9316. *Chairman*: Under your system is it regarded as a binding obligation between banker and customer that the banker should allow the customer to rise to his limit when it has been fixed?——Yes.

9317. He cannot go back on it?——Not for a period.

9318. Suppose that your moral suasion had taken the form of saying: "We do not want the total of overdrafts to amount at any time to more than a certain amount; please see if you can reduce the limits to prevent that": could it have worked then?——Yes; but we recently had a visit from one of the London bankers, who said that it was purely fortuitous that they could do it in London; the decline in the prices of raw materials, for example, had meant that industry needed smaller working capital; and this was reinforced by fiscal measures and high interest rates. The banks generally had been affected to such an extent that it just had happened that they actually went below the target the Government gave them. In a country like South Africa development is a routine process and the demand for facilities is more flexible; for these reasons the extent to which a customer will make use of his facilities is not known beforehand to the bank. So all the banks can do now is to give notice to their customers that the limits are being reduced. They must give time just as we give them time; the banker cannot immediately close up on a customer. He has to give him time to work down his stocks.

9319. *Professor Cairncross*: What do supplementary reserve requirements accomplish that could not be accomplished by the technique we use here? They have not presumably caused a reduction in advances?——They will. They must cause a reduction in advances, because the banks do not have the cash to advance on the same level as before. The banks had re-discounted Treasury Bills and commercial bills at the Reserve Bank in order to get the means with which to finance the big increase in imports for their customers; under the system of supplementary reserve requirements, even if they do re-discount with the Bank, the increase in cash does not count any more for the purposes of an increase in credit. They are now faced with a decrease in their holdings of these securities, so that they are forced to bring down advances and discounts in one way or another.

9320. I thought your previous point was that they just could not?——They could if they had the courage.

9321. *Professor Sayers*: Do you mean that they must have this public measure to point to as a justification for breaking what had previously been regarded as their moral undertakings to their customers?——Exactly. That is the point. There is indeed a super-authority operating and enabling them to get away with it.

9322. *Professor Cairncross*: Suppose the Government said that all the banks in South Africa must reduce their outstanding advances by 10 per cent. within six months; would not the effect of that be at least in the same direction as the effect of raising of reserve requirements?——I do not think so in the circumstances of South Africa, and I am inclined to think in practically all countries, including the United Kingdom. I think that the supplementary reserve requirement has an additional force to the other, which is a request. The bankers cannot bring down everybody's advances by the same amount; they must distinguish between customers, to see who made the biggest increase in his overdraft in the past year. They seem to have thought that they could not do it in the other way, but now they are bound to say: "I have got to do it: my reserve position by 30th June has got to be adjusted by so much. Then the next 2 per cent. increase comes at the end of July, and Reserve Bank has warned us that they are probably going to increase it further if they do not get the desired results". We will go for the whole 10 per cent. increase, which is in South Africa today £50,000,000, because their liabilities are £500,000,000. The banks collectively will have to find £50 million more cash or securities of the type which will qualify. They cannot sell Treasury Bills or Land Bank bills to get cash with which to finance imports, because they will be short of the reserve balance. This measure somehow brings it home more, not only to the banks but to their customers, to the public as a whole, that this is a measure taken by the authorities. When the authorities say that the banks must not allow any net increase in advances, or must bring them down by 10 per cent., it somehow does not seem to have the same psychological effect.

9323. *Professor Sayers*: You seem to argue that what lies behind the need for this more concrete force is the force of competition between the banks. Would you say that competition between the banks in South Africa is sharper than in the U.K.?——Maybe; I do not know

enough about the position here to say. It is possible that the entry of a new bank a few years ago introduced a sharper element of competition than you have here in the United Kingdom.

9324. United Kingdom bankers gave this undertaking in London, which you say they felt quite unable to give in South African conditions; does not that point to some difference of that kind?——Yes.

9325. *Chairman*: Then we come to "interest rate policy and open market operations". You say in paragraph 14:

"In the gilt-edged market, for example, the continual presence of the Reserve Bank has been essential to the existence of an orderly and reasonably active market and the Bank has accordingly had to determine the pattern of rates for the various maturities, instead of leaving it to the interplay of such market forces as happened to exist at any time."

What measures are taken by the Bank to achieve that result of determining the pattern of rates for the various maturities? In what securities or paper do you operate, and by how much, and by what kind of operation?——We operate in Government stocks, because Treasury Bills are not readily marketable. There is not an active market in Treasury Bills; there is no broker dealing with Treasury Bills or commercial bills. With Treasury Bills it is a question of re-discount with the Reserve Bank by a commercial bank or a discount house, or an open sale to the Bank. There is a market for Government stocks, whether one year or twenty year stocks, and there are transactions all the time. But the market is relatively narrow, so that to ensure that there is at all times a buyer or a seller the Bank takes that place; it sets up for all the different maturities at any given moment prices at which it is prepared to buy or to sell Government stocks out of its portfolio. There are times when the demand for Government stocks exceeds the supply, and we provide it out of our portfolio. As the brokers know, in determining the prices for the various maturities of stocks we have regard to supply and demand, or what we consider would be the relationship over a period. When I say that the market is narrow I mean that on any one day or in any one week there may be people wishing to sell Government stocks, but there may be no buyer that week, though there might be the next week. The Reserve Bank takes the place of the buyer; then subsequently, if there is a demand for that stock, it sells again. So we have regard to market forces in so far as we can determine them, but we do not let the forces do it on any particular day. If we find that we have to make net purchases continuously for a time, that in itself is evidence that demand is smaller than supply and that we should adjust our rate. That would be an indication that market forces were going in the opposite direction to what we had been acting on, and so the Reserve Bank would give way. Whether it changes its Bank Rate or not, it is in the market and may give way, as it has already done on two occasions this year in February and last month. In both cases we shifted the yields on which we worked by one quarter per cent. without changing the Bank Rate, because we found that it was in the public sector of the capital market where the demand was excessive. There was no case for a rise in mortgage rates or building society rates, but there was a case for a rise in the gilt-edged market because of the big expenditure in the public sector in excess of what we thought the country could afford, as we told the Government. Last year in my address to stockholders the point was mentioned; it is public knowledge that the Reserve Bank considers that both capital and current expenditure in the public sector is on too high a level at this particular stage. Indeed, the demand for funds from the public sector, not just from the Government but the municipalities and the public utility corporations for power, water and so on, definitely exceeded the supply; so we consider that we can shift down our prices in the market. We have done it several times before, but this year twice without a change in Bank Rate. The Treasury has been informed every time of what it was proposed to do. The matter was discussed at Cabinet level, and they had reluctantly to accept the fact that, if they want to continue carrying out the present capital programmes, even after cutting down the level, they have to pay more. We have, as in all tho under-developed countries, immature markets. We cannot leave the market entirely alone; we have to operate, but we do not operate by setting a fixed limit and saying that we supply credit on that particular level. We have changed from time to time, but the effect is that the changes are more gradual and that there are fewer fluctuations than in a market like London's. In South Africa the market moves by definite steps in a general trend rather than by fluctuating upwards and downwards a lot.

9326. *Professor Sayers*: You found that at existing rates of interest the market was tending to unload securities on to you; your response to that was not to say that the whole range of interest rates must change, but to use your market position to see that the change took place in a particular sector?——That is the point.

9327. Your reason for that discriminating treatment was that you took the view that capital expenditure in that sector was unduly heavy in relation to the national reserves?——Yes.

9328. So, while by your market action you determine the pattern of interest rates, you have not been saying that the total pressure of demand in the country is such that you must raise the whole pattern of interest rates; you see where the pressure of demand is excessive and you alter the pattern to fit your views on that?——Yes. The other pressure of demand was in the import sector and the hire purchase sector. We agreed that the banks should raise their rates for those purposes, but in the mortgage field there was no reason for any increase in the rates in private investment. There has been a decline which is rather disquieting; we have an increase in public investment and a decline in private investment. We consider that if the whole structure of interest rates were raised it would be to the detriment of private investment.

9329. Looking at the effect of this discriminating change in pattern of rates, are you expecting that because of the relative rise in rates in the public sector the spending in the public sector on capital development will be checked?——We are hoping for it. It has already had an effect on the municipalities according to newspaper reports; the chairman of a finance committee will tell his full council that they have got to cut down the frills.

9330. Because the rates of interest have gone up?——Yes. Then the Minister of Finance claimed that it would strengthen his position in the Cabinet if he said: "You see what has happened; and this will just go on. They will have to raise the rate by another quarter and then a half per cent., and we will get to an impossible position". When I left South Africa I was told by the Treasury that the various Ministers were all having another look at the estimates of their departments, trying to keep them down.

9331. So you consider that you have power over the pattern of interest rates, and you use that power; and you believe that that power has an effect upon the pressure of capital spending in the various sectors?——It is experimental, of course. It is the first time we have done it this way. Next year I may have a different view. But we felt that we must have an opportunity of looking around and seeing what happens in the world and what is going to happen further in South Africa. We may revise our opinion at any time.

9332. This method of operation, of determining the right pattern of interest rates might conceivably lead you, though it has not on this occasion led you, into a situation in which you found that a very large total of long-term securities was unloaded on to the Bank. Would you accept that position?——No. There have been times when we have dropped out of the market to see what happens if market forces are the only forces operating. By changing the rate, or rather our bid prices, we have so far had an effect. If no notice were taken of that, and sales came up even though they would be at a loss, we should have to reconsider our position. We are not bound to buy all the stocks offered. There have been cases where we have refused to do so, even though we maintained the bid price in the market. Financial institutions are after all always in a special case; so we wish to know who is the seller. We may hear that it is a building society; so we have a talk to them and ask what they want it for. They may say that it is to subscribe to a new loan that a public utility corporation is putting on the market. This is a case of moral suasion; we say that we think that it would be wrong for us to supply credit in order to make a new loan the success it would not otherwise be.

9333. *Chairman*: It means very close supervision?——Yes. It is only when a financial institution, whether a bank, an insurance society or a building society, is concerned that we intervene in that way. We consider that

the financial institutions should be within our orbit in one way or another, though not always as close as in the case of the banks, and that we can exercise some moral suasion over what they do.

9334. *Professor Cairncross*: Do you not know exactly who holds the debt from month to month?——Yes, we have figures about the ownership of the public debt.

9335. You can watch every single transaction that matters?——Yes, if it is a big size. The Public Debt Commissioners also operate in the market, and our secretary is always in contact with their secretary, so that they do not operate against one another. If it is a big transaction we know who is at the back of it.

9336. *Professor Sayers*: The right and the ability to change rates by operating in the capital market would seem to be absolutely vital to your position, so far as this moral suasion is concerned, because if the market were entirely free you could not fix the pattern of rates and say that you would not go on absorbing stock indefinitely?——That is so.

9337. What matters here is not merely the smallness of the market but your power to discourage people from offering stock for sale?——Yes.

9338. *Sir John Woods*: It is known generally in South Africa that the Bank is prepared to operate in the market and to change the rates and alter the price of stock. I take it you do not feel that that knowledge is likely to change the willingness of investors to take up new Government issues?——They have to judge also what the situation is likely to be, and what we are likely to do. Last month there was a conversion issue, a rather large one for South Africa, and more than one-third of the holders were not prepared to convert because they were in a difficult state and they welcomed the opportunity to get the money back without a loss. When the Government looked for new money to make up for the gap they had great difficulty in getting it even though they raised their rates by a quarter per cent. (which the Reserve Bank had done in the market) to the highest rate we have had in the Union since 1920 or thereabouts. Notwithstanding that the conversion was not really a success, the Reserve Bank had to help to make it a success. That is taken by some as an indication that rates have not gone high enough; so unless the Reserve Bank were to announce that it was going to defend the market at that level investment in gilt edged stock might not be so readily forthcoming. That is something we still have to face. The Government is now free for months and months, but the Electricity Supply Commission has to come to the market in October again in Johannesburg. There have been a few occasions on which the Reserve Bank felt that it had to give some indication that it was going to make a stand at that level, and thereafter investment went on freely.

9339. *Chairman*: How did you give the indication?——By an announcement.

9340. Your Bank can set the pattern of interest rates and can at any time take a decision to shift the yield; and any investor in that market would find the capital value of his investment at any one time was affected by your decision. It could be said that that would scare him away. Have you any comment on that?——I do not think it would scare him any more than if it was market forces that did it. Market forces would probably do it more violently with greater fluctuations. The market always overdoes any movement. If it goes upwards it goes too far for a time, and then there is some slide backwards before it goes up again. I have reason to believe that in South Africa there is greater confidence in the gilt-edged market because of the Reserve Bank's operations. In the first place, there are fewer fluctuations than there would otherwise be in the market; secondly they consider the Bank must have a pretty good reason for doing what it does; and thirdly it does not change too frequently. It does help the position for at least some time; and many institutions must invest. They do not mind holding back if they think that they may be able to get stocks cheaper next week, but if they think that it is going to be a matter of months it does not pay them to stay away from the market. Even if they think that in six months' time there is going to be another change it pays them to make the investment now. So I would say, I hope correctly, that we are a stabilising force, not only in the market but in the minds of the investors.

9341. *Professor Cairncross*: Your market debt is very different from ours: about two-thirds is held by the Government and that leaves one-third, nearly all of which is held by intermediaries of one kind or another. That being so, who do you expect to bring into the market when you lower the price of the debt? Twice this year you have raised your yields, and lowered the support price for debt; did you do that in expectation you would bring fresh buyers into the market?——Not so much into the market as into the new issues which have to be made by the Government, the public utility corporations and the municipalities in the course of the year. The capital programmes of all these public bodies are very large, so it is to give the investors some incentive to subscribe for the new issues, on the ground that this level will hold. The open market operations are not on any scale. Apart from the public, there are a host of smaller financial institutions of a local nature operating at only one town, about which we do not concern ourselves. When I say that we try to exercise moral suasion on non-bank financial institutions as well as on banks, we really have in mind the large ones with whom we have dealings of one kind or another; but there is a large number of smaller institutions, and the general public, which we have to leave out of account.

9342. Have you in practice found that the two changes you have made in the gilt-edged market have stabilised it?——I would not be prepared to go as far as that yet, but it has been an incentive to some institutions to invest more in gilt-edged investments rather than in mortgages. There are people who say: "If I can get a twenty year Electricity Supply Commission stock, I shall be sure of twenty years at that rate." The mortgage rate may have to come down, if things in the world go in the direction of cheap money. I think it is possible that we have gone now to the upper limit needed for stabilising the market and getting new subscriptions. London affects us more than any other market; there the rate has come down recently and expectations are firmer.

9343. *Chairman*: In paragraph 19 you refer to exchange control; we should be interested to know how effective you have found exchange control in South Africa, and whether you are able to retain exchange control movements of capital without simultaneously having control of current transactions?——The exchange control operates on current transactions as well. The exchange proceeds from exports, for example, have to be paid into a South African bank within a certain period, and there is a form on which the exporter has to indicate when the funds will be available and where he will pay them in. That is the same procedure as is used in the United Kingdom for exports to non-sterling countries. All that has happened is that we now apply it to sterling as well as non-sterling countries. We have had exchange control on transactions with non-sterling countries from the time the United Kingdom introduced it in September, 1939; we have just applied the same procedure to sterling countries, whether for exports or imports. A person who has to remit dividends abroad naturally has to mention that to his banker; but we allow the banks a large measure of discretion. The banks are not going to follow up their customers as to whether that was really an interest payment, but for statistical purposes the customer has to indicate what he wants foreign exchange for.

9344. Was there a period when you did exercise control over the movement of capital to London, although not over current transactions?——For one year, from February 1956 to February 1957, we had a very loose form of control which aimed merely at capital transactions; we did not at that time extend the export control procedure for non-sterling countries to the sterling area. It is only last month that it was decided to apply it more strictly. I may put it this way: until last month the exchange control over transactions with the sterling area was not really of the nature of a control. It was just an indication of intention and of the duty of management; there was no real machinery of control. Last month it was finally decided to make it a control.

9345. *Lord Harcourt*: And the control now applies to current as well as capital transactions?——Yes, except that on outgoings for imports, interest or dividend payments,

insurance payments and freight the banks are not expected to follow it up too closely. For exports, exporters have to fill in a form saying exactly where the goods are going, how the settlement will be made and when.

9346. *Professor Cairncross*: The context of paragraph 19 relates to funds being transferred to London to take advantage of the higher rates in London. What you are telling us, if I understand it, is that, during the period when you had control over the movement of capital but not over current transactions, this was more an indication from the Reserve Bank and the Government of what you would like to see happen than of effective control?——Yes. There was no question of a prosecution, for example, when we introduced it in a more virulent form last month. We virtually had to say that we would not notice anything that was omitted before.

9347. Does this imply that you were not successful in insulating your monetary system from the effect of higher interest rates in London?——Yes.

9348. And one reason for the introduction of the tighter control clause last month was the pull of higher rates in the other parts of the sterling area?——Yes, and the credit squeeze, which we have regarded as even more important than the higher money rates. We have found, as I shall have to tell my friends at the Bank of England, that the credit squeeze here was nullified in many cases by parent companies calling on their subsidiaries to send their cash balances to London or, if they did not have enough, even to borrow from a bank or insurance company and send that also. To that extent they could avoid the squeeze here, but the squeeze affected us in South Africa.

(Adjourned until 2.15 p.m.)

MR. M. H. DE KOCK *further examined*

9349. *Chairman*: From paragraphs 20 to 22 I have the impression that under your system a change of Bank Rate carries itself almost completely through the whole financial system; everything virtually, even building societies and the mortgage rate, adjust themselves to it?——Yes.

9350. Then you say that there may be times when you do not want to achieve a completely widespread change of interest rates like that, and therefore you adopt the more limited way of resorting to changes in the pattern of gilt-edged rates. If you achieve an alteration of the gilt-edged rate pattern, does not that reflect back upon the rates of interest charged for other purposes?——Only in a certain field. It would affect Treasury Bill rates and call money rates; but, except to the extent that the commercial banks on their own put up their rates for certain purposes although the Bank Rate has remained the same (that has been done with our consent), it does not necessarily go right through. When the Bank Rate is changed it normally affects not only the lending rates of the banks but their deposit rates. Their deposit rates are in competition with the deposit rates of the building societies; because of their structure the societies have to pay more for deposits, on fixed term deposits as they mature and on savings deposits immediately, and therefore they have to raise their lending rates, which are mainly for mortgages, immediately. We have given some consideration to an alteration in the structure of building societies to avoid this necessary connection between the Bank Rate and mortgage rates. We consider that the time has come, as they are such a tremendous organisation, relatively much larger than in the United Kingdom, when the building societies should try to get more of their funds on a longer-term basis, so that they do not have to change their mortgage rates immediately, not just on new loans but on past loans as well. They do get a good deal of their funds now in the form of shares, but they are not shares in the ordinary sense; they are really a fixed interest deposit for five years or longer, but they have the obligation to raise the rate of interest on shares when they raise the rate on deposits. It is just the way the system has grown up. Building societies have become very important in South Africa. Their total assets are over £400 million, which is a lot of money in a small community like the Union; that shows the extent to which they have developed. They have allowed their shares to be used in some instances virtually as call money. Again that is partly a question of competition. They give their shareholders to understand that if they are in a fix and need the money suddenly, and if it suits the society, the society will pay them out. We have complained to them that they are in effect giving a higher rate of interest on call money; just as the commercial banks have spoiled their customers by allowing them to think that lines of credit, instead of being repayable on demand, are fixed for a period of twelve months at a time, so building societies have spoiled their customers by giving them to understand that if they need the money before the time it will probably suit them to pay it out. In a crisis they can make use of their legal position, but we consider that that is going to create a great deal of resentment. It is like the old joke about a banker being ready to give you an umbrella when it is fine weather, and at the first sign of rain he calls the umbrella back. The building societies have not had a crisis for many years (1932 was the last) and a financial structure has been built up in South Africa which has various unsatisfactory features and which makes the use of the Bank Rate inflexible. Some bankers object that it limits the scope for the use of Bank Rate because of the inter-connections with mortgage rates and certain other loans.

9351. You find it too comprehensive in its influence?——Yes.

9352. *Professor Sayers*: Is not this tendency of banks, building societies and others to spoil their customers, as you put it, one of the natural consequences of the development of financial institutions, including central banking? Financial institutions become more effective in equating the liquidity of their assets with the habits of their depositors. This is one of the facts of life which any monetary authority has got to take for granted; to try to struggle against this tendency of institutions to concede more and more to their depositing customers is surely, if I may use the phrase, "spitting against the wind"?——We consider that the stage has been reached in South Africa where something has to be done. There is a similar outlook elsewhere; and that is why there is a Radcliffe Committee, why they have a Congressional inquiry in the United States, and why in Canada they are also considering some such inquiry. We have an inquiry in South Africa, only there the Reserve Bank is doing it, not a committee or commission of inquiry. There have been many developments in the financial field in the last twenty years all over the world; one has affected the other, and so we get to a stage where there are a number of unsatisfactory features, and where not only the central bank but the institutions themselves are ripe for a discussion of ways and means. The United Building Society alone already has £130 million of funds, and is growing at the rate of about £15 million per annum. How can they confine themselves to the building society movement? They do not find sufficient demand for mortgages of the type in which they should engage, so they grant mortgages on big office buildings or blocks of flats; and not just on buildings for residential purposes: they even make loans to an industrial enterprise by means of a mortgage on the buildings and land belonging to the enterprise. The building societies draw such a large proportion of the savings of the country through their various means of fixed deposits, savings deposits, and all sorts of shares, that they themselves feel the time has come for a revision of the system under which they work.

9353. Would you not agree that it is no accident that this is an international phenomenon, and that the position in South Africa that building society rates have become very quickly sensitive to changes in the Bank Rate cannot be upset without very substantial interference with their business?——Yes.

9354. You would, I gather, like to have their rates more under your control, as something independent of the Bank Rate?——Yes.

9355. *Chairman*: And as something independent of your adjustment of the gilt-edged rate too? I was puzzled

to know how you could put up the cost of horrowing against the Government without putting up the rate for private investment at the same time. Can you isolate those two?——In certain circumstances, and at certain times. I do not say it can be done all along. Whenever we have both excess of investment and excess of consumption, with strong inflationary pressures, then it suits us to have a Bank Rate that works right through the financial structure, because we desire to cut down the demand for goods and services generally. But we get other times when circumstances are of a mixed pattern, as we have had recently, where we have tried at least to punish some without affecting the others. Whether we can maintain that is still a doubtful matter; but for a period it can he done. If we do not take too long to get the adjustment right in the public sector and the imports sector, then it will have worked; if we fail to achieve our purposes in the two sectors that we want to affect, then obviously we will have to reconsider the matter.

9356. *Professor Sayers*: Your difficulty in separating the building societies' rate from the Bank Rate does, on the face of it, qualify very considerably what you were saying this morning about your ability to control the gilt-edged rate separately from the Bank Rate. It is not an inevitable conflict, but it is a little strange, that this one part of the market should be tied to the banking sector very closely indeed, and yet you feel that the gilt-edged market is entirely under your control, that you can keep that in hand and hold the pattern of interest rates you think suits the relative degrees of pressure in the various sectors of the economy. How confident do you feel that you can hold a sectional pattern of interest rates?——It depends upon how soon the parties concerned react to the way the Reserve Bank regards the situation. If the public sector is sufficiently influenced by the increases we brought about in their rates, and it has the effect of reducing their requirements and cutting down their programmes; if the business community is prompt enough to accept the situation as we see it and reduce their imports; and if the hire purchase finance companies also take the hint that it is in the interests of the country not to encourage too much hire purchase credit, even if they can get the funds from the public directly in the form of deposits or investment certificates or savings certificates, whatever they may call it; we shall have achieved our objects. Of course we have also at the back of our minds developments elsewhere in the world. We have banked on the downward trend not only in North America and the Continent but in London. The first decrease in the London Bank Rate came later than we thought; then there was the second, and we are hoping for no complications in the economic or labour situation here to delay the further downward movement of the rate. If the course of events here had caused the authorities to maintain the rate at 7 per cent., irrespective of the way the exchange rates went, or other circumstances, then we should probably have been in trouble by now already. But the downward movement has started here, and it is gathering momentum all over the world. So I would say that the external factor is also important to us. We have just been relying on certain things happening in certain parts of our financial structure and in the world at large; and to the extent that we are correct in that assessment we have a chance of getting over this difficulty. If things go the other way, then obviously we shall have to revise our own attitude. We are at least trying an experiment. We know that there are economists all over the world looking for new ways of doing things, so we are trying to give them something to think about!

9357. Looking at how your system works internally, I gather from what you were telling us this morning that the pressure of capital spending in the public sector is sensitive to rates of interest in the gilt-edged market, which you have directly under your control; that the building societies' rates of interest have their effect on the housing and general building situation, and that these rates tend to move directly with the Bank Rate; and that the Bank Rate governs the lending rates of the commercial banks, and that these lending rates are important in influencing the demand for imports; so that, having a considerable influence on these rates of interest, you have a very considerable influence on these three important branches of spending. Is that right?——Yes.

9358. But you are a little worried by the fact that the building societies' rates, which have this influence on building activity, seem to be tied rather too automatically to the Bank Rate?——Yes, and through competition with the commercial banks for deposits.

9359. It is because of that competition with the commercial banks for deposits that their rates are tied closely to the Bank Rate?——Yes.

9360. You think that there are some times when you would want to change the Bank Rate, because of its influence on particularly the demand for imports, when you would not want to change your influence over the general building situation?——Yes.

9361. Do you see any way of separating the structure of the building societies' rates from the Bank Rate?——If the building societies became less dependent on deposits and try to get some of their funds, as we think they should do, on the Continental model, on five-year debentures, ten-year debentures, or twenty-year debentures, at a given rate of interest which did not have to be changed, so that they did not have to change the mortgage rates, it could be done. If a building society is dependent in securing its funds on a changing Bank Rate, it in turn must protect its position with its horrowing customers.

9362. It is there that I cannot help feeling that you are "spitting against the wind". It is natural for the building societies' rate to become more sensitive in time to the Bank Rate. How do you think you can encourage the building societies to order their affairs in the way you are suggesting, so that their rates are less sensitive? Is there anything the central bank can do to push them in this direction?——The building societies have certain privileges, such as exemption from taxation, and yet they are competing more and more with institutions which are liable to taxation. They are encroaching in various ways on the terrain of the commercial banks: for example, they operate their savings deposit accounts very much like a current account in the bank, but without cheques; the depositor can put in and draw out; or he can deposit his wages and ask his building society to pay his monthly accounts at shops. I think the taxation aspect should be made effective in any case, because it is not only in that way that they compete with private enterprise; they all put up big buildings where they use, say, the ground floor and the first floor, and all the other floors are put out to rent, and the rents they get are in competition with others, but on a lower level than would otherwise have been the case, because they do not pay tax on the rent. There is no aspect of their income which is subject to taxation. There are various ways of making desirable changes; those who want to remain building societies in the ordinary way can remain under that Act, but others who want to expand beyond the scope for building societies have already broken the spirit of the Act in various ways. At least they can be induced to do it on a better basis, if they would only say that the shares that they issue will not be regarded as repayable whenever somebody pleads a need for funds because of family troubles, when in fact he wants to buy some gold shares, because someone says that gold is going up. They pay out too easily; the whole conception of shares has been broken. As to deposits, I admit that they have drawn a tremendous proportion of savings in that way, and that has forced the banks to quote high rates, much higher than in London. The banks are now complaining to us about the high cost of their funds to them, when it is all their own doing. They must not only compete with the building societies for the funds; so the banks pay rather higher rates for the very deposits which compete with building societies; for a deposit fixed for 12 months, up to £100,000 per person, they pay 4½ per cent. today. That is the Bank Rate.

9363. *Professor Cairncross*: Is it your view that in due course every central bank will require to take some partial control over other intermediaries like building societies or hire purchase companies?——I think that that stage is definitely coming. I mentioned that point in 1946 in my book on central banking; twelve years have passed, and many people have asked me what I have done about the matter I raised myself, and I have had to admit that I have done nothing. But in the last twelve months developments in our country have been such that they are now forcing the issue. An inquiry is being made by the Reserve Bank at the request of the Treasury, who in turn have been influenced by a question put in Parliament last year, into the whole set-up with a view to making suggestions for a revision of the legal framework in which these other institutions work. Hire purchase companies, for example, have

more than doubled in the last twelve months, and they succeed in drawing funds from the public in various ways. Some of them do not mind falling under the Banking Act as a deposit-receiving institution; others do not even want to fall under that Act, and they call their paper investment certificates or debenture certificates, but they are like twelve-month deposits or two-year deposits. Then deposit-receiving institutions under the Banking Act are not subject to the same stringent requirements as the commercial banks. We feel that that group of what are called deposit-receiving institutions should be split up into the genuine savings bank or trust company, such as the local institutions we have in many towns, which are the institutions we had in mind when the Banking Act was drawn up in 1942, and the rest: the new ones, the hire purchase companies, discount houses, accepting houses (and there is talk of further such institutions) should come in a separate category with more stringent requirements, closer to the commercial banks than the savings banks and trust companies. I am playing with the idea of having a variable reserve ratio applied to hire purchase finance companies, as we now do in the case of banks, so that whenever we have to contract bank credit, as we have to do now, we can avoid a shift of funds to other forms of credit which compete with the banks. As it is, our policy on the banking side is being nullified by what is happening in the hire purchase companies. We ask the commercial banks not to grant additional credit, which they have agreed to do and were quite happy to do, but hire purchase companies have got their funds from other sources. So I am thinking of working out some means of applying it; I had hoped that this Committee would report in time for us to make use of its recommendations, so far as we have things in common. We think that some of the matters which are worrying us in South Africa today are also worrying the Committee, and that we might get some hints from this side.

9364. Do you see any way in which you could control trade credit granted by one company to another?——The only way we have thought of was to ask the Banks to be careful in their granting of credit not to enable one customer to borrow more than he needs for his own purposes in order to help someone else who has been refused further facilities on the ground of having reached his limit. They try to watch that to the extent that they can, because they do not like it themselves.

9365. *Professor Sayers*: It might be argued that powers over the quantity of credit available in particular channels would not much matter, as you have sufficient control of the situation in regard to interest rates. I gather you would not take that position?——It takes some time to use up the buffers. When a contractionist policy is being followed there are funds which can still be played with over which we have no control: big credit balances held by certain concerns, which they can either use for their own purposes, or which they can lend out to others who are short of funds. But there is a limit to the extent to which that can be done, and if the central bank succeeds in keeping an uncertainty in the minds of business people as to their ability to sell short-term assets without a loss whenever they might need to, and if they have reason to believe also that the central bank has got other methods up its sleeve, and that the Government may also apply certain fiscal measures, such as higher taxation, that element of uncertainty in the business community can make those who are liquid at the moment wary of using up their liquidity, for fear that they may not be able to get funds if they make some miscalculation in their requirements.

9366. You insert the gelatine of uncertainty into their liquidity?——Yes.

9367. *Chairman*: In paragraph 29 you give the forms in which, under the existing scheme, supplementary reserves can be held: Treasury Bills, other short-term Government stock, credit facilities to the Land Bank, or other assets approved of by the Reserve Bank. Where does the initiative lie in deciding the form of the supplementary reserve? Are there rules made by the Reserve Bank as to what they are to be?——Those are the assets mentioned in the Act. The initiative lies with the Reserve Bank, because it will not sell any of these assets which it holds itself if it considers that the banks should keep the reserve in the form of cash. The banks are not able to buy Treasury Bills in the market; we do not have markets as in London for Treasury Bills or short-term Government stock. The Reserve Bank usually has some Land Bank and Treasury bills; it lies with the Reserve Bank whether or not to sell these assets to the commercial banks in order to enable them to have a reserve which is interest-bearing, instead of a cash reserve at the Reserve Bank which earns no interest. Normally it would suit us to do so. We want to compensate the banks for having to maintain supplementary reserve requirements, even though we consider they have been guilty of excesses in a particular case, as we think that having to contract credit in the private sector, or forfeit a higher rate of interest, is sufficient as a punishment.

9368. *Sir John Woods*: You think the punishment fits the crime if they suffer the difference in interest between a loan to the private sector and the rate they are given on Treasury Bills?——Yes.

9369. *Professor Sayers*: You still let them have the rate of interest on Treasury Bills, which is rather more than on cash; that is tempering the wind to the shorn lambs?——Yes. If we were to get a flood of capital from the United Kingdom, as we had once before, when there was a fear of nationalisation, that capital would be reflected in the demand liabilities of the commercial banks, and such funds are usually not put out on fixed deposit or invested in any other form. In those circumstances we could apply the supplementary reserve requirement to neutralise the whole of the increase in such liabilities; the banks would virtually have to hold it in the form of cash in the Reserve Bank, because there would not be these other securities available. It would not be penal, because they do not pay interest on the additional funds they receive from abroad, any more than they get interest on their reserve balances from the Reserve Bank. We would not feel any qualms about that. But now, where we require them to contract their advances at a given rate of interest, to require them to keep what they realise in the form of non-interest bearing cash would be too much of a punishment. Sir John Woods said something about the punishment fitting the crime; but it is only a small crime!

9370. *Professor Cairncross*: You have never instituted a higher reserve requirement for deposits by non-residents?——No, we have never followed the system which Germany now has; we have not had the problem for many years. It will be time enough to do it when we do get too much in foreign deposits.

9371. You see no disadvantages in this suggestion of supplementary reserve requirements? You mention a lot of advantages; is there nothing on the other side?——For certain people in the country there would be the disadvantage that credit is contracted; but we consider that we require a contraction of bank credit, and such disadvantages as flow from that to certain sections of the economy cannot be helped.

9372. You are not afraid the Government might think this was a good way of ensuring that its own obligations were held? They might think that it was a cheap way of borrowing?——Yes; instead of getting it from the central bank they would then get it from the commercial banks. We cannot prevent the Government from using bank credit, whether central or commercial; we may criticise the Government, we may make use of tradition in informing the public of where we disagree; but the Government has the final word, if Parliament supports it. In this particular case it would mean more commercial bank credit to the public sector and less central bank credit, but we do not think it would mean more in total bank credit.

9373. *Professor Sayers*: One of the difficulties of this technique in this country would be that some of the assets that would naturally be put in the supplementary reserve are market assets, and the availability of them to the banks therefore depends to some extent on banking habits and habits of other financial institutions. Am I right in gathering that you do not face this trouble, that the instruments concerned are not market instruments, and their supply is very much under your control?——Yes; we have a supply in our portfolio, and we are happy to offload it on to the banks in order to help them with their supplementary requirements.

9374. *Sir Oliver Franks*: If you decide over a period of months gradually to increase the supplementary reserve requirements, and you hold that this will in fact compel the commercial banks to restrict their lending either by way of overdraft or by way of discount, what is it which prevents the commercial banks dealing with the situation

not by contracting their lending but by selling their investments? In this country there is a general market in Government stock, and a bank might have an option, if it had in some way to increase its liquidity or reserves, whether it should reduce its lending or sell investments. It is its ability to sell investments that makes it necessary here to restrict lending. Does your more positive role in the gilt-edged market avoid this difficulty in South Africa?——Yes; the stocks they would want to sell would be offered to the Bank on a large scale, and the Bank would say: "We do not expect you to sell your securities as a way out." There is frequently no other market for it, whereas here the banks may be selling it to foreign banks operating in London, or to industrial companies.

9375. *Chairman*: Then you deal with the importance of the foreign sector. Then we come to a section on general liquidity; you say in paragraph 40: "the effectiveness of monetary policy depends in large measure on the extent to which it controls general liquidity outside as well as within the banking system." You deal with the extent to which the financial institutions outside the banking system itself are comparable in effect with the banks and how far they are distinct.—*Professor Sayers*: I have found this an analysis with which I am very much in agreement, but there is one sentence in paragraph 46 which I should like to have elucidated: "It is ironical that the application of a tight money policy involving high rates of interest makes it easier for these institutions to induce such a shift of funds." How does the appearance of high rates of interest make it easier for these institutions, if the high rates of interest are general?——I had in mind that the hire purchase finance companies can raise their rates for loans for hire purchase purposes more than the commercial banks do. In such circumstances I would attach importance not so much to the rates of interest as to the squeeze that comes with tight money. There are customers of the banks who cannot get an advance from the banks for their purposes, but can go to the hire purchase companies or some other of these institutions who are free to quote high rates, and can offer relatively high rates for funds lent on deposits or investment certificates in order to meet this demand for funds from people who are insensitive to high rates, who can either make a big profit themselves, if they can get the use of funds, or want to purchase motor cars or refrigerators or radiograms and do not mind paying what is virtually a usurious rate. The banks on the other hand are limited in their ability to raise rates faster than the central bank.

9376. You are underlining the stickiness of bank rates, and the fact that there is an unsatisfied fringe of borrowers that varies very much according to the tightness or looseness of credit conditions generally?——Yes.

9377. *Professor Cairncross*: Does it follow from the argument you set out in these pages that there is a danger that when you operate on the quantity of money the banks as particular financial institutions may be penalised, and that, if you are going to operate a credit squeeze, it should if possible operate widely over the whole field of finance and not narrowly on one set of institutions?——Yes. Years ago, when commercial banks were the main financial intermediaries, the authorities could by contracting bank credit achieve all that they wanted to achieve. In the thirties we considered that that was all that was necessary. Since that time the development of these other financial institutions has been far more active than that of the banks, and they are encroaching more and more on the field of the banks in all sorts of little ways; and today the banks are hampered in their attempts to follow the requests of the central bank. That is one of the factors which make it difficult for the banks to comply with our requests. They welcome the application of the supplementary reserve requirement, as I said this morning, but on the other hand they plead with us to do something about the competing institutions and get them under control as well.

9378. *Chairman*: As you say in paragraph 52, "if monetary policy is to be really effective in the future these other financial institutions must somehow be brought within its orbit to a greater extent"?——Yes.

9379. Then we come to the questions on collection and publication of statistics. When you collect statistics, is that done by a voluntary arrangement which you have with the banks and other persons from who you collect them, or is there some statutory scheme which gives you the power to require them?——The commercial banks and most other financial institutions, whether loan banks, or people's banks, or the deposit-receiving institutions of which I have spoken, or hire purchase companies, or trust companies, or the savings banks, have to render quarterly statements, or in some cases half yearly statements, under the Banking Act. Commercial banks have to render monthly as well as quarterly statements.

9380. Are they in detail that is adequate for your purposes?——Yes. In drawing up the forms the Registrar of Banks consulted with the Reserve Bank as to the details we would require.

9381. Can he prescribe from time to time what is needed?——Yes; so we can always have consultations if we want to go further. Then we get certain statistics voluntarily from the banks; we have asked them to give analyses of their advances and discounts and of deposits, so that we may know what is going on. They used to do it for their own purpose, but each bank had its own form of analysis, and we wanted a uniform one, so we drew up the form, and they voluntarily complied with that. But the census of our foreign assets and liabilities had to be done under legislation. We asked the Minister of Finance for the power to collect those figures. So we had the census of foreign assets and liabilities in great detail. It took our statistical staff a year to work out exactly the form in which it should be done, after consulting with accountants of big business concerns and financial institutions, studying what the United States and Canada and Holland had done and noting all the snags they had encountered, and we now have the results. We have had to revise many of our previous estimates in the balance of payments and national accounts as a result of what we found out.

9382. Would your experience suggest that, if one is going to have details in some volume of this kind from banks and others, it is more comfortable for them if they are under statutory direction with regard to what they are to produce? You suggested in connection with the supplementary reserve requirement that a statutory direction really helped their position?——Yes. I think the banks, like other institutions and even individuals, want to feel that others in the same line of activity are going to be doing it in the same way, and that the obligation on one is not going to hamper him in relation to his competitors.

9383. *Professor Cairncross*: Did you run into the difficulty that some of the banks were reluctant to disclose precise figures about assets and liabilities because this might give away their hidden reserves?——In this case of the census, our statistician discussed that point with me recently. We have only four banks worth mentioning, and two of them control 85 per cent. of the total. He said that, if we gave the banking figures as a group it would look like a global figure, but with Barclays D.C.O. having, say, 42 per cent., and the Standard Bank 42 per cent., Barclays would be able to say: "I know my position and I can be pretty sure the rest is primarily the Standard Bank". I agreed that we would not give a separate figure for the banking sector, but that we would have to lump it in with other financial institutions, because the banks were promised when we took the census that we would not disclose any figures which would enable competitors to find out what the position was.

9384. *Chairman*: You met the banks' misgivings on this point of figures by putting their figures in with other financial institutions in the aggregate?——The banks themselves did not raise the point. That is what the head of our Department of Economic Research and Statistics had suggested to me. In the general statement which accompanied the forms to be filled in for this purpose, we had promised the banks that there would be no disclosure of any secret information, and that not even the rest of the Bank, the Exchange Control Department, for example, would be given an opportunity of seeing the details, and certainly not the Commissioner for Inland Revenue. It will be the responsibility of the head of our Department of Economic Research and Statistics to see that, while as much detailed information as possible is made available for economists and bankers and the public generally, and for outside use as well, there will be nothing which reveals or permits intelligent speculation about the position

of particular institutions, so that in every group there must be sufficient institutions to conceal the position of the individual institutions in the group.

9385. That provides for not disclosing to a competitor the details of the position of another institution. Do your banks also have a system under which their published accounts do not reveal inner reserves?——Yes. It is generally accepted that banks must be permitted to have secret reserves. Auditors in South Africa are very strict, based on the British principles, but they have made an exception for years in the case of banks. Of course, a bank auditor qualifies his statement, making it clear (though not in those words) that he has permitted the bank not to disclose certain material facts.

9386. *Professor Sayers*: You seem to attach importance to this on the ground that the banks would not want their secret reserves assessed by each other: you did not mention the effect of public disclosure, of the realisation by the outside public of how much there would be in the reserves. Am I right in thinking that it is only the competitors' knowledge that you found a matter of concern?——Yes.

9387. *Sir John Woods*: Can you give us any sort of indication of the size of the Department of Economic Research and Statistics in the Bank? How many qualified staff does it include?——Ten.

9388. *Professor Cairncross*: Does the Government issue a statistical bulletin as well as the Reserve Bank?——Yes.

9389. *Profesor Sayers*: Is the annual report by the Board of Directors agreed with the Government before publication?——No.

9390. Do you consult with the Government at all on the ideas that are to be discussed in the report?——No. The Governor's address is submitted to the Minister of Finance and the Secretary for Finance as a matter of courtesy before it is delivered. They have an opportunity therefore to point out any inequity that is represented in it. They might say: "We find fault with your representation of the Government's position; the correct position is so-and-so", and if the Governor accepts that he has over-stated or under-stated the case he can adjust it. They can merely make a request, but it is the responsibility of the Governor. But no Minister of Finance has ever acted on this as if he had the right to ask the Governor to remove a certain section from his report which would not suit the political position.

9391. *Chairman*: That brings us to your very interesting answer on the working of the sterling area arrangements. You have mentioned already the outflow that you observe owing to U.K. measures, even causing subsidiaries of U.K. parent companies to transmit their local funds and to acquire funds locally by borrowing for transmission to the United Kingdom. What has been the scale of this?——We cannot measure it exactly, but we have reason to believe that it has assumed very considerable dimensions, though not recently; the move has stopped, not only, I would say, because the London Bank Rate was reduced, but because it had worked itself out.

9392. Was it a product of our credit squeeze as from the middle of 1955, or a product of the 7 per cent. Bank Rate in September, 1957?——We noticed something of it between February, 1956, and February, 1957, when the London Bank Rate was 5½ per cent., but the rise to 7 per cent. in September last brought about a greater change; and the credit squeeze was made to function more severely on the later occasion.

9393. *Professor Cairncross*: You did say earlier that your advice from one of the British bankers visiting South Africa was that the credit squeeze in the latter period had not been very effective in diminishing advances in this country. Was it the higher rate of interest which was the primary factor?——Yes; but the banks did not know exactly what was going to happen next. What they did know was that this time the British Government meant business, and the Bank of England would operate accordingly. I think that that made them very careful to follow the requests of the authorities as far as possible.

9394. *Sir Oliver Franks*: In paragraph 79 I notice a view which I think I have heard before from the representatives of South Africa?——Yes; just like the proposal for the expansion of the International Monetary Fund which we keep hearing from the United Kingdom!

Chairman: I think that concludes our questions; thank you very much, Mr. de Kock, for what has been to us a very useful and illuminating day.——*Mr. de Kock*: We are in turn looking forward to the publication of your Report.

(*Adjourned until Thursday, 19th June, 1958, at 11 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-SEVENTH DAY

Thursday, 19th June, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 9395 to 9530 only.)
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

MR. WINFIELD W. RIEFLER, Assistant to the Chairman of the Board of Governors of the Federal Reserve System, U.S.A

9395. *Chairman*: We are most grateful for the memorandum* that you have supplied us with, Mr. Riefler; there are one or two questions we should like to ask you, arising from your answers to the questions that we evolved for you. Our first question was on the division of monetary responsibilities between the Federal Reserve and the Administration. You point out that in addition to the Federal Reserve System and the Treasury there are other governmental agencies which have power to affect credit, being authorised to guarantee, insure or extend credit of various types. Is there any system by which their activities are co-ordinated with the policies of the Federal Reserve System?——*Mr. Riefler*: We are in very frequent contact. They are responsible to the Treasury for a part of their finance; when they raise money they have to go to the Treasury for approval, and the housing agencies consult with the Treasury and the Council of Economic Advisers for clearance when they are going to change the terms of guarantees on housing loans; but I would not call it in any sense a system of close co-ordination.

9396. Have difficulties involving conflicts of policy arisen with any of these independent agencies?——There cannot help but be; these agencies have specific responsibilities and are quite close to the fields in which they operate, housing in particular: frequently, for example, they are trying to expand housing credits at a time when we would have liked to see them curtailed.

9397. Does it provoke public discussion?——A little; not much.

9398. You quote to us a phrase which comes back to us in many contexts, that the Federal Reserve System should be, not independent of government, but independent within the structure of government. Would you enlarge upon what that phrase stands for? Does it mean that, so far as control of the money supply is a function of government, the authority for that is vested in the Board of Governors, or in the System, and nobody can overrule it on that important aspect of its work?——Yes. Our governmental system is different from yours. With the separation of powers the Federal Reserve is legally an arm of Congress. The power over money is a power that resides by the constitution with Congress; the Administration may not tell the Federal Reserve how to exercise the powers that Congress has entrusted to it. We think of it as a sort of trust. These powers are subject to withdrawal by Congress at any time, or can be changed by the law.

9399. It is the independence from the executive that is the essential part of your position?——That is right. It is very deep in the history of central banking in the United States, both in the First and Second Bank Acts, that the power of money creation should be safeguarded so far as possible both from political pressure and from private pressure. Our central banking legislation has always been drawn to create checks and balances that will give immunity from pressures from either source.

9400. I think you say that, accepting that independence, you do regard it as the duty of the system to work in accordance with the national economic policies?——Yes.

* Memoranda of Evidence Part V No. 8 (I).

9401. How and by what agency would they be defined?——They are generally defined in the Employment Act, 1946, which is directed towards growth and stability. Those are the goals the Federal Reserve had in view for itself before the Employment Act, going back to the Annual Report of 1923, when the Federal Reserve Board first set these as goals for monetary policy. We have no problem of defining goals in that sense.

9402. You would look for the national economic objectives, not in any current declarations of the members of the executive, but in interpretations of the Act which has been passed by Congress and is still in force?——Yes.

9403. Would it be right to suppose that those objectives would only be defined in the very broadest sense?——That is right.

9404. The interpretation of how to achieve them, and how to apply your instruments to that purpose, is really left entirely in your hands?——So far as the instruments are given to us in the Act, yes.

9405. *Sir Oliver Franks*: For a time the Secretary of the Treasury was a member of the Federal Reserve Board, and then that lapsed. It would be natural for an outsider to suppose that the presence of the Secretary of the Treasury *ex officio* on the Board of Governors the Federal Reserve System might have been thought of as an attempt to link the executive and the child of Congress, so to speak, in a formal way, and that the abandonment of that position was also important as recognising that the executive and the child of Congress should not be formally linked in that sort of way. Are reflections like that in order, or are they irrelevant?——That is perfectly correct. The original Act created a Board of seven members, two of whom were members *ex officio*, the Secretary of the Treasury and the Comptroller of the Currency, which is not really a monetary office despite its title. That was an attempt to achieve a formal link between the executive and the supervision of the Reserve Banks, but it did not work. As the system evolved the Federal Reserve Board sits in almost continuous session. It meets customarily once a day, and obviously neither the Secretary of the Treasury nor the Comptroller of the Currency could attend those sessions continuously. When we came to the revisions of 1935, Senator Glass, a former Secretary of the Treasury, was the chairman of the Senate Sub-Committee that revised the Federal Reserve Act, and had strong opinions about it. At that time the Secretary of the Treasury was Secretary Morgenthau. Senator Glass was clear that a divorce must be made, and a line must be sharply drawn between the System and the Administration which he claimed had tried to boss the Board. At the same time Secretary Morgenthau personally requested that a change be made, and that he be removed from the Board. He did not think it a proper connection for him to have. So the Secretary of the Treasury and at the same time the Comptroller of Currency, by agreement between Congressional leaders working on this, were removed from the Board.

9406. Would it be the general opinion that experience over the twenty years that have elapsed since the change was made had proved that the change made for a right relationship?——I think it is better. It is a difficult problem. Obviously the Secretary of the Treasury has to be in very intimate contact with the Chairman of the Board. Their financial problems are similar, and either one can take the kind of position where be would step on the others toes too easily. The procedure, since the Accord in 1951, has been that the Chairman of the Board lunches every Monday with the Secretary of the Treasury, and that the Under Secretary and top Treasury staff come over and lunch with the Chairman and Vice-Chairman and the top ranking technical staff of the Board on Wednesdays. In between there are pretty continuous contacts between the Treasury and the Board whenever anything comes up between them. I think the relationship that has been established has been as close to a model working relationship as you could find.

9407. *Mr. Woodcock*: This means, leaving Congress on one side, that, as between the Administration and the Federal Reserve on an issue of policy, the initiative and the last word rest with the Federal Reserve? Suppose that the Administration want a certain economic climate to be created, they can merely discuss their desires with the Federal Reserve?——The only question that comes up relates to the reading of the business and credit situation. Sometimes there are differences of view. The question then is whose judgment is going to prevail. Our position is that obviously the people who are more specialised in reading the business and credit situation have to make the judgment. It would make no sense to have us try to make a judgment on what the business and credit demand is, and then have somebody else superimposing another judgment. It ought to be made by whoever is most capable of making it.

9408. *Professor Cairncross*: When the Federal Reserve Board approves a rise in the discount rate by one of the Banks, would that approval be communicated to the Treasury first before action was taken?——We try as a matter of courtesy to let them know before it is announced to the public after the action is taken at the Board. We let them know beforehand that it is under consideration, and we would normally try to inform the President's office, the White House, as well as the Secretary of the Treasury after a decision is taken and before the announcement. But we announce changes in the discount rate at 4.30 p.m. after the exchanges are closed, and do not meet to take formal action usually until 3.30 p.m., so that the announcement follows the action immediately. Sometimes we are unable to inform people by telephone.

9409. *Mr. Jones*: To what extent do the Board of Governors exercise control as to what the discount rate should be in one or other of the Federal Reserve Banks?——A discount rate change is normally initiated by one of the Federal Reserve Banks, and then has to be approved by the Board. But the Board also has the power to establish a discount rate without the approval of the Bank concerned; that has only been done twice in the history of the System. In general we try to do it the other way; obviously one cannot make the System work if the directors of the Banks feel that they do not have a voice in its operations, and it would only be under extraordinary circumstances that the Board would impose a discount rate on a Federal Reserve Bank. On the other hand, a Federal Reserve Bank may recommend a change in the discount rate, but the Board may defer acting on it. It may disapprove, in which case the situation is dead immediately; or it may defer action, and that may go on for some time. The purpose of deferring action may be to consult other Federal Reserve Banks.

9410. Is it a long tradition to have these twelve Federal Reserve Banks, or have they grown from some smaller number? Are they in being to have regard to the economic and industrial conditions that might be obtaining in various parts of the country?——The twelve were established originally in 1914. The country is divided into twelve Federal Reserve districts. Each bank is a representation of local interests and the local community. For example, in recent months it has been quite interesting that, when they have come in to report on conditions, the presidents from the three agricultural districts of Dallas, Kansas City and Minneapolis have been reporting practically no recession in their areas. Agriculture has been so much better this year than for a number of years that we get a complete variance between the reports of the economic conditions in the predominantly agricultural regions of the country and those that are mostly industrial. That blend of opinion is coming into us all the time from the twelve Banks, each of which is in a different economic situation.

9411. As against our general Bank Rate in Britain, would it be possible in the tradition and method of operation in the United States for a man in one area to take advantage of cheaper credit in another?——Yes, in a lot of different ways. Our loan market is in a sense a national loan market. The United States is a country in which a business can get to be a very large business; in general we have larger business units than we have banking units. That means that very large businesses tend to have credit and borrowing connections with fifty or even a hundred leading banks in the country; when they borrow they may submit applications simultaneously to a hundred banks. Because of that any business large enough to have national credit standing naturally borrows in the cheapest market. A Federal Reserve Bank itself lends only to its own member banks, by means of discounts. A member bank in the 12th district can only borrow from the Federal Reserve Bank in the 12th district, not from any other Reserve Bank. There is a very active market for Federal funds, that is to say balances in a Reserve Bank that are eligible to serve as reserves. That market is going on actively all the time. It is centred in New York. Banks all over the country will call up and say: "We have surplus reserves that we are willing to offer; what will you pay for them?" Or they will say: "We need reserves"; and they would try to buy them in the Federal funds market before they came to us to borrow. That is an extremely active market. In that sense a bank in the 12th district can get its reserve balances from a bank in another district which has surplus reserves.

9412. Would it have the advantage of a cheaper rate of credit?——It would have the advantage of whatever the national rate is. There would be a national rate, which may be cheaper than the rate in the district.

9413. Does it give rise to any confusion?——I do not want to give the impression that a difference of discount rates is regular. Usually we have a uniform rate between the twelve districts; but we frequently have differences.

9414. Those differences would arise if there was, say, a depression in one particular area?——Not so much that. It is the judgment of the directors in that area as to what the situation calls for; and it might be a judgment of the national or the local situation. It would be a judgment that the Board of Governors would have to corroborate. If the banks in a given district were expanding credit quite rapidly and the directors in that district wanted to raise the discount rate to restrain the expansion, that could happen; that might be a move that other banks in other districts would not want to follow.

9415. *Professor Cairncross*: Are you saying that the initiative must come from one of the Federal Reserve Banks in bringing about changes, and that the Federal Reserve Board would not impose its view on the other banks if only one moved initially, so that there may be a succession of changes in discount rates in different banks, while things would be discussed in Washington?——The Presidents of the Federal Reserve Banks keep in constant touch with each other at the Open Market Committee meetings every three weeks. There is always a discussion of the discount rate, and there is a chance to round up everybody's opinions. But the actual formal initiative would come, not necessarily but almost invariably, from a Federal Reserve district, probably on the initiative of the President of the Bank; making a recommendation to his directors. He, of course, would have been in touch with the whole group of Presidents and Governors.

9416. This means that there is a distinction between your powers over interest rates and your powers over open market operations? The open market operations are presumably decided upon at the meetings of the Open Market Committee, but decisions on interest rates are decentralised to some extent?——Open market

operations are decided by the Open Market Committee, which consists of seven members of the Board of Governors and five Presidents. Discount rate changes are normally initiated by a Federal Reserve Bank and approved by the Board, but can be established by the Board irrespective of the attitude of the Federal Reserve Bank. That has only happened twice.

9417. Would it be your practical experience that if a rise in the rate were sanctioned for one district, other districts would be forced into line through open market operations if in no other way?——One district usually would not matter. If most of the banks are at a given level and a few are out, Federal funds create operating problems that will make those Banks want to get into line.

9418. *Professor Sayers*: Assuming this contrast between the decentralisation of initiative on rates and the complete centralisation of open market operation decisions, am I right in thinking that the open market operation decisions were completely centralised about thirty-five years ago because it was found that it was technically inconvenient to have anything but centralisation?——Yes. At the beginning open market operations were not conceived of as a policy. In 1921, with the liquidation of credit some of the federal banks began buying government securities for the sake of maintaining their earnings. It was the market reaction to that which forced recognition of the fact that open market operations were a policy instrument, and the System set up the first informal committee to centralise and co-ordinate these operations. That was later developed into the present formal Open Market Committee with complete control. The original Federal Reserve Act clearly envisaged the country containing twelve Federal Reserve Banks standing independent from each other. I do not think that the founders realised the extent to which we had a national money market. But the original Act provided for approval of rate changes, and ultimate powers of determination, by the Federal Reserve Board. That has given enough central control of the discount rate to remove any need for changing the law to make it work; but obviously if one were starting now one would not create a system with this separation of responsibilities for open market operations and discount rates.

9419. It looks a bit odd to a visitor from outside but it in fact has worked that way?——Because the System has gradually knit itself into a System, and is now closely knit.

9420. *Lord Harcourt*: At moments when there are differentials in the rediscount rates, is there necessarily any differential in the rate at which commercial banks are prepared to lend to industrial clients?——The prime loan rate is a national rate.

9421. Irrespective of any differential of discount rates?——Yes.

9422. *Professor Sayers*: May I come back to the relationship between the Treasury and the Federal Reserve when there is a change in discount rates? You indicated that when the Board takes a formal decision on a rate, it informs the Treasury if possible. I take it that the information is strictly information; that it is not at that point consultation?——That is right. There may be consultation and seeking advice beforehand as to a general impending situation; but when action is finally taken, then there is information.

9423. Would I be right in assuming that in the course of these weekly contacts between the Secretary of the Treasury and the head of the Federal Reserve the head of the Federal Reserve would make it his business to try to persuade the Secretary of the Treasury that some coming movement of discount rates was in the right direction?——He would try to get his views. If the Secretary of the Treasury did not think it was a move that was appropriate, the Chairman of the Board would obviously try to convince him. More than that; he would try to understand thoroughly what considerations the Secretary had in mind. But there is no question about the decision. It is the Board's decision made without influence.

9424. *Professor Cairncross*: Is your policy wholly free of pressure from the legislature, from Congress? If there is a difference of view expressed in Congress as to the credit policy to be pursued, is there any way in which pressure can be brought to bear on the Federal Reserve Board?——Yes. Congress takes an active interest (some members take a very active interest) in credit policy and calls for testimony at committee meetings; there are pretty frequent sessions. We handle our own funds; they cannot bring pressure in the sense of refusing to vote for the budget. The Federal Reserve Board is not under technical pressure in that way. In general I have had the feeling, when we were up testifying before Congress, that, though certain critics may be subjecting us to a very rigorous and severe cross-examination, the majority of the members present in the committee thought that we are doing the right thing.

9425. Is it possible to remove from office any member of the Board of Governors?——For a cause.

9426. That is an executive act of the President, not Congress?——The law gives that to the President.

9427. Has it ever occurred?——No.

9428. *Professor Sayers*: Would you say that the necessity to explain constantly before committees of Congress tends to weaken the Federal Reserve in its actions, or in its power to recruit able men?——I do not think that it has affected recruitment in the slightest. The Federal Reserve system stands high in public esteem. Obviously congressional activities are important; Congress is the ultimate fount of power. I have not found that their activities embarrassed discount and open market operations at all, but when we had the selective credit controls on real estate and automobile instalment credit, there were difficulties. Local builders and local automobile dealers are likely to be important constituents, and would go and protest to their Congressmen, who would be constantly telephoning us. Congress two or three times set the terms itself, or made modifications of the terms, and that did create real difficulty. The Chairman of the Board of Governors finally said that he did not want to have anything to do with powers of that kind unless they were formally vested in the Federal Reserve Board by Act, and not subject to continual renewal.

9429. *Chairman*: Is there any standing committee of Congress which is charged with your field, so that you have to report to it?——There are banking and currency committees of both the House of Representatives and the Senate.

9430. Would the Chairman and other representatives of the Board appear annually, or more frequently, before those committees?——At least annually; but we are down there on a variety of things. The committees consider the Board and its staff as their professional advisers on a very wide range of financial legislation. They will usually ask for the formal opinion of the Board on housing legislation and legislation on public works. They will frequently call the Board down to testify on this legislation, just from the point of view of being professional advisers. They consider that the Board can give it disinterested advice, and they avail themselves of that advice.

9431. *Professor Sayers*: Is this advice given entirely in public session, or sometimes privately and sometimes publicly?——Usually it starts with a letter; they write a letter to the Federal Reserve Board asking for advice on a given bill. That may or may not be subsequently published. It is up to Congress later whether they include it in their report or not. If we appear before them in session, it is almost invariably published; but they can, if they want, have a private session.

9432. It is a matter for decision by the Congressional committee?——Completely.

9433. *Chairman*: It would be right then to think of a constant active exchange of view on policy between the Board on the one hand and committees of Congress on the other?——Individuals on committees, yes; five hundred people cannot take part.

9434. *Professor Cairncross*: You mentioned that selective controls had been exercised for a time, but under powers that did not allow you to escape a good deal of pressure from individual Congressmen, and that the stage had been reached at which the Chairman of the Board felt that the Board could not continue to make use of these controls unless powers were vested in the Federal Reserve by Act. This raises rather an important issue. Do you feel that the system under which the Federal Reserve Board enjoys its present independence rests in part on the

exercise of purely general powers, and would be difficult to maintain if you started exercising discriminatory powers?——I think there is a point there.

9435. If your executive were engaged in other intervention, by import control or control of capital investment, do you think it might be more difficult to maintain isolation of the judgment of the Federal Reserve Board from the judgment of the executive?——That was not the point I was bringing up. The question in my mind is whether, if the Federal Reserve Board had power to control credit for real estate, we should be able to maintain our independence or not, because it would involve specific interference with individual actions. I think that such powers might be more effective if lodged in the executive, if they are going to be lodged anywhere at all; but I have not made up my mind.

9436. *Professor Sayers*: I thought that your point was on the fact that the power was temporary?——That was clearly one of the problems. We have no problem on the selective control of margin requirements, but that does not excite a great deal of individual critical response.

9437. *Chairman*: I would like to ask one or two questions about the make-up of the membership of the Federal Reserve Board. First of all, if anybody becomes a member he is obliged by statute to devote his whole time to the business of the board. Has there ever been in your history any system under which there were part-time members of the Board?——No.

9438. A member therefore gives up what have hitherto been his active employments elsewhere. Is there any rule or tradition that he must separate himself from private interests?——If you mean disposal of his securities and things like that, I do not think there is any rule on it. I know that each incoming member of the Board goes over the situation carefully, and if he feels any conflict of interest, will probably talk about it to the Congressional committee.

9439. Then he can say that he has put it on the record?——Yes.

9440. The President with whom lies the appointment must have regard to a fair representation of the financial, agricultural, industrial and commercial interests and geographical divisions of the country. How does that work if they must be whole-time members and must give up their other activities.——It would apply to their back history. For example the Dean of a very important agricultural school came to us as an agricultural representative and gave up the deanship; he had been a director of a branch of the Federal Reserve Bank, Dallas, before he came to us.

9441. Does taking a Governorship commonly involve financial sacrifice?——Almost invariably. There have been one or two cases where there was no financial sacrifice, but it is unlikely for there not to be some.

9442. Is there difficulty of recruitment under current economic conditions on that ground?——Yes, there is.

9443. It is also a statutory obligation that no member of the Board of Governors shall be an officer or director of any bank, banking institution, trust company or Federal Reserve Bank or hold any stock in any such banking organisation. That does not mean that he cannot, at the time of his appointment, be a director or officer of a bank?——He could before he was appointed.

9444. What is that evident view of the necessity of separating him from even holding any stock in a banking organisation based on? Is it fear of interest?——Naturally. The Board is also a very important supervisory body.

9445. *Professor Sayers*: So that it necessarily has some relation with every individual member bank?——Yes. The American system of banking has grown up under strict statutory rules. Under the Holding Companies Act, for example, the Federal Reserve Board is required to supervise closely bank mergers. I rather think that it is not a good thing to mix the monetary powers and this kind of supervision in the central bank, but that is the way it is.

9446. *Chairman*: What is involved in supervision? Is it in the course of every year sending inspectors?——We have regular bank examiners who examine all of the State member-banks. Usually we co-operate with the State authorities; the Federal Reserve and the State examiners will appear at a State bank at the same time, and examine it together. The national banks are examined by the Comptroller of the Currency, and their examination reports are sent to the Federal Reserve. We also exchange reports with the Federal Deposit Insurance Corporation. We try to work it out so that there is no duplication in the actual physical examination of a bank. The reports are circulated to the different supervisory agencies and reviewed independently. Our examiners review the examination reports of every single member bank. They will always have a check list of banks that are to be more closely watched; they examine them frequently and they will be kept under closer supervision. At the end of an examination the examiner always meets with the board of directors at the bank for a discussion of the bank's condition. Boards of directors place great store by these reports. A review of the examination may very well be sent to the bank calling attention to certain practices subject to question. In addition to that our banking laws are quite specific, possibly too specific, in requiring approval or disapproval of a great many actions that come up. In addition to that mergers are under the jurisdiction of the Board, which has to decide whether a bank can enter into a merger or not, and has to think of its relation to the anti-trust laws. The supervisory activities take up a great deal of the Board's time.

9447. *Professor Sayers*: Are the supervisory activities divorced entirely from considerations of central banking policy?——Not completely, but pretty generally. It is generally agreed that the supervisors cannot be asked to administer credit policy, or to vary their interpretation of rules in accordance with the economic climate. We try to keep them from accentuating the economic climate, but we cannot really dictate.

9448. General principles must be laid down for these supervisors, where you have a very large number of supervisors and a very large number of banks to which they have to go. General rules must be laid down governing, for instance, the valuation of assets; how are those general rules settled?——We try to work them out so that book valuations of assets do not vary with changes in market quotations, such as might be brought about by our own actions. For example, securities that are classified in the highest grades are valued on a formal conventional basis. The supervisory authorities take these formal values, not current market quotations, in judging the position of the bank's portfolio. For securities under the top grades, however, valuations would be based on market quotations.

9449. So that when you bring about a general rise in the yields of Government bonds that would only affect the commercial banks in so far as they felt obliged to realise their bonds?——That would obviously affect the banks, because there would be a change in the market value of their assets; but the supervisor would not say that a bank had suffered an impairment of capital on account of it, and that he therefore had occasion to close its doors.

9450. *Sir Oliver Franks*: If the Federal Reserve System did not have to have all these supervisory duties laid upon it, but was more narrowly confined to major tasks of central banking policy and decision, would those who framed and guided the Federal Reserve System have taken the same view of the necessity of its Governors being seen to be divorced from banking interests?——I think they would have. The Federal Reserve Act resulted from the currency crisis of 1907. The Aldrich Committee, after elaborate investigations, recommended the establishment of a central bank in New York with bankers at the head. That was the original bill brought into Congress. It went down to defeat under the traditional suspicion of banking and banking interests. It was the genius of Woodrow Wilson, when he became President, to work out the basis under which the Federal Reserve System has developed; there were to be twelve regional banks, which assured the public that the System would be responsive to local needs and not solely to New York; the co-ordinating powers were placed in the Federal Reserve Board in Washington which allayed the suspicion that monetary powers might be manipulated in the private interest, and there was provision for full-time responsibility on the part of the Board members, and divorcement of any specific financial connection with banking.

9451. If you abstract from the political context of those times, and regard it rather more generally in terms

of what is advisable in modern times as such, do you think it would be generally felt, both in the System and outside it, that this provision was wise and necessary?——I have never heard it questioned. I think that it is accepted as obvious.

9452. How far do you regard this insistence on the visible independence of the Board of Governors from private banking interests as related to, because counter-balancing, the independence of the Board from political interests or pressures: that is to say, from the power of the executive? Are these to be thought of as a necessary counter-balance, or has each its own separate justification?——I would think both. We tried to set up a system which would be responsive to and intimately associated with private finance and private industry, and at the same time with the Administration. Because it is government, it is necessarily intimately associated with the processes of government and politics; but one wants also that the system be above and separated and immunised from them. That was accomplished by long terms of appointment for members of the Board, making it impossible for any President to appoint a majority of the Board under ordinary circumstances, by giving them complete independence from political pressures, and by ensuring that they were not subject to private influence in their official duties.

9453. Was there any conscious analogy with the Supreme Court?——The Supreme Court has been referred to throughout as one of the analogies. The Court is intimately connected with the executive Department of Justice, and receptive to suggestions from the Department of Justice. The same is true of the Federal Reserve System and the Treasury. Historically, I suppose, in the majority of cases, loss in purchasing power of the currency has been due to fiscal pressures emanating from Treasuries, rather than from private business; the monetary authorities should be immune as much as we can immunise them from those pressures.

9454. If the System is in this way by statute independent of the executive, and therefore from direct political pressure, and also independent of private interests, is the argument ever heard that, by being so insulated, they are in an ivory tower and out of touch with what is going on in the length and breadth of the United States?——Yes, Mr. Elliott Bell does say that in *Businessweek*; anyone wishing to criticise the system is very likely to say that. I do not think it is taken very seriously. The system, through the directors of the Banks and the branches, and through its contacts, is intimately bound into the structure of the economy. In a sense it is the most important recorder of the state of the economy of the country; often the same people who are opposed to some action taken and who raise the cry of the "ivory tower", rush to us to corroborate any judgment they have on economic questions.

9455. How large a part in your view does the Federal Advisory Council play from this aspect, because that is a body which is not drawn from within the System, but consists of twelve representative bankers drawn from outside?——The Federal Advisory Council was originally a political compromise with the proponents of the Aldrich Bill. The Aldrich Bill had envisaged a single central bank, with a board of directors composed of private bankers. When it was defeated the Federal Reserve Act was passed, with the twelve regional Banks and the Board of Governors; the group that were supposed to run the central bank proposed by the Aldrich Committee were given a share in the picture by creating the Federal Advisory Council. It is a statutory body, which consists of one banker from each district; he is usually a leading commercial banker, the sort of person who would have been on the board of the Aldrich body. For a good many years its relationship with the system was not very active; it is hard to find a correct relationship. However, it has been quite successful lately. In the last six years the organizational problems which used to be bothersome have disappeared, and a very successful relationship with the Council has developed.

9456. *Chairman*: Are its discussions public?——No.

9457. What is the range of its discussions?——Some time before each meeting, we will send them a list of the questions we would like discussed, and they will send us their list, if they have any. The questions we send them will always be questions on the prospects of loan demand, and the prospects of the economy as we see them; a series of questions like that. Then we will ask them for their view of the policy actions we have taken in the past. For example, we are asking them now, after a year of operation under the Holding Companies Act, whether they have any amendments to suggest. They will ask us questions of the same kind. When they come, they have a meeting with a member of the economic staff who briefs them on the economic situation as we see it; then they go into a meeting of their own, and they prepare a series of answers to the questions that are asked; those answers are circulated to the Board. Then there is a meeting with the Board, at which there is a free discussion, and minutes are taken. Meetings take place four times a year; but they may be called more frequently.

9458. *Sir John Woods*: You say in your paper that the Council consists of twelve members, selected usually from representative bankers in each district. I read that to mean they are not necessarily bankers within the Federal Reserve System; they can be outside bankers?——The members of the Advisory Council are selected by the boards of directors of the Reserve Banks. I suppose they could select almost anybody, but they do select the leading bankers, on a rotating basis. For a long time it was the same ones, but finally the principle was established that the job rotates.

9459. These questions which are discussed at the meetings must point towards future actions to be taken by the Federal Reserve Board?——No, they do not, as a matter of fact. The discussion is pretty sterile at that level. I do not think the Board ever gives any indication of how it is going to act.

9460. Is that as a matter of policy, on the ground that it might cause embarrassment, since the bankers are going to be personally affected?——Yes. Our general theory is that we could not possibly enjoy the independence and the powers we have, if we had anything less than full and frank disclosure. On the other hand, we are not going to disclose anything that is going to redound to individual profit. We try to make our regular statistical reports as frank and free as possible, and make complete disclosures that way. We try to give as full a discussion of our philosophy and motivation as possible. But we try to draw the line at any prospective action. That means that when an action comes the public know it, and know it instantly; and they know the kind of motives that would have governed. But we obviously should not let them know a prospective action.

9461. *Professor Sayers*: In the discussions with the Advisory Council, although the Board may not be pointing to future prospective actions, it must be concerned very much to draw upon the Council for a view of the economic climate. You said that you regarded this body as very successful in the last few years. Has its success consisted at all largely in influencing the Board's view of what the economic climate throughout the coutry is? Has it been valuable in that way?——Yes; at a meeting of the Council the first thing they do is to have a run around; each one gives the picture in his district as he sees it. The Board, through its technical staff, has as finished and fine an economic picture as it is possible to get in the United States. It has an elaborate staff and it is carefully done; but it is valuable to get this corroboration. It has happened several times in the last few years that the staff might be recording a mixed situation, or a stand-off, and the members of the Council would come in and give the picture of loan demand as they saw it coming to them at their banks. It is a helpful corroboration of the economic reports we get from other sources, and it is very valuable in that way.

9462. That is the movement of opinion in one direction. What about the other direction? Do you attach importance to this Advisory Council in feeding out into the country Federal Reserve ideas, motives, and so on?——Yes; it is a two-way contact. If they have confidence in us, that will permeate the banking community. The people from our member banks, because they are members, because they sit as directors of the Federal Reserve Banks, and because they have the Federal Advisory Council, do have a chance to see us and to see whether we are in an ivory tower.

9463. When you used the word 'successful', with regard to this Advisory Council, were you thinking of the traffic in both directions?——I was really thinking that

it was frequently remarked about ten years ago that this was a useless body; a great many people a decade ago would have said that it never amounted to much. Since the Accord, for some reason, the Council has become useful. Too often its meetings were sterile in the old days; they were all at cross-purposes. It has not happened like that recently, and so it has been successful.

9464. Why is that? Is it that people have generally been able to understand what is going on more, or is it change of personnel?——Both.

9465. *Chairman*: Now we come to your heading IV: Direction of Monetary and Credit Policies; and that leads us in to your answer to our second question. I think it would be most helpful for us if one or two of our members travelled rather at large over this particular field with you, so that we could all get an impression of what it all amounts to, rather than that we should work on the points page by page.—*Professor Sayers*: May I first ask a question about your powers in the main fields of central banking operations? You attach most importance, I gather, to open market operations and discount rates; you regard these as the centre of central banking?——Yes. It is one of our problems to describe these things, when we are asked to describe them separately. Actually, they are like the two blades of a pair of scissors: the open market operation makes no sense without the discount rate operation, and the discount rate operation would not be effective without the open market operation.

9466. On the interest rate side you fix the discount rate for each Federal Reserve Bank; are there any other interest rates over which the Federal Reserve Board or the Federal Reserve Banks have direct power?——Yes. For example, under the Korean War Act, the Pentagon or other agencies in the Government that are ordering defence equipment, can guarantee loans to their contractors. They place an order with a firm, perhaps a firm not large enough to be able to borrow on its own responsibility for an order of that size; then the Pentagon or the Atomic Energy Commission can guarantee the loan, and the bank will then make it. The Federal Reserve Board is instructed to set the maximum rates for those loans.

9467. Have you any direct powers over rates of interest paid by the commercial banks?——For time and savings deposits we set the maximum rate for the member banks, and the Federal Deposit Insurance Corporation sets it for the non-member banks.

9468. What is the present maximum?——3 per cent.

9469. Is it varied every time the discount rate is varied?——No; the rate was $2\frac{1}{2}$ per cent. from 1935 until it was raised to 3 per cent. in December, 1956.

9470. Is there any marked movement of actual rates below that maximum, or does the maximum tend to become the minimum as well?——A great many banks have now gone up to 2 per cent., if not more; the average rate would range between 2 per cent. and 3 per cent.

9471. And the changes are very few?——It is a little difficult to say. During the recession when nobody wanted to pay any interest on deposits, and the banks did not want the deposits, the banks in general tended to de-emphasise their savings deposit business. They paid a low rate in general and did not try to encourage them. Then, when interest rates in the market began to rise, there was more activity in that area, and some of the banks began to activate their savings deposit business and promote it quite actively. When the Board raised the maximum rate on savings and time deposits to 3 per cent. at the end of 1956, a great many more banks became active and very effective. It was quite a lesson to me that activity on the part of certain banks to attract savings was successful. There is now a fair proportion of banks that are very active in stimulating savings deposit business, and another very large section which remains inactive, and the rates paid will vary as between the two.

9472. Why does the Federal Reserve Board have this power?——For historical reasons. In the 1929-33 crisis the Senate committee that went into the crisis concluded that payment of interest on demand deposits had been a cause of competition between banks which bad led to their acquiring unsound assets, and that a great many of the purchases of foreign loans that later went into default, South American loans with high interest rates, for example, were made by small banks around the country who needed the interest in order to get a high enough income to be able to pay high interest on their demand deposits and attract them from other banks. There is something to this analysis, but I think it may have been over-played. The move was not recommended by the System, but payment of interest on demand deposits was abolished.

9473. That is an absolute law?——Yes, it is a law. At the same time, and for the same reasons, Congress put a duty on the Federal Reserve Board to place a ceiling on rates of interest on time and savings deposits, and a similar duty for the insured non-member banks was placed on the Federal Deposit Insurance Corporation. It is an extremely difficult law to administer, because all sorts of services can be called payment of interest, and there are more and more competitive activities of this type between banks. We are not happy with the task of administration.

9474. Are there any powers at all over the lending rates charged by banks?——No, except the State usury laws.

9475. Those would apply in some States, and not in others?——That is right.

9476. *Professor Cairncross*: Is there active competition between time deposits and Treasury Bills? Is there any switch from Treasury Bills into saving deposits?——Not into savings deposits; there would be into time deposits. But at the present time a great many of the foreign reserves are held as time deposits. A great many of the States have their State funds either in bills, securities, or in time deposits. A point came up a couple of years ago, when the bill rate went up above the $2\frac{1}{2}$ per cent. ceiling. Certain States had been depositing funds with banks at $2\frac{1}{2}$ per cent., but when the bill rate went above $2\frac{1}{2}$ per cent. they had to take the funds out of time deposit and put them in bills, because the State law required them to use either deposits or bills, whichever paid the higher return.

9477. *Professor Sayers*: Am I right in thinking that the Treasury Bill rate is normally below the time deposit rate, at any rate over the last few years?——It was definitely so, until two or three years ago.

9478. And that is the present position?——It is now.

9479. *Professor Cairncross*: Are you not afraid that the Treasury Bill market will evaporate because of the attraction of time deposits?——No. Quite a few banks wish that the Federal Reserve Board would lower the maximum rate, because 3 per cent. is too expensive to pay at present, and for competitive reasons they do not want to put it down on their own initiative. But we have made it clear that the ceiling is a ceiling, and not anything else.

9480. *Professor Sayers*: How wide is the market for Treasury Bills? Who holds Treasury Bills?——*Mr. Riefler*: One of the biggest group of holders is foreign central banks. Corporations would account for a very large proportion.—*Professor Sayers*: By corporations you mean industrial and trading companies—*Mr. Riefler*: Yes. The banks have about \$3,000 m.; the Federal Reserve has anything from \$1,000 m. to \$2,000 m. at the present time. It is the widest market we have.

9481. That is something we find surprising. Given the relationship between the time deposit rate and the Treasury Bill rates, why do people want Treasury Bills rather than time deposits?——The time deposit rate actually paid has gone down from 3 per cent.; the ceiling is still 3 per cent. on a time deposit.

9482. *Professor Cairncross*: You were telling us that the rate on Treasury Bills is normally lower than the rate on time deposits. Why do corporations, for instance, elect to hold Treasury Bills, if this is so?——They would have the use of the money continuously.

9483. *Professor Sayers*: They can sell Treasury Bills at any time; whereas the time deposits are at what sort of notice?——They have to be six months to qualify for the highest rate; but they can be at 60 or 90 days' notice.

9484. *Professor Cairncross*: Is there nothing short of 60 days?——There is a 30-day category; we never altered the ceiling on that.

9485. And on that category would the rate again be above the Treasury Bill rate?——It is 1 per cent. at the moment.

9486. *Professor Sayers*: Am I right in thinking that the law that restricts the payment of interest on deposits has a restriction that no interest may be paid on anything repayable within 30 days?—That is right.

9487. Is tax payable on the discount on Treasury Bills?—Yes.

9488. And on interest on bank deposits?—Yes.

9489. What about Government bonds generally?——Yes. There are a few outstanding which are tax exempt, but none have been issued since early in 1941 by the Federal Government; the tax exempted issues are now very small in number, and will be completely matured in a few years. Tax exemption is only found in State and municipal security issues (which are not subject to Federal taxes) and housing issues, for public housing; those issues are technically State and municipal issues, but the service is really guaranteed by the Federal Government. That is the only case where, indirectly, there is tax exemption on something that is federally sustained.

9490. When one is thinking of the effect of changes in interest rates, the extent to which interest is reduced by taxation is a factor in this country; we have got into the habit of thinking that roughly half the impact of an interest rate change is absorbed by taxation. What is the corresponding proportion in the United States?——For a corporation it would be 52 per cent.

9491. Whether they are paying or receiving interest?——Yes. The effect of taxation creates a problem. When we had the excess profits tax, I remember we figured out that it would take a 6 or 7 per cent. discount rate to make it unprofitable for certain banking corporations liable to excess profits tax to borrow.

9492. Looking at the experience of the last few years, it appears from your paper that the Board has considered that its first objective must be to control the reserve positions of the member banks, and that it is by doing this that it controls the reserve situation in the country; that it has used its open market operations to control the reserve position, because it has been able to conduct open market operations with a good deal of freedom; but that it has not on the whole been necessary to vary the reserve requirements much. Is that right?——It is a little difficult to say. We really use both open market operations and reserve requirements to control the reserve position, particularly to control the amount of borrowing; and then we use the discount rates and the enforcement of the tradition against continuous borrowing to get a financial result. A change in reserve requirements is one way of putting money in the market, and purchases of Government securities in the open market is another way; they are alternative ways.

9493. The continuous method you use is the open market operation?——Yes. The reserve requirement weapon is a difficult one to use. For instance, it would only be in peculiar circumstances that we could raise reserve requirements. Under the free market technique, any announcement of a rise in reserve requirements would mean that buying in the Government securities market would dry up, and we would have to go in and support the market, which we would not want to do; so it is very difficult. There could be exceptional circumstances where we could use the reserve requirement as a tightening device; but they would be exceptional circumstances, not general. On the down side it is quite different: we can always reduce reserve requirements without creating an upset in the market. We have now reduced reserve requirements five times in the last four or five years.

9494. If this is your view, sooner or later your reserve requirements will get down to the statutory minimum and the weapon will be thereafter useless?——Except for broad adjustments in peculiar circumstances.

9495. Surely circumstances might arise in which you might want to consider raising the reserve requirements and would not mind the consequences to the gilt-edged market? Surely it would only be in an inflationary situation you would want to act; and then it would not matter if you temporarily dried up the gilt-edged market?——We are not worrying about drying it up; we are worrying about being brought in to support it.

9496. Why should you mind about a collapse if it is an inflationary situation?——We might not.

9497. Is it not possible that this is a weapon which is likely to go out of use, if it is only flexible in one direction?——So far as only being flexible in one direction goes, the fact is that it is with certain exceptions; the increases in wartime, for example. But it is a real question, to my mind, whether those increases served any useful purpose whatever. They were introduced, and then the bond market was pegged; I do not see that they really performed any function.

9498. Is not that on the basis that you have got power in open market operations? In those open market operations does the Federal Reserve confine itself entirely to operations in bills?——Preferably bills and short-term securities, except in the case of a disorderly market.

9499. You say short term securities; how short?——It is not categorical; the idea is as short as possible. We would not choose one-year maturities if we had four-month certificates, unless there were peculiar reasons for it.

9500. Is this confinement of operations to the very short end of the market based on the view that the only thing the Federal Reserve seeks to achieve by its open market operations is an effect on bank reserve positions?——No, it is based on the view that the only way the Federal Reserve achieves an important effect is through what it does to banking reserves; which is quite different.

9501. *Professor Cairncross*: Do we take this to mean that you are conscious when you operate in the open market that you are influencing long-term rates as well?——*Mr. Riefler*: That is what we have thought about. I have written an article for the Federal Reserve Bulletin on this problem of influencing long-term rates*, and I can give you copies if you would like to have it.—*Professor Sayers*: I wonder if we could have it, so that we can study it before you come back again, and deal with this part of the discussion on that basis when we have read it.

9502. *Professor Cairncross*: You said, if I understood you aright, that you would like to operate in the shortest maturities you could. How do you relate this to your knowledge that in your open market operations you are bound to influence long-term rates? Do you think that you exercise just as much pressure that way as by operating in long-term maturities?——What the Federal Reserve deals with is reserve funds; the only result it gets is through providing or withdrawing reserve funds.

9503. *Professor Sayers*: I do not think that that is what the Federal Reserve Board says about the system. It does say various things that might be held to call for the Federal Reserve to exercise as big an effect as it can on long-term rates. Is that not so?——I think that is the way we operate.

9504. You believe that by operating in the short end of the market only you secure the maximum effect that you could possibly get on the long end of the market?——The maximum good effect in general, yes. We want to avoid spurious effects in the long-term market, where rate moves do not mean anything significant economically, or mislead us. But I think this discussion could be better continued after this article is read.

9505. *Professor Cairncross*: May I turn to another question? There is a very big difference between the way you operate and the way we operate. This means, I take it, that there is a lot of direct contact between the commercial banks and the Federal Reserve Banks, such as would not occur between the commercial banks here and the Bank of England. Do you believe this is an important merit of the Federal Reserve System, or do you think it makes very little difference?——There is a tradition that the member banks of the Federal Reserve System make their short-term adjustments through borrowing from the Federal Reserve Banks, and that that borrowing is purely for short-term adjustment; it is not continuous. That is the heart and centre of our particular method of operations, by open market operations and reserve requirements on the one hand and discount rate policy on the other. If our banks borrowed freely from the Federal Reserve at the discount rate, and stayed in debt as long as they could legally do so our system would not work; we would have to devise something else.

9506. Can you exercise more pressure on the commercial banks through this contact than you would if you were operating mainly through operations in the short term market and the rates of interest prevailing there?——I think so, yes.

* *Open Market Operations in Long-Term Securities*: see *Federal Reserve Bulletin* for November 1958.

9507. You feel that the commercial banks are in a hurry to get out of debt to the Federal Reserve Banks?——It is mixed. A very large proportion of the banks in the country make it a general principle never to borrow from the Federal Reserve Bank at all; they want to stand completely on their own feet. Another group will think of borrowing as a distinctly emergency privilege; and then there are the very active, aggressive banks in every district, who are out to borrow all they can, and have to be talked to by the Federal Reserve Bank.

9508. *Professor Sayers*: How frequent are these occasions of talking to them?——None would happen at the present time, because now we have excess reserves all over; but in a period of restraint I suppose there would be fifty to a hundred banks in the course of a year.

9509. What do you say to them?——The President of the Federal Reserve Bank and a representative of the member bank will go over their situation and operations, and it will be pointed out to them that they are borrowing pretty continuously, and that this is not due to withdrawals of deposits, but because their portfolios have been expanding during the period. They will point out, say, that they have disposed of all of their bills and that, if they are going to get out of debt, they will have to dispose of some five year notes selling at 93, on which they would sustain a heavy loss. The Federal Reserve Bank would never want to suggest to a bank how it should handle its affairs; it would never tell them they would have to take that loss. But they would sit with the bank and look at the situation, and the bank would decide whether it would be better to clear up its portfolio and get back on its own feet and out of debt. They are never forced to do it, but the situation is mutually looked at.

9510. Would you have different ideas at different times about the directions in which banks should be expected to curtail their portfolios?——You mean the quality of assets?

9511. Yes, or that they should curtail advances rather than holdings of Government bonds?——It is very difficult to advise banks in that way; we would not do it, I think. The Act was amended in 1933 specifically to put on the boards of directors of Federal Reserve Banks the responsibility for keeping a continuous review of the general credit policy of the member banks as regards speculative commitments, speculative loans, etc. That responsibility is related purely and solely to the granting of rediscounts for the member bank; it does not come under the general supervisory powers. At the time the bank comes in for a rediscount it will be given consideration. Actually what happens is that when a member bank comes in for rediscount, it is made almost automatically, because the bank is in a rush for the money for that day's clearing; the review is almost always subsequent, and it is based on the pattern of borrowing the bank has adopted over a period of time. If there were a definite problem of speculative excesses, such as I have mentioned, that would obviously come in for discussion; but that would probably already have been discussed through the examiners' reports for some time previously. But in general the Federal Reserve Bank does not tell a member bank how to manage its money.

9512. It would just expect the member bank to do something about the situation, and it would exercise its right to look into the current affairs of the bank in some detail?——Yes. The application form for a rediscount has a request for salient information on the course of deposits and loans in the various categories. The statistical organisations of the Federal Reserve Bank now usually work with the discount departments, and they maintain charts on each bank, so that they can see quite quickly what the occasion for the borrowing is, whether it is a loss of deposits or an increase in investments, or whether it is unwillingness to adjust investments.

9513. *Professor Cairncross*: Is there a clear list of the types of paper acceptable for rediscount?——Practically all the rediscounts are Government paper.

9514. Is there a limit on maturity?——Any Government paper can be rediscounted.

9515. You do not draw the line at five years or ten years?——No.

9516. *Professor Sayers*: So that your contact with the rediscounting member banks is of such a nature that your control remains essentially a quantitative control, and that you do not, except in the very broadest way, operate qualitatively on the types of assets held; is that right?——Yes. We have a very broad interest in high quality bank assets, which is exercised under the supervisory function in a lot of different ways; but specifically the Federal Reserve Bank would never want to tell a member bank how to manage its business. That is a relationship they would never let themselves get into; they would never let a member banker get into the position of being able to say that the Federal Reserve Bank forced him to follow some particular course and thereby ruined him.

9517. *Chairman*: You said, I think, that the clue to the effective working of your system was that, as a whole, the banks regarded their right to discount as merely a right for temporary borrowing?——Not a right; it is a privilege.

9518. A privilege, which you conceded to them; but it is essential that they should regard it as only a temporary adjustment of the situation. Suppose that there was a change in the banking attitude, and they forced your hand, what measures would you take to assert your control over the bank reserves?——We would have, I think, to apply stricter discipline on the members. In a system with 7,000 member banks, we could not possibly have each bank borrowing up to the limit at the central bank.

9519. *Professor Sayers*: Why not?——There would be such over-borrowing.

9520. You mean you would in some way or other have to find some means of preventing it? I cannot for the moment see why it is an impossible situation?——The opportunity would be too broad, I think; if the member banks were sure of being able to borrow, and of borrowing for a very long period, they would be able to go out and make commitments in the long-term market, for example, at returns away above the discount rate. They might freeze their position, and extend themselves improperly; and when those reserves all came into the market we should have an inflationary problem.

9521. Do your commercial banks have money lent at call to any large extent?——No; the call market has disappeared. In its place there are residuals. The banks, particularly the New York banks, lend funds to financial houses on Wall Street, a lot of it technically on call; but I would not call it a call market. In fact, however, it is used like the call market. The loans to the dealers in United States Government securities are pretty similar to call loans. The money market banks in New York post a rate in the morning at which they are willing to lend, or renew loans carried over, to dealers in Government securities; if they want to take the loans up and get that money, they raise the rate, and that is posted, quite objectively, without regard to whether the dealer likes it or not. It is money at call, and therefore it is like the old call money market. In the last five years the dealers have developed a much broader market for financing outside the banks with their customers, such as large corporations, through the device of the repurchase agreement. They will sell Government securities on a repurchase agreement to the large corporations, and in that way get funds to finance their activities. Those agreements will take various forms. Some of them will be set for a period of time; some of them to coincide with a date convenient for the corporation, a dividend date or something like that. Others will be running temporarily, callable at any moment. The Government security dealers also have the same kind of arrangements, either through repurchase agreements or loans, with a large number of banks outside New York. The money, bill and short-term Government securities market is an extremely active market. The dealers are in more or less continuous telephone contact with all the principal buyers and sellers, corporations, banks, insurance companies, etc., all over the country, all day long. In those contacts they are offering both to buy and to sell securities and usually also to borrow funds. In process of this sweeping the country they borrow as much as they can up to the deadline, which is around 2.00 p.m. in New York, and they go to New York to cover the remainder. They usually borrow funds outside New York at much more favourable rates, and come to New York and take the margin at the rates charged there, which are less favourable.

9522. *Professor Cairncross*: If you were trying to restrict credit, which of the liquid assets of the commercial banks do you think would be compressed first?——Usually the Treasury Bills. The acceptance market is just beginning to revive, and the banks bold practically no acceptances for their own account. Acceptances they acquire are mostly for foreign clients, who consider them a favoured investment medium.

9523. Who would buy these Treasury Bills?——Everybody.

9524. You would exclude banks, presumably?——A lot of bank money is in Treasury Bills.

9525. *Professor Sayers*: Suppose that the Federal Reserve were creating a tight condition by selling Treasury Bills; that would lead the commercial banks to sell Treasury Bills too. A lot of Treasury Bills would have to be unloaded by the banking system as a whole. Where would they go?——Corporations would buy a lot of them; and the rate would go higher, and that would mean that people would want them as an alternative to deposits, I suppose. A lot of individuals would buy them too; the category "Other Investors" covers a great number of corporate buyers.

9526. Is there any tendency, when you are doing this, for the Treasury to get frightened about who is going to take up the next week's Treasury Bills?——No, that never happens; it is only once in a while that we find people raising the question. The auction is a real auction. It is organised in the sense that the dealers who are regular participants in the auction are those who would be eligible for repurchase agreements with the Federal Reserve. They understand that the auction must be covered.

9527. How must it be covered?——It is their responsibility to cover it, and they understand that. They have to put a hid in; it does not have to be a realistic bid, but the auction must be covered.

9528. Why must it be covered?——They understand it; that is part of their relationship to the Treasury and to the bill market, if they are to be considered primary dealers.

9529. *Chairman*: How much is there an organised body, of dealers who understand that they must cover the auction?——It is not an organised body now at all. We had the accredited dealer relationship during the war and in the days after the war, in which the dealers signed an agreement with the Federal Reserve in which they agreed to specific things. That has been completely abolished. The Federal Reserve now will deal with any dealer who is a primary dealer; that means being an active participant in the Government securities market both ways, being able to make a firm bid and offer prices over the telephone and make good on them, and bidding in auctions, and getting bills and distributing them. If his credit standing is good, the Federal Reserve Bank will make repurchase agreements available to such a primary dealer. I do not think there is at the present time any written requirement to cover bill auctions, but there is no question but that the dealers all understand that it is their responsibility to cover bill auctions, and the bill auction always is covered. Each one customarily puts in a total amount of bids related to his general position in the market. The bids are, however, completely his own affair; he will decide whether he is going to bid closely for bills or whether he will put in a cover bid, in which case the bid will be somewhat off the market, and he will only get the bills if the auction has a long tail, as once in a while it will have. The bids are made individually, and it is very close bidding. The dealers bid for a certain amount of bills for their own account, and then they will put in a lot of bids for their customers' accounts. Active conversations go on on Monday morning as to the way the auction is going, and there is a range of views early in the morning as to where the auction might come out; the consensus narrows towards 1.30 p.m., and then after the auction the dealers all exchange information on what they bid and the prices, so that they usually have a pretty fair idea by late afternoon on Monday as to how many bills they have probably got.

9530. *Professor Cairncross*: Are they able to come to the Federal Reserve Bank and obtain additional funds to cover the issues?——No; they pay for them on Thursday. Usually they are fairly well out of them by then. If they are not, it is part of their general problem of financing their portfolios. If by Thursday morning the dealers still have a certain amount of increase in portfolios which has not been covered, that becomes almost a general money market question. The dealers will make every effort to get money outside New York first. The Federal Reserve will have looked at the total reserve position, and that will be one of the factors taken into account in the decision as to what it will do that day. It may have decided that the reserve position should be eased. It will put money in the market that day; it may decide to put money into buying bills, or it may decide to put money into repurchase agreements because it wants to take it out again next day. If it has made that decision it will let the dealers know, usually before noon, that it will be willing to consider repurchase agreements. The dealers will say how much they would like, and the Federal Reserve will usually give them a proportion. Usually they will go into the market to cover the marginal remainder—they will go to the money market banks. It is understood that the money market banks offer this facility for the dealers. The money market banks post a rate on loans to dealers; but if the dealer comes in and wants that loan, he usually gets it, even though the bank is forced to borrow from the Federal Reserve Bank as a result. If it posted that rate in the morning, it usually makes good in the afternoon, though it may withdraw the offer. If the dealer is caught at the end of the day, the Manufacturers' Trust Company which handles the clearing mechanism for transfers of securities will cover his requirements. That is part of the clearing mechanism arrangement. He will be covered at a price at the end of the day.

Chairman: I think we will break off now, and resume at 2.15 p.m.

(*Adjourned until* 2.15 *p.m.*)

Mr. Winfield W. Riefler further examined.

9531. *Chairman*: Mr. Riefler, before lunch you were dealing with questions about how the weekly auction of the Treasury Bills was effectively covered. I think that, since we are going to have the opportunity of seeing you again next week, it would be best if we left over our questions on the more technical aspect of your article on open market operations in long term securities and questions associated with it and took them as a connected piece.—*Mr. Woodcock*: Could I just clear up one or two points of detail on that before we pass on? You said, I think, that the dealers talk a lot amongst themselves before the auction actually opens and that as a result of this talking they get an idea, within a very narrow range, of the prices that will be offered; do you know of any arrangement, either tacit or formal, whereby they do fix amongst themselves the price they are going to offer?——*Mr. Riefler*: No, it is a completely free auction; each dealer is out to cover the information be gets from the others, and have his own bid as close as possible and to get what he wants as cheaply as he can. The really smart dealers are quite proud of their record of getting a larger proportion of the bills at a lower price than their competitors. There is no agreed bid of any kind. The only special arrangement is that any small buyer (for instance a small bank) who does not know how to handle the auction can put in a bid for up to $200,000 of bills in the auction at average auction price, and the Treasury will allot those bids up to $200,000. Apart from that it is completely free.

9532. Do you know if the bid put in by an individual bidder is one bid at one price?——He may put in one, but the typical bid is a range of prices.

9533. So bills are sold at the auction at varying prices?——Yes, and the thing we watch each week when the auction results come out is the length of the tail: how much has to go to the highest bids to cover the auction.

9534. *Professor Sayers*: Does the dealer commonly bid for customers as well as for himself?——Yes; it is the bidding for customers that produces this range of chit-chat

in the market during the day, because a customer may enter his bid through any one of a number of banks. He will be talking to the different banks about the auction and the bid, so there is a great deal of conversation in the market. At our 11.00 a.m. call to New York we usually get a fairly wide range of prices. By 12 noon it will be much narrower, and by 1.15 p.m. the estimates really become close. Some of the houses which are very close to the Federal Reserve Bank and can get a messenger over do not make up their figures until the last few minutes before the close, and the messenger rushes over to get them in.

9535. Am I right in thinking that bids come in from all over the United States?——Yes, from all over the country, not only from New York.

9536. *Professor Cairncross*: The total size of the issue is known, I take it?——Oh, yes.

9537. *Sir Reginald Verdon Smith*: What sort of number of dealers are there bidding?——There are about nineteen dealers, including the dealer banks, who bid regularly, and then there will be others. The number of dealers has gone up from twelve to nineteen. There are about twelve dealers whom we would regard as in the class of general dealers in the money markets, but when it comes to actually bidding and getting bills pretty regularly it runs up to about nineteen at present.

9538. *Chairman*: Then may we see what questions arise on the latter part of your paper, on the organisation and staffing of the Federal Reserve System, and on publicity? I wanted to put a general question to you arising out of your paper: I get the impression that the Federal Open Market Committee has become the most important element in the operation of the system; would you accept that?——It is emerging in that way. That is quite revolutionary. In the last few years, since the Accord, great emphasis has been put on developing the Federal Open Market Committee as an operating committee. The Executive Committee which used to operate was abolished, and now all of the presidents come in, not only those on the committee, but all twelve. The aeroplane makes it possible for the twelve presidents of the Federal Reserve Banks to come in once every three weeks accompanied by statistical and economic staffs to meet with the full Board. Each president brings his own economist for his area. There is a very comprehensive review of the economic situation. Our staff in Washington will have worked all the preceding week putting together an elaborate document on the current state of the economy. Presidents will come in, with all their contacts in individual districts. There is a general discussion around the table until a decision is reached as to open market policy for the next three weeks. In that process it is necessary, of course, to discuss reserve requirements and discount rates; but there is great care taken to make that a discussion and in no sense a commitment. No president is committed by anything he says at that meeting as to what he may recommend to his board of directors Sometimes he changes his mind within the week, recommending something different from what he said that he was feeling when he was taking part in the Open Market Committee meeting. One thing that has enhanced the importance of the Committee is the requirement that the Federal Reserve Board should, in the case of all policy actions, publish the actions, the votes for and against, and the reasons therefor. This is a very difficult requirement. Some thought it was silly at first, and, in fact, it was never very relevant so long as the Executive Committee was in existence. Open market action by itself is a moment-to-moment business, and when we were having full meetings of the Open Market Committee only four times a year they had to give a considerable range of authority to the Executive Committee which did not have to publish a policy record. So under that arrangement the requirement to publish was not very operative. When it was decided four or five years ago that the time had come to abolish the Executive Committee and bring in the full group, this policy record became a very living document, because by law it had to tell the votes and the reasons therefor, both positive and negative. That, I think, has lifted the level of discussion to a higher level; it has given depth of content to it. Certainly the Open Market Committee is emerging as the central forum of the System.

9539. *Professor Sayers*: These are all full time people?——Yes.

9540. They serve in some degree the same sort of purpose, I suppose, as the Federal Advisory Council; they bring in views and they take out views?——Yes; but these are responsible people in the System, with their votes.

9541. *Chairman*: It is a union of the executive heads of the regional organisations with the members of the Federal Reserve Board?——That is it.

9542. That means that they are all whole time working members of the System. The Committee deals with and makes decisions about what you regard as your central activity, which is your open market operations, but in the course of that it feels it necessary to review and discuss Federal Reserve policy as a whole, as related to that. So it is really the force of circumstances, aided by modern transport facilities, which is making it what it is?——It is quite an evolution.

9543. *Mr. Woodcock*: The members of the Board of Governors are in a majority?——Yes. When it comes to a vote it is amazing how much these things are taken as a matter of consensus; but there are differences, and then it is voted out. When it comes to voting, seven of the members are the members of the Board of Governors, and the other members of the Committee are five of the twelve presidents. The President of the Federal Reserve Bank of New York is always a member of the Committee, and the other four seats rotate among the other presidents; but the discussions and the minutes treat them all on a parity; all twelve are always there participating in all discussions.

9544. *Chairman*: The President of the New York Bank is a regular member of the Committee?——Yes. He was put in as a permanent member of the Committee, and the New York Bank is the operative agency; but the latter is not a matter of law. The Federal Open Market Committee in its organisation meeting each March decides which bank will be the operating bank. They have always decided on New York for obvious reasons, but that is a matter of choice by the Committee and not a matter of law.

9545. *Mr. Woodcock*: When it comes to voting, do the members of the Board of Governors vote as one man?——No, they do not; they vote as individual members of the Committee.

9546. *Professor Sayers*: I see from the records for 1957, that nearly all the votes were unanimous, or at least no votes are recorded against the action decided. There are three or four cases where there is one vote against, and there is one case at least where there are two votes against; but the general tendency seems to be for the votes to be all for. I suppose a vote is generally taken after a consensus has emerged?——Yes.

9547. And this is entirely consistent with there being very strong differences, I imagine, in the discussion?——At the beginning, yes. The vote is taken last thing before the adjournment.

9548. So that a member recorded as voting against would be voting against because after the discussion he remained unconvinced and of such strong opinion that he wanted it to be recorded; and all these decisions, the detailed reasoning and the votes cast are recorded in the annual report published?——That is right; and we are trying very hard to make those revealing records.

9549. My impression is that this is a much longer section of the annual report for 1957 than was the case in previous years?——Ever since the Executive Committee was abolished it has been like this. Really, if anyone wanted to analyse those reports, he could find out a great deal; but nobody has done so yet.

9550. *Sir Oliver Franks*: Why is it, if you can go to these lengths in open discussion, subsequently reported and published, that you are worrying so little about the possible embarrassments of the motives, the springs of action and the decisions of the system becoming known and being commented upon? I suppose that next week's action is not published?——That is the thing we try to conceal.

9551. Can you help us to understand why you have no sense of embarrassment, why you think that this gives strength and is healthy rather than the opposite; because it is obviously a matter of considerable importance and relevant to other democratic countries?——Obviously the

Federal Reserve System would not have the power and independence it has been given if it were suspect. We have lived with the problem of independence in the context of our actual operations in the last ten years, and I know that we could not operate effectively in the United States if we did not have the freedom to act and the freedom to be responsible. If the System is going to have this independence, which I think is absolutely crucial to monetary operations, it has to have confidence. Confidence in our motives is most important. There is nothing that transcends that; that is why the members of the Board are divorced from specific pecuniary connections with banking and put "in an ivory tower". Next, there has to be confidence in the competence of the System; we try to engender that by having the very best staff and the best technical work we can get, and also by explaining what we are doing for all to see. Central banking in the end will always be a mystery, not because it is too difficult to understand but because it takes concentrated work to keep up with. I know; I was out for thirteen years, and I was not current with central banking problems while I was out because I just did not have the time to study the figures and the details. It takes time and application. So it is necessary to do two things: (1) to let everybody know that the System is anxious to explain what it is about, its motivations and principles of action, so that whether people have time to study it or not, they have the assurance that it is prepared to explain; (2) to make sure that those people who do take the trouble to become expert on these matters (as some of the dealers and some of the banks do) find the explanations adequate and complete, that they can find in them a complete rationalisation for past action, and therefore a fair basis of comprehension of future actions.

9552. So you would relate very closely in your own mind the independence of the monetary authority with full disclosure, not just of its operations, but of its reasons and motives?——That is right. No body of this kind can have independence without it; the public will not trust it.

9553. *Mr. Woodcock*: How often is this record of the Open Market Committee published?——Once a year.

9554. What about other publications?——Our balance sheet is published as of every Wednesday. As I said in the memorandum, great care is taken to make it a revealing balance sheet. In the United States, banks are allowed to average their reserves, over a week for city banks and over half a month if they are country banks. Figures as of a given Wednesday, consequently, do not really tell the story because they may be quite far from the mean, so weekly average figures have been developed to reveal what the actual balances were that affected the money market. Then, efforts have been made to clean up the concepts. Some of the items on the weekly statement were fuzzy, for example, loans used to lump together both loans to member banks and loans to foreign banks. That has been changed. The result is that anybody who is in the market and wants to analyse what has actually been done, gets the applicable information sometimes as fast as we do. There are many other regular releases, of course, than the weekly statement. In addition, all policy actions are announced immediately. So much for information covering actual operations; on the other side, the System tries to educate the public with respect to the philosophy that governs its actions. It publishes *Purposes and Functions*, an elaborate advanced-level textbook on money and banking. It also has many publications of a more popular type as well as those for a pretty sophisticated audience. Each tries to convey the same story and reach the same type of understanding in groups at the different levels. In that way, an effort is made to reach everyone so far as it is possible. In so far as actual future operations are concerned, we say nothing, but we do have a detailed discussion of past operations in the *Annual Report* which comes out some time after the end of the year. The interval is long enough so that people cannot interpret from the explanation of an action taken, say, in December, the logical succeeding action that would have to be taken, say, in February. If the reasons for an action were published immediately, a very clever operator might have a basis to forecast future action. We think we escape that hazard by publishing only once a year. Maybe we are wrong in this attitude toward publication. In any case, it is consistent with what the law requires.

9555. But your motives cannot come under discussion at the time?——No.

9556. *Professor Sayers*: But you do, in fact, make statements which can reasonably be described as policy statements during the year?——Yes; but that is at our discretion. When we go to Congress for a review we have to treat the current situation, but aside from that, though we all of us may and do accept speaking engagements and speak on the current situation, they are at our discretion, and we can refuse if we think it would be embarrassing.

9557. Do you often feel that it is embarrassing?——Sometimes; it depends.

9558. The figures of your operations, which are published very fully indeed, show the extent of your open market operations at a particular time; but they do not particularise in which securities you have been dealing?——Yes, that information can be obtained.

9559. How frequently is that published?——That is not published as daily averages, but the weekly statement on Wednesdays has the securities classified as to bills, certificates, bonds, and then it also has a classification of maturities: within 15 days, within 90 days, within a year, within five years, etc.; so observers can inform themselves quite accurately as to what has happened, if they want to.

9560. Do you feel that this publication is any embarrassment to your market operations?——No; but we find that the dealers and the larger banks, who really follow it very closely, use those statistics. They have their own running estimates of the location of securities in the market, and they use their knowledge of buying and selling of individual firms to obtain a rough idea of where the securities are located.

9561. *Professor Cairncross*: You do not go to the Treasury for permission to publish statistics?——No.

9562. *Professor Sayers*: When you say that these people are constantly studying the statistics you publish, do you consider that their study of the statistics is an advantage or a disadvantage?——It makes for a better market. We depend on the market process and we try to make it as good a market as we can; that accounts for most of our activities in this area.

9563. *Mr. Woodcock*: When you say "we accept speaking engagements", who are "we"?——The members of the Board and the senior staff.

9564. Are you open to questions at these meetings?——Yes indeed.

9565. *Sir Oliver Franks*: Could you give us a brief description of what members of the Board and senior members of the staff do do in this way, and conversely of what is done (if you do it) in the way of bringing the public into the System and explaining to them, whether by way of lectures to groups or by publications, what you are after? How far do you set out to educate people about the System in these ways?——As far as speaking engagements are concerned, they are after all of us a great deal; most of the Board, most of the senior staff, and also the staffs of the Federal Reserve Banks. Those engagements come up mostly at meetings of special groups. We get the full range of audiences. One that I usually get is the mortgage bankers, who are very closely affected by our policies, and probably include some of our severest critics and also, I suppose, our staunchest defenders. Interestingly enough, some of them have become convinced that monetary policy is very important and are defending us even though their own industry has been hit rather hard at times. The mortgage market is very large, and the mortgage bankers know that the magic of central banking is not the only reason why they may or may not have funds available for mortgage lending; they know that somebody also has to do the actual saving. In a period of restriction, when mortgage funds are less readily available and more expensive, they are likely to understand that there are competing demands for those savings and that the Federal Reserve is trying to do a job of equating saving and investment.

Then there are the professors of money and banking, a real and most effective pressure group. People still use the old cliché of the System being under the domination of bankers, but the Federal Reserve System has never been under the domination of bankers. The professors

of money and banking are the ones who make their living by watching what we are doing and criticising us. They are alert and conscious that central banking is a technical, professional operation. They comprise the public we really have to watch. We put all professors of money and banking on the mailing list for our publications; and a lot of them have worked on our staff at one time or another. We have wide contacts with them. Most of the Federal Reserve Banks have seminars once a year. I will describe a typical one at Chicago; the others are similar to it. The Federal Reserve Bank of Chicago has an arrangement with the Northwestern University, by which the two of them jointly sponsor an annual seminar of teachers of money and banking that lasts for three days. The University contacts about thirty different colleges in its district, and asks each college to nominate a member of the faculty to go to the seminar. The University will exercise a veto on the nominations, so as to see that the colleges do not always nominate the same men, and that they do get down into the teaching ranks. Those thirty people come into Chicago. The Federal Reserve Bank puts them up at an hotel and gives them their meals in the Federal Reserve building. They start with an evening dinner and meeting at which the different people are introduced, and there is a talk by the President of the Federal Reserve Bank. Next morning there will probably be a session on the use of the discount instrument, followed by one on the clearing and collection services of the Federal Reserve Bank. Then there will be a luncheon meeting, with a member of the Board of Governors to talk to them. Then there will be a session on reserve requirements, followed by another which will be on some other operating problem of the Federal Reserve Bank. In the evening a leading member of the Bank staff will give a talk. The next morning they have a session; I might be there, or someone else from the senior staff in Washington, and I might talk about Federal Reserve policy, the things we are trying to do, and the difficulties of judging the economic situation. Then somebody from the New York Bank may describe the working of the money market. It is really up to the lecturer what goes on at those meetings. There may be somebody from the Treasury to describe debt management operation and how the Treasury and the Federal Reserve cooperate. After three days of this sort of thing they go home; and they are then circularised by the University, asking for their criticisms of what was arranged and how it might be improved next year. These seminars have been very valuable. We have probably a thousand teachers of money and banking in the United States who have been through this experience once or twice. The atmosphere is completely free; there is no intellectual domination; nobody tries to put anything over at all. It is completely on the level. They get a chance of a pretty good insight into what the Federal Reserve System is all about.

9566. *Chairman*: You have explained already that as a matter of principle you think that full disclosure is a corollary of independence; and you said that to make your policy work you wanted as good a market as you could get, and you thought that this was a positive aid to improving the market. There is one more thing I would like to know: suppose that you were not pressed by the general principle; do you think that, if you did not give this current information about your operations, you would be able more effectively to impose your policies about reserves upon the banks?——No, I think we need a knowledgeable market. There are always occasions when handling the market is a problem. There are occasions when, if the manager of the account can buy or sell some securities without the market knowing it, that will help his purposes. I am convinced, however, that on balance one gains by not doing that, that we gain by making full disclosure to the market of what we are doing. It is a question not only of confidence but of the level of discussion; if you read the market advisory service in the United States today and compare them with six or eight years ago, you will find a level of sophistication and confidence and understanding that is immeasurably higher. I think that is the fruit of the effort we have been putting during these years into giving information and making full disclosure.

9567. *Professor Cairncross*: Do you find any difficulty in getting from the commercial banks a statement of their assets that conceals their hidden reserves, or do you find they are prepared to see their hidden reserves revealed to the public?——The banks are for the most part required to report four times a year; that is compulsory reporting and must be done on the basis of rules established by the supervisory authorities such as the Comptroller of the Currency for the writing down of assets. These might differ from the banks' own.

9568. But in that case what you subsequently publish would be an aggregate for all the banks?——The problem actually came up in 1933. After the bank holiday, the banks were asked to report their position according to their own books. We were surprised to find that they thought their capital position was much better than the official reports were indicating. That is the only occasion I recall that the question has come up of differences between the banks' internal reports and the report submitted to the supervisory authorities. Most of the figures we get from the banks are furnished voluntarily. Both the weekly and monthly reports are voluntary and we would not go to the point of trying to reconcile them with the books. They are requested to give information on specific items such as loans or deposits. They would not throw light on the presence or absence of hidden reserves.

9569. But you would be in a position under the law to require a statement of assets on any basis that you chose?——Yes.

9570. May I come to the question of staff, which you discuss in your paper? You mention that the Federal Reserve System seconds its staff on occasion for service abroad. Have you found that other central banks second their staff for service with you for a short time?——Sometimes, yes. People come over to visit for quite considerable periods. Of course, nobody knows better than you the present Washington set-up; with the International Monetary Fund and the World Bank there, the central banks are constantly sending their people over. The Bank of England has sent many more people who have become thoroughly familiar with the Federal Reserve System in Washington than we have to London. We will have to go some distance to catch up with them. The record of the Bank of England with the Fund has been magnificent.

9571. So if the Bank of England send someone to Washington to serve with the Fund, he can take advantage of consultation with the System without working within it?——Yes; we welcome them, and do everything we can to help them.

9572. How free are you in recruitment of staff? Do you have a budget of your own?——The Federal Reserve System is outside the budget control of Congress; the Act specifically provides that the Federal Reserve Board will pay its expenses by levies on the Federal Reserve Banks, and the Federal Reserve Banks with the present open market portfolio have enormous earnings; as of now they are from choice turning over $500 to $600m. a year to the Treasury as excess earnings. The Act also provides that the Board shall be in complete charge of recruitment and rates of compensation, so that it can in fact recruit anybody and theoretically pay any rate of emolument. Actually it conforms very closely to the standards of the Civil Service in Washington.

9573. But it has power to pay more if it so desires?——Yes.

9574. *Professor Sayers*: Is there any movement of personnel from Treasury to the Federal Reserve, and from the Federal Reserve to the Treasury?——Not much.

9575. Or any other branch of the Administration?——Washington is one labour market, and it is really the only labour market for technical personnel in the Government; so we do have a great many of our staff, the lower staff particularly, drawn from other agencies, and *vice versa*. It is less so with the higher staff. We have a number of economists, and occasionally our people will leave to go to the Census or something similar. There is more movement between the Federal Reserve Board staff and the Federal Reserve Bank staffs.

9576. You do not take any systematic measures to try to ensure that some of your staff have bad experience in the Treasury, or *vice versa*?——No.

9577. Would you regard that as something useful?——Our Treasury is different from yours. I was adviser there for years; and clearly nobody could do that effectively as a part-time job; that advisory work is full time. They always have a group of technical advisers; but when it comes down to their actual staff work there would not be any particular reason for training our people there.

9578. Not even in debt management?——No.

Chairman: I am sorry to say that I must leave now, because I have a duty at another place. But I do not want to curtail the discussion, and I will ask Sir Oliver Franks to take the chair.

(*The Chairman withdrew.*)

Sir Oliver Franks *in the Chair.*

9579. *Professor Cairncross*: Do you find it curious that you should have so many economists, and the Bank of England so few?——The idea of central banks developing economic staffs started with the Federal Reserve. Central banking is a good subject for economists; they have more background for understanding it than other people. Once we had started recruiting an economic staff it was fairly normal and natural that the whole System should begin to draw on that staff for help in performing its functions. As I have said, Federal Reserve economists are now very numerous; they are relied on to contribute to the performance of functions which in other central banks would be contributed by other technical people with other technical backgrounds.

9580. In this country, of course, the Treasury carries out some of the functions that fall on the Federal Reserve System in America. At one time there must have been fairly close relationships between the Federal Reserve System and the Bank of England, because, if I remember rightly, you supplied an economic adviser to the Bank of England for quite a time. Do you make a point of having someone from the Federal Reserve System over in London and in touch with the Bank of England?——No, we do not. The Treasury has the function of maintaining foreign representatives; we have none. Our people are only abroad on call. Lately quite a few of our people have received Rockefeller training awards, and have wanted to come over to England; the Bank of England has given them a home and treated them very nicely, and we consider that very valuable training.

9581. *Lord Harcourt*: Do the individual Federal Reserve Banks have large staffs of economists of their own, or do they rely largely on the services which come from the Board?——No, each Bank has its own research department. It would not be as big as the Federal Reserve Board's staff by any means; but the New York Bank's staff is very large, and Chicago is quite large, and all of them are appreciable. They work on local problems, and they work with the Board staff on national problems, and they advise their Presidents with regard to the decisions of the Open Market Committee.

9582. *Professor Cairncross*: You have undertaken a number of important pioneering pieces of research in the Federal Reserve?——Yes. We try to keep a balance between day-to-day business and credit analysis and long-term research. The most important point about recruiting a high-quality research staff is to maintain complete internal freedom of thought, judgment and expression. The big danger is that, as a staff becomes known, it will become completely immersed in writing memoranda on current problems. We have to do a considerable amount of that but we have tried to vary the experience by also making definite provision within the System for long-range fundamental research. For example, we have just taken on the responsibility to develop better savings statistics. We are going to organize the work and take the leadership in the development of basic statistics on savings in the United States. That will involve new independent staff appointments and quite fundamental work. Congress pressed us to undertake this. They also turned to us last year for a comprehensive study of the adequacy of small business financing. We have published the first part of our study on that and hope to come up next year with the final part. It is a very elaborate piece of research and investigation. Last year, at the request of the President, we made a similar study of the behaviour of consumer credit.

9583. Have you carried out any special inquiries on trade credit? I believe you regularly publish data which show the liquidity of corporations?——That is about as far as we have gone. I think that this material on small business financing will give us more of an entry into that field. We are going to use the survey technique; we are going to send out people with a fair background of accounting to interview a sample of small business firms, to try to get a deeper insight into their financial problems. A great deal of general statistical work has been held up because of absence of knowledge in that area.

9584. Do you think a central bank ought to collect data of that kind?——Our principle is that somebody ought to collect it; it ought to be available. We are responsible for financial statistics—we think that we ought to take the initiative to get the banking and monetary statistics. The rest of our statistical work is work which we pioneer if nobody else will do it; if somebody else comes along we will turn over our calculations to them, if they will do them as well as we do or better. But it is essential that these areas of the economy should be covered.

9585. *Lord Harcourt*: Do the departments produce a great number of statistics in the United States?——Yes. Our statistical machine is not centralised at all. Most of the statistics have grown up as a result of the actual operating needs of somebody or other, and have then been adapted for central use. Many of them are collected by trade associations, or come from some private source, and the Government puts them together.

9586. *Professor Cairncross*: To go back to savings statistics for the moment, you will be aware that it is extremely difficult to interpret the rather limited data we have for the United Kingdom. Do you find the statistics you have for the United States give you a fairly clear lead as to what is happening to savings?——It is an awfully difficult area.

9587. What kind of weaknesses do you find in the existing data you collect?——It is easy enough to collect data on savings bank deposits, and that sort of thing, but it is much harder when one comes to repayments on instalment loans, and that kind of dissaving, and disposal of securities. One of the big weaknesses is that in most of our calculations figures covering unincorporated business are listed with those covering individuals. That is the kind of weakness that our present effort will try to clarify.

9588. *Professor Sayers*: Do you find that commercial banks and others from whom you collect statistics complain of the work involved in gathering these statistics for you?——Yes; we have to watch that very carefully. Periodically a complaint comes up of duplication of statistics; we have to see that we avoid that. In general what happens is that the banks themselves become interested; once they appoint economists and begin to develop a statistical staff the problem is more or less solved. When somebody within the bank wants to get that kind of information from internal sources to further his own job, the problem begins to disappear. But with the bank which is so small that it does not have anybody in it who is particularly trained in this field, we do have difficulties and we have to go slow.

9589. *Sir John Woods*: Is it not true that you have more and more begun to pick out economists and put them into executive posts?——Yes. Four of our present presidents and three of our first vice-presidents were economists. It

is quite interesting that the economist training in the Federal Reserve seems to lead on to top executive positions.

9590. Have you any method of picking these economists who besides being well qualified academically have executive capacity?——They have been with us for some time.

9591. It is your experience of the man?——Yes.

9592. *Professor Cairncross*: When you take a young man into the Federal Reserve Board staff, is he taken on a permanent footing, or is he taken for a period of years?——He is taken on temporarily; it is not specifically temporary, but it is understood to be more or less on a trial basis. In general we keep in touch with the graduate schools, and try to get recommendations from our friends on the faculties there of their really outstanding people; then we go after them, and have to bid pretty hard. Frequently we lose them because others outbid us.

9593. When you take a man at the postgraduate stage, be comes to you for a period of years?——He would usually stay there two or three years, and in that time be would get to know whether be would like that kind of work and want to stay on, and we would get to know whether we would like to keep him.

9594. *Sir Reginald Verdon Smith*: In what you ere saying, are you speaking of beadquarters in Washington, or all the Banks?——I am thinking of headquarters in Washington, but at the Banks it would be pretty much the same. The Directors of the Federal Reserve Bank in Chicago bave tried a new approach; they have offered three very good fellowships to top graduate students in the Federal Reserve Bank and doing a research study during the first summer at quite a bigh rate of pay; getting a stipend while they are doing their graduate work, and presumably carrying on as a thesis the study they started at the Federal Reserve Bank, and then coming back to the Federal Reserve Bank at the end of the course to work for three months at the same fairly good rate of pay. The stipend amounts to about $4,000 a year. Afterwards the man is free to go anywhere he wants to, but the Federal Reserve has had a chance to see whether he is a good person and is in a position to bid for him, and he has got to know the Federal Reserve organisation and whether be would like to stay with it. That approach is working out very well, and I think other Banks will probably start the same sort of recruitment programme.

9595. So it is becoming more and more of a career occupation?——Yes.

9596. *Professor Cairncross*: When the Federal Reserve Board started the policy of recruiting economists, was there a large supply to be drawn upon, or did they have difficulty?——No, it was a contribution of Walter Stewart's. At the very beginning of the System there was a staff working in New York, while the Board was in Washington; they helped write articles and made certain studies but it was not a staff that lived and worked together full time. Walter Stewart came down to the Board in 1923 and started building up this economic work. He was a very magnetic person, and a great stimulus to the staff; none of us who were in that original staff that be brought together will ever forget it.

9597. *Sir Oliver Franks*: Could I ask one question on a rather different topic? I have tbe impression that in one or two countries where the way things are done is not exactly the same as either ours or yours (I am thinking of Canada and South Africa) the senior people in the central bank are allowed to take an interest in the formulation of fiscal policy, the reason for this being that it would be difficult in their view for people responsible for monetary policy to go ahead unless they knew what was happening on the fiscal front, and *vice versa*. We had the impression when talking to the Governor of the South African Reserve Bank recently that be or his people would normally sit in when fiscal policy was being formulated. Of course in the U.S.A. the ground situation is different; it is not simply the Treasury, but there is also the Director of the Budget and so forth, but obviously the inter-working of fiscal and monetary policy is the same everywhere. Allowing for differences in the circumstances, how far do these considerations enter in, and how far do they not?——On the budget side, *i.e.* on expenditure and taxation, that, as any of you know who have lived in Washington, is a matter of decision by Congress. We talk freely with the Treasury, and they get our ideas, but we never bave any remote feeling that we bave special influence on decisions. It is not the kind of situation in which the voice of the Federal Reserve Board, though it might urge important considerations, would be given great weight. On the debt management side it is different. I suppose that most of our discussions with the Treasury relate to problems of debt management, and of course the Federal Reserve Bank of New York is the fiscal agent to the Treasury, and actually executes most of the debt operations. They are in touch with them on the telephone every half hour throughout the day, discussing the market, discussing the prospects of the next issue, what it looks like, what the options are, what the dealers are saying about it, what the professionals are saying about it, and so on. The Deputy Under-Secretary and the Assistant Secretary of the Treasury in charge of debt management, who come over to our staff luncheons, make very wide contacts with the financial community and maintain them continuously, on the debt position and on the probable or possible options for the next financing. If a heavy maturity is coming, say, on the 15th of a month, about a month before that they will invariably call in the Government Securities Committee of the American Bankers Association and also of the Investment Bankers' Association; if they are considering long-term issues they will also call in committees from the savings banks and insurance companies. These committees will all come to Washington, and they will all be told of the amount of debt that is maturing, and they will be given a review of the prospective fiscal position as it applies to the debt; then they go off by themselves and hammer out a recommendation as to the form of refinancing, or the new cash financing if that is the problem. They meet with the Secretary of the Treasury, and give their report. One of us may be there. The officials of the Treasury, of course, will have been talking it over with our people for weeks beforehand. After those reports are in the Secretary of the Treasury will usually meet the Chairman of the Board, and possibly somebody, frequently the Manager, from the Federal Reserve Bank of New York, and a decision will be made. But it is a decision which the Secretary makes, and it has to have the approval of the President before the announcement can be made.

9598. *Professor Sayers*: When the Treasury undertakes a financing operation does it afterwards announce the result of its issue, and disclose the percentage the market has taken up?——Yes.

9599. Is that a genuine figure of sales outside the Government machine?——Yes.

9600. Has there been any suggestion that the publication of these figures is a disadvantage to the Treasury in its operations?——No. It is part of the general knowledge the market has. They know what the total debt is, and the amount in the Federal Reserve System is generally known; the amount in the Treasury Trust Funds is negligible, not over one or two per cent. in most cases. The Treasury Trust Funds essentially hold special issues and not the marketable issues, although the Treasury does on occasion buy some marketable issues for the Trust Funds. I have a little note on that which I can hand in to you if you want*. Subscriptions come in; if it is a refinancing operation the Treasury always exchanges the Federal Reserve maturities in full. If it is a cash financing, it announces the percentage alloted to the market, and it always tells what it allots to its own funds. There is full disclosure.

9601. *Professor Cairncross*: What sets a limit to the Government debt in the U.S.A.?——There is a ceiling, which can only be changed by Congressional Act.

9602. It therefore does not rest with the Federal Reserve System anyway to determine whether it will hold more debt above the ceiling or not?——The total debt is fixed by the ceiling, and that includes debt beld by the Federal Reserve System, so we could not belp the Treasury to escape the debt ceiling.

9603. I take it that it also rests with the Treasury to decide whether it will issue short-term debt or long-term debt?——Yes.

9604. Is the Federal Reserve System in any way involved in meeting the Government's requirements of short-term debt, except in the rather circuitous way that you described

* See Memoranda of Evidence Part V No. 8 (III).

to us this morning?——The Federal Reserve System in general is not allowed to buy securities from the Government, except for a $5,000 million authorisation that goes on for two years at a time. It is up for renewal right now; the Bill went to Congress the other day. Under that authorization we can lend to the Treasury directly up to $5,000 million. It is distinctly understood from the legislative record that that authority is to be used solely for interim financing of the Treasury over periods like tax periods; it is a day to day advance. We had one this spring; that was the first one since 1954. It is very seldom used; but on days when there is a big turnover in taxes, the Treasury may not have funds in the tax loan accounts at the member banks which it can draw on in time. If it cannot draw on them in time, it will finance by drawing on the Federal Reserve for a day or two until the tax cheques come back after collection.

9605. The formal position, as I understand it, is that you determine the supply of money, and the Treasury determines the supply of debt within the ceiling and the distribution of debt by maturities, subject to discussion with you on forthcoming maturities, and the price at which new issues should be made?——Yes. We feel no obligation to take an institutional position; there may be three of us and each may make a different suggestion. There is a discussion of the problem, but we do not present the Treasury with advice from the Federal Reserve as an institution.

9606. Institutionally you have control of the supply of money and the Treasury has control of the debt, though you may meet and discuss things?——Yes; we very carefully arrange for full discussion.

9607. *Lord Harcourt*: Are U.S. government securities ever underwritten at issue?——No.

9608. Then if an issue is made and it is under-subscribed by the public, where does the balance of the subscription come from?——Cash issues are usually oversubscribed; once in a while an issue is weak. Up to the time of the Accord, all Treasury securities were pegged. After the Accord, for about eighteen months, it was felt that issues as large as these Treasury issues needed underwriting for the same reason that private security issues required underwriting. In particular, a tremendous turnover of securities was involved in the course of a refinancing. Consequently, the Federal Reserve, after the announcement of the new issue, would enter the market to buy the maturing issues for which the exchange was being offered. It would do this from the time the terms on the new issue were announced until the subscription books were closed, in such a way as to maintain a slight premium on the maturing issue, something like 3/64ths above par or better. The purpose was to provide an inducement to any holder of the maturing issue who did not intend to tender it for exchange into the new issue, an inducement to sell it in the market rather than to hold on to maturity. In other words, the purpose was to reduce attrition, i.e., cash redemption to the Treasury. In practice, in the free markets that prevailed after the Accord it was all too frequently found that the maturing issue was acquired by the Federal Reserve in tremendous amounts. In fact, there was a lesson to be learned.

When a firm underwriting bid is present during these large exchanges, there seems to be a tendency for the market to flood the Open Market Account with securities. The turnover at such a time is necessarily large and it is apparently just too easy for the dealers to turn securities in to the Account on a small margin of profit rather than to evaluate the merits of the exchange and seek out and persuade prospective investors to buy the rights.

This situation began to get seriously embarrassing, until finally, after some very heavy underwriting purchases in the refinancings of August and September 1952, it was decided to see what would happen if no bids were put into the market, if the market were permitted to react to the exchange offering without underwriting support from the Federal Reserve.

Now, when a new security is offered only in exchange for a maturing security, there cannot be oversubscription; there will always be some attrition, because someone will fail to exchange and will present the security for cash. In the case of these exchange offerings, consequently, the relative success of an exchange is measured by the percentage of attrition. This percentage has consistently been less since the Federal Reserve stopped underwriting, if one measures attrition by the amount of the securities presented for redemption by the Treasury in cash plus the amount purchased by the Federal Reserve when it acted as underwriter. The total attrition has actually been less since the refinancing was left completely to the market (as has been done, with only one exception, since 1952) than it was when the Federal Reserve was underwriting.

That finding has been challenged on the ground that other circumstances were not equal, particularly that attrition is always less in easy money periods such as prevailed in 1954. We have tested that challenge by a rather elaborate statistical investigation into all of the exchanges since 1952, allowing, so far as possible, for all the variations and difficulties due to the particular times when the exchanges were being made. The figures still come out to indicate that the attrition has been less since the refinancing was left to the market process than it was when the issues were underwritten by the Federal Reserve System. A great deal, of course, depends upon the coupons the Treasury offers, and it is probably true that more care will be exercised to offer terms of exchange that will be attractive to the market and thus tend to minimize attrition, if there is no underwriting.

9609. You say that every cash issue is always oversubscribed?——Practically. There was a problem in the fall of 1955, when we had raised the discount rate just before a new issue was brought out, and it came at the seasonal turn of the year when everything is most difficult. That issue looked as if it were going to go sour that day, and the Committee decided to go in and buy. They bought, I think, $167 mn. worth, and the issue was a success.

Sir Oliver Franks: Then, if there are no further questions, I think we look forward to our next occasion. Thank you very much.

(Adjourned until Thursday, 26th June, 1958, at 10.45 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-EIGHTH DAY

Thursday, 26th June, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.	PROFESSOR R. S. SAYERS, F.B.A.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.	SIR REGINALD VERDON SMITH
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	GEORGE WOODCOCK, ESQ., C.B.E.
W. B. JONES, ESQ., O.B.E.	SIR JOHN WOODS, G.C.B., M.V.O.
	MR. R. T. ARMSTRONG, *Secretary*

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary, SIR LESLIE ROWAN, K.C.B., C.V.O., a Second Secretary and SIR EDMUND COMPTON, K.B.E., C.B., a Third Secretary, H.M. Treasury, called and examined.

9610. *Chairman:* Sir Roger, we are very grateful to you and your colleagues for coming back to give us a little more help, on export credits and on the forward exchange market. Can we start with export credit?——*Sir Roger Makins:* Before we begin on that, we should like to amplify something Sir Leslie Rowan said about the resources of international institutions. Since the last time we were here there have been various developments on which I think it might be convenient for you to have a very short statement from Sir Leslie.—*Sir Leslie Rowan:* On 28th November last when Professor Cairncross asked some questions on this, he said [Qn. 2590]: "When I referred to the European Payments Union and to the International Monetary Fund, I was in effect asking whether there are any proposals of which we are not aware, or any suggestion that you would like to put before us, which bear in mind that the total pressure on liquidity may grow more severe as time goes on". I said that we had no proposals to make for increasing the resources of the International Monetary Fund, but there were possibilities there. Since then, as I think you will all be aware from various references in the Press and elsewhere, we have had a number of discussions on the problems of international liquidity. I wanted to make this statement because I did not want the Committee to think that I had concealed anything from them when I last gave my evidence; the discussions which we had on international liquidity took place subsequent to that meeting, in fact during this year. We had not then, and we have not now, made any specific proposals. On the other hand, we have had discussion directed towards the question whether international liquidity (and I might perhaps extend it to cover also the form of liquidity, if I might use the word in a very loose sense, that the International Bank provides as well as that which the International Monetary Fund provides) is likely to be adequate for the needs as one sees them developing over a period of years, in the same way as those who sat down at Bretton Woods had to look at the needs as they saw them developing over a period of years rather than immediately. The first point is to establish whether there is any problem, whether there is a general agreement that there is inadequacy; it would be after that that the question of how that inadequacy could best be met would come up. I just wanted to make that general statement.

9611. *Professor Cairncross:* Would it be in order to ask whether you have also made certain suggestions about the future operation of the European Payments Union?——The operation of the European Payments Union is at any rate to some extent tied up with the convertibility of currencies. As you know, there is a provision in the agreement whereby if a majority of the countries (that is a majority in proportion to their importance in the Union) make their currencies convertible, they can ask for the Union to come to an end. There is already agreement for the bringing in in those circumstances of the European Monetary Agreement, which includes in it a new fund. How or to what extent that particular agreement, and particularly the fund aspect of it, might be affected either by differences which have taken place in the relative strength and importance of the countries economically speaking since it was drawn up, or by the outcome of the negotiations on the Free Trade Area, is a question which must remain open. Apart from the European Monetary Agreement, which was agreed in principle before we last gave evidence to you, we have not made any specific proposals, although there have been suggestions that we might have what was called a two-tier fund. The European Monetary Fund was supposed to be a one-tier fund, in the sense that it would give credit in no cases automatically, but only on the basis of need shown. If there was any idea of any further development of the kind I have mentioned there might be an automatic part and a second part for needs shown, but that is not in the range of anything very concrete.

9612. I asked the question only because the amount of liquidity furnished through the E.P.U. has been significant during the last ten years, and the relations there over the next ten years would obviously be of importance?——I would agree with that.

9613. *Chairman:* May we then come to the question of export credits? Since we saw you last year we have had a certain amount of evidence from various sources on the subject of credit for exports, and we have had a full and informative day with Mr. Owen and his colleagues from the Export Credits Guarantee Department. Certain points have been put before us and there have been questions of some importance about which it was suggested that we should make recommendations. When we read the Budget speech this year we saw that there had been going on, concurrently with our hearings, a detailed review of the facilities provided by the Department. We are not making any complaint about this; but it would help us with our own work to know how far you were able to go on these various points and what the conclusions were that you formed on them, apart from the general statement, which was, no doubt, all the Chancellor had time for, that the situation seemed to you satisfactory but might need alterations in accordance with the development of competition in credit terms. There are also one or two questions about the position of the Department, and on the source of decision on its policies, which we would like to explore with you. Perhaps I could take first the point about the length of terms of credit guaranteed by the credit insurers. It has been said to us that the effective limitation for certain kinds of exports is five years from shipment. It is suggested that in the competitive world in which those exports have to live that is not long enough, and we are losing export orders which might come to us simply by virtue of this limitation. On the other hand three reasons have been given us for the desirability of it being kept to five years. One suggestion was that as a matter of policy the U.K. could not afford a longer term for financing exports of that kind; another was that it was the proper given principle of credit insurance not to go beyond five years; a third was that it was the practical limit for businessmen (represented by the Advisory Council) to foresee, and they could not be expected to foresee anything wider. Could you tell us how far you went into this and what the reasons for your conclusions were?——*Sir*

Roger Makins: Sir Leslie Rowan has been particularly concerned with this question in the last few months, and with the work which led up to the Chancellor's statement, so I will ask him to speak on this question.—*Sir Leslie Rowan*: The question of the adequacy or inadequacy of the insurance which is given by E.C.G.D. has to be one which is continuously looked at. When it was looked at, both by the E.C.G.D. and by the interdepartmental committee, we were very conscious of the fact that there were some problems in it, particularly the longer term problems, which would have to be looked at in the light of your deliberations. Therefore there was no intention or purpose in this in any way to cut across your work.—*Chairman*: We fully understand that and, as I say, make no complaint.—*Sir Leslie Rowan*: I wanted to make that clear. There was a particular urgency at that time because, as I think you will recall, there was a good deal of publicity given then to a particular contract, in which the question arose whether or not we should go beyond the normal term of five years from shipment.

I think that I can perhaps best deal with this by taking the main points in turn. First of all the Chancellor said (and I think this has caused a good deal of comment) that E.C.G.D. provides as good an insurance cover as one can get, in comparison with other countries. There is, as you know, the Berne Union, through which we got a great deal of information about what other countries are doing, and which seeks to try to maintain a certain similarity between the policies which the various countries follow. If one looks at the comparative credit which is given by the various European bodies, there was a report recently made under the O.E.E.C. which was called the Ansiaux Report, and I think that some of the facts which came out in that show that in certain areas at any rate the E.C.G.D. does give extremely good cover, and better cover than others. For example, if you take the question of the percentage of credit guaranteed, which is certainly, if not the most important, at any rate a pretty important aspect for a manufacturer, E.C.G.D. gives 85 per cent. cover against insolvency and 95 per cent. against other risks. The German institutions, about which one hears a great deal, have a maximum of 80 per cent.; the Belgians range from 60 to 90 per cent.; France offers 90 per cent. to public buyers and 80 per cent. to private buyers. Then there is the delay between default and payment of a claim. E.C.G.D. pay within one to six months, and in most cases in three months. In Italy it is six to twelve months, and the same in the Netherlands; France, Sweden and Switzerland take six months. One can again look at the Export-Import Bank in the U.S. There we are dealing with a body which does two things: it gives export credit and makes long-term loans. On the export credits side there are one or two important factors. Exporters are required to obtain payment of at least 20 per cent. cash with order, compared with E.C.G.D.'s normal 10 per cent., and they are required to make their own arrangements for financing at least a further 20 per cent. of the invoice value. As opposed to this, under the American system the exporter receives an effective guarantee of payment at due date, and exporters are assured before contracts are negotiated that finance will be available. Those are both important advantages.

It was on the basis of certain considerations of that kind that we came to the conclusion that the service which was provided by E.C.G.D. was a good one. On the question specifically raised, of the five years after shipment, there are certain considerations which are important. As you know, our E.C.G.D. arrangements include an Advisory Council; we have found that there is obvious value in drawing on the experience of advisers from finance and commerce and industry, and their views are certainly sought and very strongly respected on many aspects of E.C.G.D. business. I think that one of the aspects on which we would seek their advice would be this question of the length of cover. It is also a matter which comes up very strongly in the discussions in the Berne Union, and there by and large the view has been taken that five years is the horizon of insurable risk on a trading transaction.

9614. That is setting a principle by practical considerations; it is not thought that a business man can be expected to measure risks for a longer period than that?——I think that is right; and I think that we have also to consider whether in a trading transaction it is reasonable, in a case where the Exchequer is the final recipient of losses, that we should cover longer risks. After all, long-term investment is quite a different matter from a trading arrangement.

9615. I quite appreciate the different aspects of that; but you were referring to the view of the Berne Union, and I think you were saying that it was a view based on practical considerations?——Yes, I was. There is another factor here which is of importance. There has been some recent reference to the dangers of a credit race. It can be argued that some people do not observe the rules; in a few recent cases, to which a certain amount of publicity has been given, it has been suggested that Germany is not keeping the rules. But on the whole we have taken two views: first, that it would not suit us to get involved in a credit race involving progressive lengthening of credit insurance; second, that we do not think that there is a credit race on at the moment. There may be exceptions, which are duly taken up. For example, two cases have recently arisen in the case of Germany; two institutions there gave certain lengthy term credit facilities. This was taken up at the Berne Union, and the German authorities denied that the new arrangements constituted a threat of a credit race. They said that credit insurance would not be given beyond five years after delivery, and that some misunderstanding may have arisen as a result of confusing pre-shipment and post-shipment credit, or from a different interpretation of long term. They also said that there were certain political implications in the case of credit given to the Arab Union.

9616. Reading the Press reports about the recent meeting of the Berne Union, I got the impression that there had been a good deal of controversy about whether Germany had been observing the principles of the Berne Union. I did not get the impression that the meeting ended with an acceptance that Germany had not been observing the principles?——I do not think it did. The only point I am making is that if there were a credit race going on, it would be unlikely that people would worry about arguing with people; they would go on and join in the race themselves. But here are two cases where they are trying to bring them back on the rails, and are saying: "We do not want to have a credit race. Let us try to stop it." Then there is another point. We depend on exports as much as most people, perhaps more than most. Before we allow ourselves to become involved in a credit race, I think that we have to consider very carefully what is going to be our position in the export market in relation to people who have greater resources, which they can make available without running into difficulties externally or internally, in order to supplement their export effort. We took a definite view that it would not be right for us in any way to take part in a race of that kind.

Then we come to another question, whether this is a completely rigid position on a limit of five years from shipment. I mentioned earlier one particular contract which gave rise to a certain amount of discussion in the early part of this year. It is not a rigid position; it would be very foolish for us, a country so dependent on exports, to take a view that come what may, and come what other people might do, we stick to a rigid five-year rule. We do not take that view. A great deal of importance in that connection must attach to what the Export-Import Bank does, and in particular to what it does about aircraft. The Export-Import Bank has been offering seven years' credit on the new big jet aircraft. We were aware of this problem, and it was referred to by the Chancellor in his Budget speech on the 15th April. He said:

> "We do not want to start a race in credit giving, but if our competitors were to push the credit terms for a particular type of export beyond those normally insurable and our exporters found themselves excluded for this reason from business, we would be bound to consider extending our cover, too, in the field of trade affected."

I want to make that point, to show that our views on this are not absolutely rigid.

The final point I would like to make on this is that there is a balance of payments consideration. I am not saying that the balance of payments consideration should in all circumstances be overriding. In certain circumstances it is very important indeed because it has effects

well outside its particular confines. If one extended the length of credit from five to seven years at the limit of the range, that would probably involve proportionate extensions in the lower period covers, and over a period of years a permanent external investment in tied credits would be built up. That is a factor which certainly has to be taken into account in this. I do not say it would be overriding, but in certain circumstances it would obviously be a factor which would have to be put against other considerations. I will not at the moment go into the other kinds of considerations, but the Chancellor did, as you know, in his Budget speech, refer to the possibilities of the use of sections 2 and 3 of the Export Guarantees Act.

9617. Could you say as a result of your recent reconsideration whether there is one dominant consideration which leads to the limitation of the permitted time for credit?——It is very difficult to pull out one dominant consideration; they all have considerable importance. If I had to choose one dominant consideration, I would take the danger of starting a credit race. In the long run, if everybody else puts up their credit to the same extent, that is not going to have any very considerable advantage for any particular participant; and in the longer run, if it does not stop at the first stage and goes on further, it may, as I said, have considerable advantages for those who are more able to put resources into an operation of this kind, because it does not have an immediate impact on their external or internal position.

9618. *Sir John Woods*: I am always puzzled by this practical view that five years after shipment is the "horizon of insurable risk". The E.C.G.D., and I think you this morning, draw a distinction between credit insurance and investment; but at the same time there are types of goods in which in past years it was perfectly common, and the ordinary practice, that payment should be made over a period related to the number of years over which the asset could pay for itself out of its own earnings. In that case the natural period of loan might be fifteen, twenty, or twenty-five years. Is this doctrine of the "horizon of insurable risk" almost equivalent to saying that in modern conditions lending for that period, on whatever type of asset, is an unsound thing to do?——No, not at all. If industry thinks that it is sound to lend for longer periods, there is nothing in our exchange control which prevents them doing so. What we are considering is to what extent it is reasonable for the Government to stand behind that judgment. If I may just develop the point which you have made, there are two aspects of paying for an asset: one is the actual job of finding the money to pay for it in one's own currency; the other aspect is the business of paying for it across the exchanges. Some assets are not self-liquidating at all; but if an asset is self-liquidating only in fifteen years' time, I do not think it follows at all that the supplier should provide that credit. Nor does it follow necessarily that the government of the supplier should stand behind the provision of that credit. I think that the insurance of credit up to five years after shipment is to provide some kind of cushion for the foreign exchange aspects of the payment for an asset, rather than the internal aspect. Moreover it seems to me that, if one is talking about a long-term investment, that ought to be done through the proper system of long-term investment abroad through the market. In this there are after all certain other guarantees; first the borrowing government's credit is involved; and the judgment of the market is involved as well, which is valuable as some assurance or some guide regarding the amount of money which is to be put up.

9619. *Chairman*: The old system, no doubt, was for the overseas purchaser of assets of this kind to raise his own money by loan on the capital market in England, and then the manufacturer was not in trouble with problems of length of finance involved. But would it be possible under current conditions to come to the London market for a loan of that kind?——Some cannot, some can. A Commonwealth country certainly can come to the London market for long-term borrowing; in fact they do so frequently. I agree that since the end of the war we have had a limitation on the access to the London market of non-Commonwealth borrowers, but I would certainly not regard it as following that the long-term finance for any particular export should be raised in the particular market from which that export emanates, because that would put everything into tied lending, and our whole objective is to get untied lending. One can get long-term finance in markets abroad, and untied long-term finance: the International Bank works entirely on the basis of international tender.

9620. *Professor Cairncross*: If you leave the International Bank on one side, can you think of any country that makes long-term loans that are not tied now?——I can think of lots of countries which should. I find it more difficult to think of countries which do.

9621. It has been put to us that there are not any except ourselves?——Loans have been raised on the New York market; Australia, and I think South Africa, have raised money in the New York market. There have been developments there of an interesting character. Until quite recently the only way money could be raised on the New York market, the only way it was raised in fact, was with a government guarantee. Recently there have been two non-government-guaranteed loans on the New York market, one by the City of Amsterdam, the other by the City of Oslo. I believe a good deal of the finance came from the places to which the loans related, but still it was an important departure in post-war lending on the New York market.

9622. But you would agree that it is very difficult for any country which is embarking on schemes involving imports of capital equipment to get untied loans for the purpose of financing the schemes, except through the International Bank?——Yes, but the exception is a pretty large one. The International Bank is lending $700 million a year, which is quite a lot of money.

9623. And the Export-Import Bank?——I have not got figures for that, I am afraid.

9624. *Professor Sayers*: Am I to understand that the five years after shipment is not related in any way to the nature of the transaction, or the nature of the goods produced, but is simply a period which is the longest period over which one can look for these purposes?——The second half of what you said is right, but not the first half. The five years is related to the nature of the goods; you would not get five years on consumer goods. But the second half of what you say is right. There have been one or two exceptions, but broadly in relation to any form of capital export, five years from shipment, which may be up to eight or nine years from the time of the placing of the contract, is the maximum which one can get.

9625. So it is an arbitrary figure?——It depends on your definition of arbitrary.

9626. How do you arrive at five years?——We take the best advice that we can.

9627. How do those advisers arrive at five years? What lies behind this figure?——I think that they have to strike a balance over all these countries who look at what they think is the normal horizon of insurable risk, and they come to the conclusion that five years is the maximum that we can go to, taking into account all the risks which are involved.

9628. *Professor Cairncross*: Would you agree that the appropriate parallel in domestic trade would be instalment buying of producer goods, where the term of credit offered would normally not exceed about five years, and where there is the option of making a public issue on the market and raising capital in that way?——The Export-Import Bank take that as the normal parallel; and they do, I think, tailor their credit insurance to what is the normal internal instalment term. I think that that is why they have moved from the five to the seven years in respect of the large jet engines.

9629. *Mr. Woodcock*: Were these German cases to which you referred government-guaranteed credits?——I cannot tell you offhand, I am afraid. May I confirm that?*

9630. *Mr. Jones*: The E.C.G.D. being a nationalised insurance organisation, the Government stands behind the business of that organisation, and is the recipient of any shocks and losses that are sustained in consequence of the failure of these insurances. Would you say from your experience of the administration that these shocks have been serious, and that the losses made good by H.M. Treasury have been large?——No. On the contrary, over the total period E.C.G.D. have made rather than lost.

9631. Would you, in view of that experience, consider that the development of this service over a longer period

**Note by witness*: In effect, these cases carried an indirect government guarantee.

would create any greater hazard than we have experienced up to now?——As I say, one takes the best advice one can on that, and the present view is that it would create a greater hazard; we should be going beyond what is the horizon of insurable risk.

9632. *Sir Oliver Franks*: Could you help us a little more about the ingredients which go into the advice which you receive, or which governments in other countries have received, on this subject, leading you and them to a view that five years is about right? The one which you have mentioned is how far forward you can see money passing over the exchanges. I am not referring to the balance of payments point, because that would affect different countries differently; but it may be that the world we live in is sufficiently uncertain for nobody to be able to see with any confidence that there will be no exchange problem if the period is more than five years. Would you say that this general political uncertainty of the world, which makes it impossible to see how the exchanges will be, is the main ingredient in the advice that is given, or are there other ingredients besides that? ——That is a very important ingredient in it. I do not know that I should put it exactly as the general political uncertainty of the world. There are other uncertainties as well, and there are powers which did not exist before the war: namely, the powers of exchange control. One is seeking in this to guarantee not merely against ordinary commercial risks but also against a risk of governmental action of one sort or another preventing the transfer of funds. Our experience is that the credit worthiness of a purchaser can be very different from the credit worthiness of his government. The combination of these factors, together with the point that we are insuring business transactions, not seeking to provide long term development finance, leads to the view that five years is about the right period.

9633. *Sir John Woods*: There are two points on that. First, that seems to me in fact to be accepting what Sir Oliver Franks said: it is the uncertainty arising from the political possibilities of government action which produces this abracadabra of the "horizon of insurable risk". But we are told that, in certain quarters at any rate, quite apart from credit insurance, finance is being made available for much longer periods than five years, particularly by the Export-Import Bank when it is operating as a lender and not as an insurer, and by other governments. For example, I heard yesterday of a ten year loan offered by the German government to the Sudan in respect of hydro-electric plant, for ten years. I do not vouch for that, but it was reported to me from the Sudan. There are a lot of people in this country who feel that in spite of the Berne Union and so on this providing of finance for longer periods than the periods of insurance is becoming a considerable risk to our heavy capital goods industries. The second point is this, that, in respect of a good many countries anyway, if finance cannot be arranged for more than five years after shipment, if it is a big railway project or something of that kind, the project does not come to life at all, unless it is done through the intervention of the World Bank.——One hears a great deal about what other governments do. I can recall that once, when I went to Germany with the then Chancellor of the Exchequer, and Professor Erhard had just returned from the Argentine, both Ministers said almost simultaneously to each other across the table exactly the same thing, only in the opposite sense: the Chancellor said: "The Argentinians have been complaining to us about the very long term credits which the Germans give", and Professor Erhard said: "And they have been complaining to us about the very long term credits which the British give". I think these things do tend to balance out. I do not know about the German government; I understand that the German government in general does not make government-to-government loans, but I may be wrong on that. Our experience has been that we have not because of this five year period lost a great deal of exports which would in the long run have been paid for, which is a very important factor from our point of view. There is under our legislation, as you know, a provision whereby we can move outside the commercial sphere and act under section 2 and section 3 of the Export Guarantees Act. We do in certain cases: some years ago, for example, we made a loan to Pakistan under section 3 of the Act. That was on normal commercial terms, but there is provision under it for making longer term credits, which would have to be tied to British exports, because that is the only basis under which the Export Guarantees Act can operate. We have felt, at any rate so far, that there was no need for a new institution to handle problems of this kind, that the powers existed and were adequate to be used if the conditions arose. But the Chancellor said that, if there were conditions of declining world trade in which our exports were being affected, we should be prepared to look at the use of those longer term powers. But I do not think that we should use the commercial section, that is section 1, of the Act as a means of making long term investments abroad. It should be used on a commercial basis for insuring, within whatever may be considered the proper period, trading transactions.

9634. *Chairman*: You dwelt earlier upon the fact that in talking about the E.C.G.D. we were talking about the actions of the Government and the responsibilities that the Government assumed by standing behind certain things; your point was that that did not preclude means being found of giving credit outside the Government's backing. I had the impression that in this matter of credit insurance of export transactions the range covered by E.C.G.D. was so large, and the spread of risk it required was so big, that really nobody else could in practice enter the field. Would you agree with that?——Perhaps I did not put my point very clearly. I would agree with you that it is probably very difficult for anybody else to enter the field, partly because the risk which one is insuring is not the kind of risk that I think a private insurer would be either willing to cover or capable of assessing. The point I was making earlier was that there is no restriction so far as exchange control is concerned on the giving of longer credit than five years. I freely recognise that that is unlikely to be given unless there is in fact credit insurance to cover it.

9635. *Lord Harcourt*: In arriving at this five year period is there, or has there been, any consideration of the availability of the credit? It may be relevant that credit up to five years is readily available from banking institutions, while long term credit of fifteen to twenty years would probably be available from insurance companies and other institutions or private lenders. Is the five year period in any way arrived at as a result of a deliberation as to whether the finance is available?——*Sir Edmund Compton*: No. If on policy grounds it was decided that there was a need for longer term credit that should be met, the question would arise about where that should come from; but the first thing which has to be established is whether that is wanted or not, and whether that is proper business to be done.

9636. *Mr. Jones*: Sir Leslie, you have told us about the necessity of avoiding the dangers of a credit race, and you made reference to the difficulties that we were experiencing as a result of the credit that is being made available by the Export-Import Bank; and, as I understand it, you interpreted the Chancellor's recent statement as meaning that, should it be necessary, you would be pushing out your powers in certain directions. Does that mean that there will be an extension of credit in certain fields beyond the period extending over five years, say to seven or some longer period?——*Sir Leslie Rowan*: The Chancellor said that, if it was found that in any particular line our exports were being damaged because other people were giving longer terms of credit, then we would be bound to consider doing the same thing ourselves. Obviously we could not, in the broad context of a general agreement that we would not compete in credit terms with each other, allow any particular range of exports to be damaged unnecessarily because one particular country was giving longer terms of credit for that type of exports. If a case were made, we would certainly look at it.

9637. Is there any real probability or possibility of development of this particular type of export credit on the basis developed between the wars of loans raised in the international market? To the extent that an importer can raise the money and pay for his goods, then there is no problem for us, if we are the supplier. What would be the effect upon our export trade, supposing that there were a trend back toward the raising of the loans required in the international money market?——It would depend as to whether those loans were tied or not.

9638. I was thinking in terms of an importer being able to raise the wind to make possible the purchase of the imports. Is it the Treasury's view that that would help substantially the development of our export market in the particular field of capital goods? What about Germany? What about Japan? What about the United States?——If an individual importer can raise finance on any particular market, the natural assumption would be that he would be raising it in relation to some particular purchase from that market. On the whole I suppose the London market within our resources provides as good a means of doing that as any market which exists. If you go to the wider concept of governments or subordinate authorities raising loans on markets, then in general those are not related specifically to purchases from that particular country. It is this kind of long term untied external lending which seems to us to be so important as a supplement to institutions like the World Bank and so forth, particularly lending by those countries which have continuingly strong external positions; for example, Germany.

9639. *Sir Oliver Franks*: Could I go one last stage with these questions about the five year rule? If the considerations of actions or happenings which would relate to the exchanges is perhaps the dominant element in making people feel that the foreseeable period is about five years, I wonder whether you have not been too modest about another consideration. When one takes the hazards of the exchanges into account, it seems to me difficult to come down very clearly to a particular period, three, five or seven years, and I wondered whether the degree to which we can afford unrequited exports, that is to say, the balance of payments consideration, is not something which at least in this last ten years, whatever may be true in the next few years, has been of major importance in bringing the period down to five years. I thought you rather underestimated the importance of that motive. I should not have been surprised if it had been almost preponderant in quite a lot of the period. What I have in mind in asking the question is this: in proportion as the degree of unrequitedness of exports, that is to say, the balance of payments problem, is of major importance, then the determination of five years must essentially be made by Government and not by business advisers. The further you have gone in your replies, the less it seems clear that the five years is really due to external advice, and the more it looks as if it were a determination (quite likely a very sensible determination) of Government. Would you comment on that?——It is not often that people say to me that I underestimate the importance of the balance of payments! I am extremely grateful for this one little swallow! However, I did perhaps skate over it too lightly. Of course it is absolutely true that our balance of payments, as part of our external monetary situation, has been a dominant factor. Indeed you will recall that in a paper on "Monetary policy and external economic problems" which we submitted to this Committee we said in the last paragraph: "having regard to the limitations of our external monetary position, doubt has existed about our capacity to carry out our domestic programmes without running into inflation." We have stressed that, and it is absolutely correct that it has been a dominant factor. It is very difficult in this to be absolutely clear what additional charge this might make to the balance of payments, because we have not comprehensive figures of all the forms of export credit that are given. We know what is given by E.C.G.D., but we do not know what is given outside E.C.G.D. But if you look at E.C.G.D. medium term guarantees, which is what we are really talking about, the figures show that repayments in 1959 on existing business are expected to be about £92 million. If the maximum period of cover was extended from five years to seven years, it might then be expected that annual repayments would be reduced by something in the region of £25 million. This would build up over two or three or four years until it got to the maximum, and I suppose at the end of the period we might have a total additional external investment, what you might call unrequited exports, reaching a maximum point; it would not go on permanently unless the totality of our trade extended. That point would be something in the region of £80 million. That is the sort of figure which one would have to contemplate building up as an additional burden on one's external position over a period of three or four years. That would be quite an important factor.

9640. *Chairman*: I had rather the same impression as Sir Oliver, that in the end this limitation of time has more policy in it than anything else. Your answer was on the practical side of what would be involved, but would you accept the general assumption?——I would accept that it has a great deal of policy in it, but I would not accept the deduction from that that it has not the support of business men, like other advice which we get from bodies like the Advisory Council and from institutions like the Berne Union.

9641. *Mr. Woodcock*: But how much policy is involved in this? We are concerned only with government-guaranteed credit for trading transactions. Let us suppose that there is no fear of a credit race; let us suppose that there is no lack of confidence generally, and no fear of the operation of exchange controls in the future; and let us assume that we are not dealing with special cases such as aircraft, which might need special treatment. Does it not follow from what you have said that you would still maintain five years as the credit horizon?——It depends a great deal on the conditions. If you are assuming that kind of world, we would naturally want to get advice from those concerned on the Advisory Council about what they would consider in those circumstances would be the normal credit horizon for a trading transaction, but from our point of view the element in the insurance risk which relates to governmental action, not to the creditworthiness of the purchaser, goes out, and it would come down to the question of how much we could afford.

9642. Is not "afford" also a question of "worth while"? I could perhaps afford to buy cigars, but I do not think it is worth my while. How far is this five years really the normal kind of thing that one would do in giving credit for a trading transaction?——I do not know; but let us assume your world. I think you are asking me what the important industrialists and exporters would be prepared to give, because they would have no risk except the risk of the creditworthiness of the person with whom they are in contact. I find that a very difficult question to answer, because I have no basis on which to go really to answer it; but I should have thought that it would in those circumstances vary enormously according not only to the goods but also to the person with whom one was doing trade.

9643. *Professor Cairncross*: Let us put the question to you the other way: if the balance of payments were very much more favourable in this country, would that cause you to modify in any way your present attitude to export credit insurance?——It would remove one deterrent.

9644. But would you in fact extend the period of five years?——I cannot possibly answer that question. All I can say is that it would remove one deterrent in the general circumstances.

9645. Would it not also remove one incentive? Is it not likely that if the balance of payments were more favourable you would have less desire to grant credit more liberally to exporters, because you would be under less pressure to increase exports?——No, because I think another series of considerations would come in. There are very important political as well as economic and social considerations relating to the development of underdeveloped countries, and all those kind of considerations would have increasing importance and weight if we did not feel that by extending ourselves too much on that we were going to bring the currency into doubt.

9646. *Sir Reginald Verdon Smith*: In that connection, I was going to ask you whether you regard the credit horizon as being at the same distance at all points of the compass?——Are you talking geographically?

9647. As from London, yes.——I think you would be very surprised, so far as governments are concerned, to know where one would regard it as being further away. It does not at all vary according to the sharp division between East and West. So far as payment is concerned, one cannot necessarily draw a sharp line as to where it goes.

9648. *Mr. Woodcock*: What would be considered as the normal division in time between a credit and an investment? Have you any views on that?——The view we take about credit is five years; as regards investment, I do not know. People raise loans for varying periods. I should imagine that the normal period for a large railway project (I am sure Sir John Woods knows more about this

than I do) might be fifteen or twenty years; for a steel-works I suppose it might be a bit shorter. When it comes to investment fifteen to twenty years seems to me the sort of terms one is talking in.

9649. That you would define as an investment?——Yes, a long-term investment.

9650. *Professor Cairncross*: I am not clear where the underdeveloped countries, which you mentioned just now, enter into this discussion? I should imagine that if the balance of payments were more favourable than it has been in the past you would take advantage not of section 1 but of sections 2 and 3 of the Act, if it were desired to extend more credit or offer more capital to the under-developed countries. I thought that the tenor of your earlier replies was that you would wish on various grounds, in which the balance of payments really did not feature very prominently, to hold to the five-year period under section 1, but that you might have reason to depart from those conditions under sections 2 and 3, if either we were exposed to greater competition from other countries and there were a credit race, or there were non-economic reasons for trying to add to the capital invested abroad?——I thought Mr. Woodcock was asking whether, if we had a world in which there was no doubt on political grounds about currency availabilities, it would be desirable to give longer credits. All I was saying was that in those circumstances a deterrent would be removed, and a factor such as the question of whether it would be more helpful in those circumstances to underdeveloped countries to get longer terms of credit would be one which weighed more heavily. After all, they are the countries which are wanting the longer-term credit.

9651. *Sir John Woods*: One other point has arisen in regard to a mixed loan, where the total credit is for a period of, say, twelve years, of which credit insurance cover is given only for the five years after shipment, the other finance being found without guarantee. I understand that the E.C.G.D. and the other members of the Berne Union have agreed that it would be improper on sound credit insurance principles to enter into an arrangement of that kind. I suppose that is based on the view of the Advisory Council. Is that a view which the Treasury supports?——Yes, we support that view. We think that it would not be very long, if we did that kind of thing, before the whole general scale of insurance credit was drawn up to that level. The kind of case which is so often mentioned is perhaps a bit shorter than yours, where the first five years are covered by the E.C.G.D. and the last two years are covered by the supplier; our view is that we should very soon find ourselves in the position where the totality of credit had been pushed willy-nilly up to seven years.

9652. You mean the total amount which would be guaranteed by the credit insurer?——Yes We think that there would be a very strong pressure indeed, once this mixed arrangement became established, for the total period of the mixed arrangement to become the normal period for the credit insurer.

9653. *Professor Sayers*: Your five year limit would in fact be practically indefensible at that point?——That is our feeling.

9654. Because it has no very clear basis of principle?——That is so.

9655. *Mr. Woodcock*: You agree with the conclusion that there is no principle involved in the five years?——I do not think there is a principle; it is a combination of practical considerations.

9656. Apart from the five years, surely there is a principle in limitation?——It is very important to be clear whether we are saying there is a principle in the five years or whether we are saying, as you are now, that there is a principle in limitation. There must be some principle in limitation, because otherwise we are not having any regard to what is called in the jargon "the horizon of insurable risk". There must be some principle there.

9657. *Chairman*: Sir Leslie, I would guess from what you said that your recent review did not cover any question of the availability of finance for exports, but was concerned solely with the operation of the Export Guarantees Act. We have had certain points of view put to us with regard to the availability of finance. Has the Treasury a view generally, first of all, as to whether finance is satisfactorily available for medium term export credits supported by a direct banker's guarantee?——*Sir Edmund Compton*: We maintain that the E.C.G.D. guarantee is an effective passport to finance in present circumstances. I think the situation might well be different if on policy grounds there was an E.C.G.D. guarantee given to credits for over five years. In that situation present sources of finance might well feel that they were not able to lend.

9658. Because it would be too long for their habitual needs, and there would be no alternative provider of finance whom it would suit?——That is really a hypothetical question, because we have not got that situation. I would not like to dogmatise about what the banks might or might not wish to do. But as we are at present it does look on the evidence we have that the present system cannot be criticised on the grounds that finance is not readily available either because this is business that the banks will not do or because it is business that they cannot do because they have not got the money to do it with.

9659. It has been suggested that this question of making finance available, possibly for a longer term, might be revolutionised if the kind of Government guarantee which is represented by the direct bankers' guarantee today could take the shape of a negotiable instrument. What do you say about that?——Any Treasury view on that is necessarily a provisional one, because one cannot be more precise without a good deal of detailed market inquiry. It would be a major exercise working this out, in terms of what the market reaction would be to an instrument of this kind.

9660. The market reaction I would have thought would be very much conditioned by the official reaction, either the Treasury or the Bank of England.—*Sir Oliver Franks*: Would it not depend very much on whether this paper was acceptable for discount at the Bank of England or not?——Yes. At this stage, in advance of a need for this instrument having been established, one's provisional view may seem perhaps unduly hostile, because the disadvantages are perhaps more apparent than the advantages. From the official end one can see in advance pretty clearly the disadvantages in the shape of disturbance to monetary management, while in the absence of need the advantages look like advantages of convenience, and perhaps no more, to the borrower; and I think those advantages might be probably hypothetical. I think the point made by Sir Oliver Franks is, if I may say so, a good one. A lot of the effect on the market would depend on the kind of instrument and the kind of paper that would result from this operation. On that we would need to pick out a special point in advance, namely whether the promissory note drawn by the foreigner was a piece of foreign government paper or was a promissory note of a non-government buyer. There would be two special difficulties about a promissory note by a foreign government guaranteed by E.C.G.D. and put into the market: first of all that it would be in a sense a reflection upon the credit of the foreign government that it needed the backing of Her Majesty's Government's name; and secondly that, if one gives a guarantee involving the taxpayers' money, one has to think about what security one can take and what recourse one can have in the case of default. I need not labour the point that in both respects one is better off if the paper is non-government paper than if it is government paper.

9661. *Professor Cairncross*: But have you not in the past made use of promissory notes issued by foreign governments and guaranteed by H.M.G. in just that way?——I know there is a pre-war precedent for such notes; I am just saying how it looks provisionally at this stage.

9662. *Chairman*: Your liability for the taxpayers' money is unconditional if a banker's guarantee is given; surely the only question is who you are liable to?——Yes. I know that the actual liability to pay on the guarantee is a liability to the holder of the note; the question always arises what the Government as guarantor does to try and recover the money that it loses in the case of a default occurring.

9663. *Professor Sayers*: What is this disadvantage that you describe as obvious from the point of view of monetary management?——I would like to come to that now. I was dealing first of all with the pre-war precedent of the Government-guaranteed promissory note, to which I think there are some objections. But, if the need arose,

a more practicable alternative might perhaps be a promissory note issued by the foreign buyer endorsed by the E.C.G.D. which would then be marketable in the United Kingdom. This would in fact be a piece of gilt-edged paper; and then if the period was right it would be, or it could be, made re-discountable at the Bank of England, in the sense that if such a piece of paper was in the hands of the discount market it might be eligible as collateral for a Bank of England advance to the market. That is what I had in mind when speaking of disturbance to market management.

9664. Need it be through the discount market?——I am trying to make a hypothesis about what sort of paper it would be. If it was re-discountable at the Bank of England in the hands of anyone it would be more gilt-edged than any gilt-edged that exists today.

9665. *Chairman*: It would give access to the Bank, which other holders of gilt-edged do not have?——Exactly. The only people who can go to the Bank of England for a loan are the discount market.

9666. *Professor Sayers*: That is surely not an inevitable feature of our life for the next century?——No; but I would think that, if this paper was given a status superior to all Government securities at the present time, in that the holder could take it to the Bank of England and get a loan on it, that that would perhaps accentuate the difficulties for the authorities in monetary management. I was putting this point about re-discountability at the Bank of England at its lowest, because I think that, if promissory notes of this kind, of five years and under, were marketed, they might well be regarded as ranking on a par with gilt-edged for a similar period, but not above it. That was the hypothesis I was trying to make.

9667. *Chairman*: You are offering a hypothesis that they might perhaps get into the hands of the discount market before being taken to the Bank?——Yes.

9668. What about the disturbance to monetary management?——The first question would be to what extent this would lead to a large volume of business in this marketable form, in contrast to or perhaps at the expense of the business now done by way of guarantee of a non-marketable advance. One would expect pressure for the extension of the scheme. There might well be a preference for it, certainly on the part of the borrower. In so far as a large volume did develop, it would add substantially to the amount of liquid and semi-liquid assets in the hands of the banking system; and the addition would, I think, take place in amounts and at times outside the control of the authorities. Moreover, in terms of the investors' readiness to buy gilt-edged securities, this new paper would be a competitor in the market, and might therefore interfere with Government funding operations. I do not want to overstress that, because one is peering into something that has not yet happened.

9669. The objection is that it would add to the volume of marketable Government obligations?——Yes. The final point, and perhaps the most uncertain part of the whole of it, is the effect that the introduction of this security would have on rates of interest. As far as I can judge the large attraction of this idea to the borrower would be that he might get his finance more cheaply this way. If we assume that this paper is on a par with gilt-edged for a comparable period and take rates as they are today, whereas an exporter would be charged 1 per cent. over the Bank Rate on his guaranteed advance today, the rate on a five-year Government security in the market is between $4\frac{1}{2}$ and $4\frac{3}{4}$ per cent. The borrower, having got the benefit of Government credit, would then try and reap that benefit by borrowing in effect on the terms applicable to Government credit for five years in the gilt-edged market.

9670. *Professor Sayers*: But surely he would be charged for this privilege in the premium? Why should he be given this as a present when the Government is taking the risk?——This is a point which would come out in the market exercise. I am thinking about how this would be viewed by the suppliers of credit who at the moment are earning 6 per cent. on this business, but would under this arrangement be asked to switch a lot of their lending from an unmarketable 6 per cent. to a marketable $4\frac{1}{2}$ per cent., taking the rates as they are today.

9671. Are you not making it much more difficult and complicated by assuming that this must be marketable paper? May I put to you the alternative hypothesis, that this is paper that is placed with the banks and the banks have the privilege of rediscounting it under specified circumstances?——That is not the hypothesis I was asked to comment on. That would be a special security which was controlled by a particular lender, namely, the bank concerned.

9672. *Chairman*: I gave you the hypothesis of a negotiable instrument because that is the phrase that has been habitually used to us. You are helping us by analysing the different possibilities. Is this not a real alternative?——I do not know that I can take that very far before making a particular study with the market, which in this case is predominantly the banks, and ascertaining how that would work out from their point of view.

9673. *Professor Cairncross*: May we ask you one thing on a point of fact? Did the pre-war system of promissory notes, which concerned the U.S.S.R. and Afghanistan particularly, work unsatisfactorily? Was the issue of promissory notes received with acclaim by the market?——I am afraid I cannot tell you what the market thought of them.

9674. It was the market reaction that you laid stress on; you said that it would be regarded as reflecting on the credit of the government concerned. I was wondering what the credit of these two governments was?——On that I was not thinking of the reaction of the market but the reaction of the government whose credit H.M.G. were offering to under-pin.

9675. *Professor Sayers*: May I go back to your difficulty about the disadvantage to monetary management? You were assuming, I think, that any addition to the volume of Government paper was to be regarded as a disadvantage from the point of view of monetary management?——I added the words: "in amounts and at times outside the control of the authorities". I am in a difficulty in making any estimate of the volume that would result and the extent that business would go over to this from non-marketable advances which account for the bulk of the outstanding business now.

9676. You agree that that was your assumption?——Yes, with that qualification.

9677. *Professor Cairncross*: Are loans made under section 3 of the Export Guarantees Act tied *ipso facto*?——*Sir Leslie Rowan*: Yes.

9678. These loans, so far as I know, have been made to such countries as Persia, Pakistan and so on not for specific projects but to cover a variety of expenses?——*Lord Harcourt*: The shopping list technique?——Pakistan had a shopping list; although we knew the particular categories of goods it was not a specific project.

9679. *Professor Cairncross*: Has there been any instance in which a project has been looked at from the point of view of offering section 3 assistance?——I would not like to answer that in general terms. I cannot recall myself having had to look at any particular case, but it may have been done by others. But it is open to be looked at; we could make a loan under section 3 relating to a specific project.

9680. So, if you wish to act as the Export-Import Banks act, although there might be problems of staffing, you would have the power to make loans of a similar character?——Yes. I would not confine the problems to those of staffing; there would be other problems as well. Subject to that I would agree that we have the powers to act as the Export-Import Bank acts, and give long term development loans related either to general expenditures or specific projects.

9681. Could you indicate what the other difficulties would be?——The question of whether we could afford it.

9682. And any others?——No, I think I will stand on that one.

9683. *Sir John Woods*: Did you use powers under section 3 to make a Government loan for the Indian steel scheme?——Yes.

(*Sir* Edmund Compton *withdrew*)

M. H. PARSONS, ESQ., an Executive Director, and R. A. O. BRIDGE, ESQ., of the Bank of England, called and examined.

9684. *Chairman*: Now, Sir Roger, may we pass on to the other subject which we wish to discuss today, the forward exchange market?——*Sir Roger Makins*: We have had to call up some reinforcements—*Mr. Parsons*: With your permission, Sir, I have brought Mr. Bridge, who has an even closer direct contact with the exchange markets than I have, and who may be able to help us on questions of fact.

9685. We have two new papers on this, a descriptive paper* by the Bank of England and a paper on policy† by the Treasury. Are there any questions on the Bank's paper?—*Professor Cairncross*: There are references in paragraphs 18 and 21 to the limits within which authorised dealers can hold foreign exchange both on open accounts and against forward transactions. May we know what these limits amount to in the aggregate?——Those limits are not an invariable aggregate amount. They can vary from time to time according to the requirements of individual banks. I should have thought that there was no harm in saying, to give you an order of magnitude, that the limits overall, which consist of both the limits on spot exchange held against forward contracts and the limits on open positions, are in the region of £100 million in the aggregate. This represents the aggregate of individual limits for some 130 banks. You may wish to ask about the extent to which these limits are utilised; I emphasise that this is an aggregate figure which in fact is nowhere near reached in ordinary circumstances.

9686. On the basis of your experience, particularly before 1951, can you give us any judgment on the extent of forward contracts that are entered into involving sterling? If you have some figures for later years, that would be all the better; but I assume that, since you were actively in the market before 1951 you would be in a position to say more definitely what the situation was at that time?——I have not really got any very reliable detailed figures on that. If the Committee would like to have some indication, I dare say we can discover that from our records. I should think that, as an order of magnitude, we might on occasions have been overbought by as much as $100 million or more.

9687. Nothing appreciably greater than $100 million?——That is an order of magnitude; it is rather a round and approximate figure.

9688. When you say that there is a large market in forward exchange, this is the order of magnitude of dealings that we should have in our minds?——That is the net position, including dealings in both directions.

9689 That is the net outstanding obligation forward?——That is so.

9690. Would we be right in assuming that you keep track of this position from time to time, and that you have some fairly accurate idea of the net forward position in sterling?——We certainly have a fairly accurate idea of the extent to which the authorised banks, for example, are holding exchange against forward obligations.

9691. That would be all that you could follow?——Yes.

9692. You would not be in a position to judge how far forward operators were taking a speculative position on the basis of their own holdings?——No. We do know, of course, the extent to which our banks have open positions at any moment of time.

9693. Would we be right in supposing that the forward transactions represent only a fairly limited fraction of the total of spot transactions?——Yes, I think you would be quite right in assuming that.

9694. What would the proportion be of one to the other in normal circumstances?——I should hesitate to hazard a guess on that.

9695. *Chairman*: May we now turn to the Treasury paper?—*Professor Sayers*: In paragraph 5 (1) you say: "Such a policy could not be prudently recommended." Then later you use the word "Furthermore", which makes me think that the reasons given following that are different from those underlying the earlier sentence. Are the reasons underlying that sentence additional to those given in the following sentences?——*Sir Leslie Rowan*: I do not think that we are drawing any distinction here. We are trying to give a coherent account of the reasons under this heading. The main reason we give is that it would involve assuming a possibly unlimited liability, and then we give other reasons, including the doubt it might cast on our reserve figures because people would know that this liability was there and might be very large and the reserve figures would therefore not have the integrity which they now have. "Such a policy could not be prudently recommended" might well be said to cover the whole of this heading.

9696. *Chairman*: It is the sheer volume of the possible commitments?——It is referred to in paragraph 18 of the Bank paper, where they say:—

"But whereas in the case of inward arbitrage there is in theory no limit to the extent to which American banks may buy spot sterling in cover of their forward sales, in the case of outward arbitrage there are defined limits."

That is the crucial connection between paragraph 5 (c) in our paper and the Bank paper.

9697. *Professor Cairncross*: Would I be right in supposing that if the Bank did assume this commitment forward it would be accumulating foreign exchange spot? Would not speculators indulging in this have to put through a swap?——*Mr. Parsons*: No. The Bank would provide the counterpart of the forward sales of exchange. The Bank would not necessarily cover itself in the spot market. We should not normally expect the Exchange Equalisation Account to act as a commercial banker would act.

9698. Does not the speculator require to part with foreign exchange in order to possess himself of sterling for this purpose?——The speculator will either enter into an outright sale of exchange forward or enter into a swap. With the forward sale there is no spot counterpart at all. With the swap there is a spot counterpart which would get mixed up in the totality of spot operations in the market.

9699. *Professor Sayers*: The first case you gave would be a pure bet between the foreign speculator and the E.E.A. on what was going to happen to the exchange rate in the future?——That is right.

9700. And there is theoretically no limit to the amount and volume of such bets?——No limit at all theoretically.

9701. That is what is meant in this paragraph 5 (c) when it says that it would in theory be without limit. Is there not a limit in the sense that the E.E.A. could eventually call the bluff of such speculators except to the extent to which they could get hold of sterling, and they could get hold of sterling to a limit that would exist in theory but which would be very high indeed as compared with any possible reserves? Is that not right?——This kind of situation occurs usually on short term expectations. The extent to which people can enter into that kind of bet on the short run is quite unlimited in theory. Let us for the moment talk in terms of selling sterling forward three months; if at the end of three months the bet has not come off on the speculator's side he has two options: he can either call in his bet, and that means he has to acquire sterling, or he can renew it for another three months.

9702. *Lord Harcourt*: By doing a swap?——Yes, and renewing his forward sale.

9703. *Professor Sayers*: And this can go on in unlimited amounts to the extent that people are free under the laws of their countries to indulge in such transactions, and it is these bets that are unlimited in practice? The E.E.A. has some such bets, I imagine, at times; it bas on occasion sold dollars forward without there being any parallel influx of spot dollars?——On occasions, undoubtedly, the E.E.A. has sold dollars forward.

9704. That makes me wonder about the sentence:—

"At times of pressure, therefore, the published reserves would mean little since the public would be interested more in the size of the forward commitments."

There are, I suppose, forward commitments at times?——*Sir Leslie Rowan*: This came up last time I gave evidence [cf. Qns. 3211-14], and I said, as Mr. Parsons has just said, that there is bound to be at times some participation

* Memoranda of Evidence Part I No. 14.
† Memoranda of Evidence Part II No. 14.

by the E.E.A. in the forward market. But that is quite a different thing from having a definite policy of supporting the rate, which would cast great doubt, which does not exist at present, over the value of the published figures.

9705. You would say that the pegging of the forward rate would be evident to the market from the circumstances, and that that would involve the E.E.A. in very heavy commitments?——Certainly.

9706. Though such commitments can occur now, it is not obvious to the market whether they are becoming very much larger; there is no reason for the market to suppose at any time that they are becoming dangerously large?——None whatever.

9707. That is the virtue of holding yourself free to alter the forward rate?——Of allowing the forward rate to alter itself. I would put it this way: if we had this, there would be a constant question mark overhanging our published figures, while under our present system there is not anything which is either material or dangerous.

9708. *Professor Cairncross*: Some of this paper seems to be written on the assumption that exchange control will continue as it now exists. What would your attitude be if exchange control was abandoned? Would you feel that you ought to have more power to intervene from time to time, perhaps more largely than you have done, in the forward exchange market?——*Sir Leslie Rowan*: I do not know. I should like to consider that question rather carefully. My feeling at first thought is that convertibility would not fundamentally alter the positions we have set ourselves.—*Mr. Parsons*: For that kind of convertibility that has been publicly discussed, which means convertibility on non-resident account and the retention of exchange control so far as United Kingdom residents are concerned over all capital movements, Sir Leslie's answer is correct. It would not make any difference to the conclusions drawn by this paper.

9709. Except to the extent that you could retreat in various ways now, which you would be debarred from doing if you had convertibility. Some support for the forward exchange market might be of more value in conditions of convertibility than in conditions of inconvertibility?——For the purposes of this discussion there is already on non-resident account sufficient convertibility as to make this valid for the kind of convertibility that we have talked about. The present situation is that we have convertibility on American and on registered account, and there is effective convertibility at a slightly different rate of exchange for holders of transferable sterling. That situation would not be radically altered in the event of normal convertibility on non-resident accounts in such a way as to invalidate the conclusions here.

9710. In paragraph (*b*) you say:—

"... if sterling is under pressure and the pound is suspect, inward interest arbitrage would be unlikely to take place, irrespective of how profitable it might be. The reason is that the Exchange Control Act enables the Government to determine how foreign held balances may be dealt with."

You are attaching here some importance even to such controls as either do exist or could be brought into existence under existing legislation?——*Sir Leslie Rowan*: The act of convertibility would not change the powers under the Exchange Control Act.

9711. *Professor Sayers*: It would still be convertibility terminable at any time?——Yes. I do not think we contemplate that the Act would alter. It might be that the Government would decide that it should, but there is no inevitable connection between that and making sterling convertible on non-resident accounts.

9712. Does not convertibility have only a very limited meaning if you are reserving the right to restrict the use of non-resident sterling at any time? If that is the kind of convertibility we are talking about, it is something very different from before 1939?——Yes, it is. It may be that a decision would be taken to change that kind of power, but at this moment I cannot say that any decision has been or would be taken to change that.

9713. *Professor Cairncross*: I am not quite clear about the reasoning in paragraph 5 (*b*). Is it implied that foreigners are afraid that forward contracts would be repudiated?——No. These are the circumstances under which the exchange rate is suspect.

9714. If I already have a contract under which I have sold sterling forward what have I to fear, unless that that contract will be repudiated?—*Chairman*: Or overridden by governmental action?——I think "overridden by governmental action" is the real point.

9715. *Professor Sayers*: It would seem to follow from the last sentence in paragraph 5 (*b*) that the effects of raising the Bank Rate on the foreign exchange situation are limited completely to the effects induced by the foreigner supposing that the higher Bank Rate will do something to the internal situation, or is a sign that something is being done to the internal situation?——I made a statement about this before this Committee on 16th January [Qn. 3211]. You will recall that at that time we said that the Bank Rate had two important elements: one was the fact that it means that a higher rate of interest can be earned on money, but I said that was not the whole of the story, and that the other important element was exactly what you have just said, namely, as a sign that action is going to be taken. That must essentially be action in the internal economy of a kind which is going to remove any doubts about the value of currency.

9716. I thought you were going much further and saying that your first point is of no account at all at the critical times of pressure?——At such times if the currency is in doubt and there happens to be some difference between the interest rates, that difference in itself is not going to be sufficient to attract the money in. On the other hand, if the difference in the interest rates came, as it came last September, from positive action taken as indicating certain views about policy, then it can have, as it did then, a very considerable effect, because both things would be operating in the same direction: there would be a higher interest rate and also a feeling of confidence on the part of foreign holders of sterling that there was going to be internal action which was going to re-establish the position of the currency.

9717. It does mean that the case, so far as the external situation is concerned, for a rise in the Bank Rate, must depend entirely on the foreigners' conviction that something is going to happen at home?——I have never taken any other view than that. One cannot separate the internal and the external, and if one does try to separate the internal and the external one will get into difficulties.

9718. It is not merely the internal situation but the foreigners' belief of what is going to happen?——Certainly, but if we are to run a world currency that is one of the things we have to take into account.

9719. *Mr. Jones*: Would you expect there to be very much movement of capital to London from dollar sources if the rate of interest in New York was 1 per cent. and in Britain 5 per cent., where the spot transaction is covered three months forward on the basis of a forward rate of $2·78 to the pound? Would that not mean in those circumstances that the return on an investment in New York would be ¼ per cent., whilst the return on investment in Britain would be 1¼ per cent. (because we are talking in terms of three months), and you would have to set against that some 14s. per cent. which would be the loss on the investment in terms of forward buying? Would it work out like that?——*Mr. Parsons*: By and large, it works out like that. The essence of the business is, as this paper explains, that you have two rates of interest, the New York rate and the London rate, which vary by so much. If the cost of insuring your exchange risk is less than the difference between the two rates, there will be a tendency for funds to move to London, other things being equal. If that cost is more than the differential between the two rates, then there will be a tendency for funds to move the other way, other things being equal.

9720. Would 4s. per cent. make all the difference over three months, because that is what it would amount to, is it not, on the figures that I have suggested?——The extent of the net margin which is necessary to move funds depends a good deal; one cannot generalise about it. I would say that at 4s. per cent. there is scarcely enough inducement to move a great deal of money which was already invested in New York to London. If somebody had new funds accumulating which he could invest in one or the other, he might then decide to come to London rather than to New York. I do not think that people would change investments in New York in order to invest in London on such a narrow margin as that.

9721. *Chairman*: We are to think of people whose whole activities are concerned with the arbitrage consideration for these purposes?——Yes.

9722. No element of costs enters into the transfer as between one centre and the other?——I think these rates we are talking of will take all costs into account. You talk of the people whose whole activities relate to arbitrage but I think it would be fair to say that most of this business is done by people who are not, as it were, professional arbitrageurs but people who have money to invest and who want to invest it in the most profitable way; and a lot of them, of course, may be commercial firms.

9723. *Lord Harcourt*: At all times there is a certain amount of highly volatile money which will move for a very small margin?——Yes. But, as we have tried to point out here, the comparisons that can be made between London and New York vary a good deal according to the kind of way in which funds are invested in either centre at any given moment.

9724. *Professor Cairncross*: I assume that most of the forward transactions that are engaged in are in dollars and not in other currencies, and that therefore there is no reason to get worried about a revaluation of one of the currencies in which the forward transactions take place. Would it be right to assume that, if the dealings on the part of the authorities were confined to dollars arbitrage would look after the other currencies, or would it be necessary to have extensive dealings in them as well as in dollars?——No. On the whole the opportunities for really extensive dealings in the forward market in other currencies are nothing like so great as in dollars and sterling.

9725. In effect then, if you are going to support any rate, the only rate you have to support is the rate in the dollar forward market?——I do not like to be as categorical as that, but I think that in the great majority of circumstances that would be so.

9726. In the last sentence of the paper you say:—

> ". . . changes in Authorised Dealers' balances are relatively small, and the movement of sterling balances suggests that fluctuations due to interest arbitrage are not unduly large."

I have a little difficulty in putting that sentence alongside the statement which you make in paragraph 5 (*a*) that when you were pegging the forward rate you found outstanding forward commitments varied enormously. What does "enormously" mean?——Part of the explanation of that is that the conditions under which we were trading in the late 1940s were rather different from those now. There is more trade being conducted now, and being conducted in sterling, than probably there was then.

9727. One principal source of changes in the forward position is excluded by the hypothesis that there could be no covered interest arbitrage in those conditions; therefore, it is only the other types of transaction that enter, the commercial motives, for instance?——Yes.

9728. You take the view at the end of paragraph 7 that those motives do not appear to be sufficient to cause any large change in the reserves; and yet in the conditions before 1951 something seems to have accounted for a very large change in forward commitments?——I can only say in reply to that that it may have been perhaps the state of the world then, and people's attitudes to the exchanges then, as compared with now; but in fact there were very substantial movements at critical moments.

9729. Much larger than later?——Yes, and they appear to have been much larger then relative to the whole than the changes in authorised dealers' balances now appear to be between a normal moment and an abnormal moment.

9730. When the E.E.A. was running a forward position as well as the authorised dealers, a much larger forward position was assumed than would be possible now?——I would not say "than would be possible", but I think that that in fact has been the case.

9731. But the limit to what is possible now is presumably well under £100 million?——This says "the movement of sterling balances suggests that fluctuations are not unduly large." This relates really to the experience as shown and is not discussing what is theoretically possible.

9732. *Mr. Jones*: Suppose that money was brought to London on the basis of a 4 per cent. interest rate differential, and covered by forward buying to secure as far as possible the value of the original capital investment; with a reasonable level of reserves and with a satisfactory trade balance would you expect the law of supply and demand to depreciate the level of the original value of the currency invested? Would you expect any fluctuation at all in those circumstances on the basis of the law of supply and demand? Could there be any hedging, or anything at all in the international movement of money, that could interfere with the value of the sterling in relation to some other currency?——*Sir Leslie Rowan*: If I get the position correctly you are assuming a situation which, unless we offset the trading situation to an undue extent by external capital payments, is one of strength. If at that period we had an interest rate of 5 per cent. here and rates were lower elsewhere, there would be little doubt about the value of the currency, and the whole influence of that would be, as I see it, not to depreciate the value of the currency but to push it up against the top limit of our margin. It would mean that money was coming in, and a strong reserve in the external financial position, and would therefore be a strengthening force and not a weakening force.

9733. *Mr. Woodcock*: I think what Mr. Jones means is: would you expect so much to come in as would have an effect on interest rates here?——*Mr. Parsons*: The point we always have to bear in mind is that when money comes here on interest rates considerations the majority of it, as we pointed out in our paper, is in fact covered forward for the exchange risk, which costs something. The more money that comes in, the more expensive that cover tends to become. There is therefore a tendency towards an equilibrium position all the time. Unless there is something to prevent that equilibrium happening, the cost of cover would equal the difference between interest rates very quickly, so that this is not normally a very large and important factor in our total reserve position. If something prevents that equilibrium position happening, it would be a very considerable force on the currency; but normally speaking the tendency is for the equilibrium to be quickly brought about.

9734. *Professor Cairncross*: May we be clear that the judgment of the last paragraph reflects the experience of the last six months? You have not been led to revise your views by what has happened lately?——*Sir Leslie Rowan*: That is so.—*Mr. Parsons*: In fact it reflects the experience of the last year.

Chairman: I think that concludes our questions; thank you very much, Sir Roger. We are very grateful to you and your colleagues for your help.

(*Adjourned until Friday, 27th June*, 1958, *at* 10.45 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

THIRTY-NINTH DAY

Friday, 27th June, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. FENRICK, *Statistical Adviser*

MR. WINFIELD W. RIEFLER, Assistant to the Chairman of the Board of Governors of the Federal Reserve System, U.S.A. called and examined.

9735. *Chairman*: Mr. Riefler, we should like to take this morning questions on your supplementary memorandum on *Open Market Operations in Long-Term Securities** and on the part of your main paper which we have left over.—*Professor Sayers*: I want to ask you a series of questions, to elucidate what I think are probably the critical points in the working of your system. I shall be asking entirely about your system, but I have in the back of my mind all the time our system, and I may want to come back and ask you to make some comparisons. I hope you will not mind if I ask you some questions which will involve your repeating points that you have made in your papers. May I think in terms of what happens when the Federal Reserve wants to restrict the level of activity in the economy? You say that in those circumstances the Federal Reserve thinks in terms of raising discount rates and selling bills; that its sale of bills is, in some ways, the more critical part of the operation, in that it brings about a change in the reserve position of the banks; and that that, by itself, will produce some rise in rates in the market, and the rise in the re-discount rate is a measure taken by the Federal Reserve to consolidate that position. Is that right?——*Mr. Riefler*: That is correct.

9736. When the commercial banks find their reserve position tightened, what do they do?——We have 7,000 member banks, most of which are small; the number of very large banks is over a hundred. If they find their position tightened and they are deficient in reserves, they have to make up that deficiency in some way. They have two options: they can either dispose of an asset, possibly a bill, which is the most liquid asset, or they can borrow in the Federal funds market or at the Federal Reserve Bank. If they borrow at the Federal Reserve Bank, it is only a temporary handling of the situation, and they realise that. Borrowing at the Federal Reserve Bank is a privilege and not a right. It is appropriately done for temporary accommodation, pending other measures of adjustment. The member banks are not supposed to regard their access to Federal Reserve Bank credit as part of their more permanent resources, or as part of their capital. If they resort to borrowing at the Federal Reserve Bank, they will still plan to make the adjustment some other way, either through the receipt of incoming funds in the normal course of operations, or in slower granting of loans, or by the sale of an asset of some kind.

9737. Insofar as they sell assets rather than restrict loans, and there is a general pressure in the whole system to sell these assets, they will sell, I suppose, predominantly assets at the short end?——The normal thing is to sell the most liquid asset. That is normally the lowest yielding, and it is held for the purpose of adjusting the position when the occasion arises. In the boom we have just been through, when the restrictive action was quite sharp, a great many banks ran out of their bills completely. A considerable number of banks were out of certificates, and in order to adjust their position had to go to notes of up to five years. You will see that reflected in the yield curve that prevailed during the boom; the five-year rate was the highest rate continuously for about a year. That reflected the fact that the banks, at that time, had got to the point where they had to dispose of their maturities in that range. It was continuously under pressure throughout the latter phases of the restrictive action.

9738. Who buys these securities that are being unloaded by the banking system?——They are bought in the market. The market is a very broad market.

9739. Could you tell us more about the market in Treasury Bills and short bonds?——We have a statistical estimate, which the Treasury gets out periodically, on the market for Government securities, and it gives the various categories of owners. That might help you.

9740. But some holders, I imagine, would be firm holders, year in and year out, for the most part?——For shorter issues, I do not think so.

9741. The shorter issue people will be in and out continually?——The banks, the insurance companies, savings banks and saving and loan associations all need Government securities for liquidity purposes; they will be buying and selling, but will hold a fair volume. Then there are the foreign holdings. Some foreign central banks hold a large body of funds in the American market today. That category has been one in which the holding of United States Government securities have grown considerably. Then the corporations invest part of their liquid assets in bills, or in loans to government security dealers to enable them to carry bills. The corporations also invest heavily in certificates, but in general they do not go over a year or fourteen months maturity. Then there is the reinvestment of funds raised in the capital markets by capital flotations. They are invested in short term money market investments. That is a very large category.

9742. And these categories are induced to buy bills and short bonds that are being unloaded by the banking system, by a rise in the rates?——Yes. The American banks are not allowed to pay interest on demand deposits, so that there is a considerable incentive for the treasurers of the larger organisations to invest directly in the market, and they do.

9743. And they will be induced to invest more if rates move up?——Yes. There is a noticeable response to the rate.

9744. So that you have a large market outside the banks, which is highly responsive, in the amount it will absorb of bills and short bonds, to changes in the rates?——Very large. The larger part of the bills and certificates are held outside the banks.

9745. It would seem to follow that, when the banking system unloads its short government paper, provided the Federal Reserve is prepared to see the rates rise, there is no danger of the Federal Reserve or the Treasury feeling that it has got to come in to absorb this paper again?——No.

* See footnote to Qn. 9501.

9746. That is a really critical point in the argument; you have an absorptive market outside the banking system. Then you have a change in the volume of bank deposits and a change in interest rates, at any rate at the short end. May I come back later to the relative importance you attach to those two, and go on, for the moment, to what happens in other parts of the market? I gather from your papers that, when short rates rise, you expect to get automatically some rise, though naturally a very much smaller rise, all the way through the rate structure?——Not invariably. The bill rate will go up and down within the week, irrespective of our policy. There are a great many forces playing on it. We can be tightening, but there may be, for example, a payment which happens to be made that day for a large capital issue, and that money goes into the bill market. Then the bill rate may react against our tightening of the reserve position. But we would expect to see a response in the interest rate structure somewhere to any tightening of the reserve position, and customarily the response will be throughout the structure to some degree.

9747. I gather that you expect that response throughout the structure, because all the way through the structure of the market there are people who are ready to shift the maturity distribution of their holdings in response to changes in relative rates?——That is one thing.

9748. You appear to attach great importance to the flexibility of the portfolios of the banks, themselves, in this respect: you indicate that the banks are always ready to shift their maturity distribution quite seriously; they are prepared to be in and out of the long end of the market, and the middle part of the market, as well as in the short end?——It will be in smaller volume at the long end.

9749. But they are, in fact, ready to be all the way along?——There are banks that are.

9750. And they are sufficiently important to make a difference?——They will be responsible for an important reaction.

9751. And that is how you get a rate change having its repercussions right through the rate structure?——The whole market is organised that way. You cannot pick out any one element.

9752. Under some circumstances would you expect the change that came at the long end, following a given change at the short end, to be bigger than at other times?——We would watch the nature of the response very carefully, to see the size of it, because that is one of the important indications of what we are doing, of the banking or market situation on which we are impinging.

9753. Does not the extent of the move at the long end depend very largely on the view people take as to how long the rise in the short rate is going to persist?——No. That will be one of the factors, but the basic factor is the actual demand for funds and the relative supply. That is fundamental.

9754. But if the market is taking the view that the demand for funds is likely to persist, then this is going to be a reason for continuing high rates at the short end, and for the long end to rise rather more?——That is the way it is figured out.

9755. You say that market expectations about the course of the demand for funds are the important thing? Sometimes they will be more definite, and the market will take a more definite view on the future for market funds, than at other times?——Yes.

9756. Therefore sometimes the repercussion at the long end will be greater than it is at other times?——One cannot tell where the repercussion will come. It may come in as strikingly in the intermediate ranges.

9757. You seem to me to be retreating a little from the position in your paper, which I thought was that you could produce whatever effect you desired at the long end by operating at the short end?——I never retreated from that position, because I would not put it that way. The central bank does not have, and I do not think anybody should have, that degree of assurance about what it does. We are watching the situation very carefully and adjusting ourselves to it, and trying to maintain what is important, a climate of restraint. But we do not say: "I want X in this particular area of interest rates".

9758. *Sir Oliver Franks*: You are always playing the tune by ear?——We have to be, because we are judging a complex and changing situation.

9759. *Professor Sayers*: So that you attach more importance to the general atmosphere of restraint, or encouragement in the other case, which you produce, than to any particular structure of interest rates?——Yes.

9760. Then is not much the most important thing you do not the buying or selling of Bills, not the raising or lowering of rates, but what you say?——No.

9761. Why do you have to operate in the market as well as telling the market what you think about things?——Our operations in the market actually determine the funds available.

9762. You are determining the volume of funds available?——With our operations, clearly.

9763. If that is so, then can you not produce what effect you like in the structure of rates, given the demand?——In the structure as a whole, yes. Perhaps we were talking at cross-purposes, because I understood you to put exclusive emphasis on the long-term rate as such. The structure as a whole has to be determined and looked at very carefully.

9764. You determine the structure of rates. Is it possible that at times you would want to bring about a bigger effect on long-term rates than you would want to produce at other times, when you are tightening the market?——I would not think of it in those terms.

9765. Then may I go on to the next step? What effects on business do you think the changes in the rates at the long end and at the short end have?——In general I think the changes at the long end are more important, in the sense that they are concerned with the financing of longer transactions; but when we are dealing with the actual day-to-day situation all rates are important, and all rates have an effect on business activity. An example of that was brought home to me very vividly in 1955. I had always been intrigued by the fact that in times of restraint short rates moved sharply above long rates, and it was not until the spring of 1955 that a situation arose to show why that must be so. In the spring of 1955 one of our larger insurance companies found that it had over-committed itself to take mortgages, and arranged a syndicate bank loan of $250 million for a year, to warehouse those mortgages. That brought the attention of other insurance companies to the same device, and they began doing it at the same time when they were bidding for more mortgages. It raised quite a problem: if an insurance company, with its enormous resources and unquestioned credit standing, begins to borrow freely at the commercial banks, or to extend commitments which, when taken up, would come into the banks, a very nasty situation could arise. I asked myself why it had never happened before. It happened in the spring of 1955 because the prime loan rate was well below the long-term yield on these mortgages; here was a transaction that was completely profitable, from the point of view of the insurance companies and of the banks; it gave the banks a very good loan, and all the brokers in the business had a fat carry. We tried to protest at that time and to use moral suasion, with some results but not too much. The situation was really corrected when the rates at the short end moved up and made the operation relatively unprofitable. In a context like that, in the spring of 1955, the most important thing we did, or could have done, was to put the short rate up faster. That is just an illustration to show that one cannot ascribe importance of various rates solely to the long rate; there are contexts where it is very much better to get the short rate up.

9766. Institutions are willing to switch their lending or borrowing from one market to another?——In that case the lending was in the short market, but it was underpinning the long market.

9767. And as you get the changes in institutional developments, you may well get forces making for the long rate to stay at the lower level, relative to what the short rate had been before?——Yes. It is very fluid, and we have to watch it.

9768. Is not the tendency, in a long inflationary period, for just this to happen?——In this particular period, this last time, the fact that the banks had lost their short liquidity, and were forced to sell their intermediates, was

the reason for the rate structure that actually developed; but that rate structure was a structure that was necessary if we wanted to have a policy of restraint. To go back to your earlier question, I would not want to say that a different structure would have been better.

9769. Suppose that you have a situation in which there is a great deal of commodity speculation, but that there did not appear to be an undue pressure of capital development plans; in that situation would you not want to see rates at the short end rise more than rates at the long end?——The demand would be at the short end, so the rates would probably go up the most there.

9770. Would you not want to exaggerate that position by pushing the short rates up more, without bringing about any reaction at the long end?——No. We get into difficulties when we want to do that. Restraint is restraint over the whole market. This business of saying: "We want to restrain industrial borrowing, but not borrowing for housing and so forth" does not work. We apply a general restraint on the availability of funds, and we cannot cut it too fine successfully. I think we get into trouble if we try to be selective.

9771. Suppose that you take the view that there is excessive pressure of long term capital development in the country, would that be a situation in which you would want to raise rates at the long end?——If we wanted to stop an excessive development, we would have to bring pressure on the whole structure of rates. Take the autumn of 1955, for example: in August and September of that year, the market finally became convinced that Reserve Bank policy was going to be stiffer than it had counted on, and, in view of those expectations, the long end rose particularly sharply. It was one of those occasions when we went wrong in judging what had actually happened; we thought we had brought more pressure that we actually had. Borrowers who faced difficulties when they went to the capital markets to borrow resorted instead to the banks where they borrowed short. Consequently, we found that we had not achieved the restraint we thought we had. This illustrates the point I was trying to make earlier, that the restraint has to be across the board. I think we would get into trouble if we tried to make a diagnosis that distinguished too much between the long and the short end. Activity can be financed by short-term loans as well as long; a corporation in handling its financial structure makes a decision as to when it will borrow long, and it may well decide to borrow short for a period and come to the capital market later to fund the loan.

9772. If you are taking the view that long term capital development is going on too rapidly, and you restrict the market at the short end, you then get some rise in rates at the long end; but does not the pace at which that rise at the long end comes about depend upon market expectations?——It would depend more on the actual demands on the market.

9773. But will you not be wanting to push rates up faster than demand drags them up?——No, it would be the supply-demand position which would determine the rate.

9774. Then why have a central bank?——You cannot restrict supply without a central bank.

9775. This sounds like the argument that, if you just had a fixed supply of money, all would be well?——No; I said we were varying the supply.

9776. You would reduce the supply of money and produce tightness at the short end?——Produce tightness throughout the market. Our tightening is more than just at the short end.

9777. But your tightening would add to the effect of rising demand in pulling rates up at the long end as well as at the short end?——Yes.

9778. *Professor Cairncross:* I gather it is your view that the pattern of rates is set by the supply of and demand for funds, and that, if you are going to restrict, the operations you indulge in are all at the short end; but your assessment of the situation depends on your view of the whole of the market?——Whether we do open market operations by selling short term securities, or change reserve requirements, or decide to do nothing because currency is being drawn out and the market is being tightened by that movement, it is the resulting reserve position that we look at in determining our operations, not the short and long rates. The Open Market Committee makes very careful projections of the expected movement of currency, the movement of gold, the movement of float, and all the other factors that play on the reserve situation, and then, since statistics can never tell the full story, it has to have regard to the feel of a market. With this picture in mind, the Committee may say: "In the economic context and climate which will probably prevail in this country in the next three weeks, we think it would be good to have negative reserves of, say, $300 million." That normally produces a moderately restrictive market. That negative reserve of $300 million may be produced without our selling a single bill. Actually we may buy bills; if the seasonal demands are such that if we did nothing negative reserves would be $500 million, and we only want $300 million, we may actually buy bills. This reserve situation may be produced by any one of a number of factors which do not involve our buying or selling anything; but it is the resulting reserve condition we look at. That plays on the entire credit situation.

9779. I thought you were taking what I should regard as a rather neutral view about the pattern of relationships between long and short rates?——I am, because here is a huge market in which there are lots of buyers, lots of sellers, lots of borrowers; the borrowers have the option of shifting between markets, so if we are going to restrain, we have to restrain right across the board.

9780. Were you going a little further here, and suggesting that the pronouncements which the Federal Reserve make, the firmness with which they intervene, in the short market or in any other way, will have an effect on opinion about the movement of rates, and may influence the long rate more or less according to the degree or massiveness of the intervention, so that you are not entirely neutral?——No, we cannot be.

9781. You can, if you choose, intervene in such a way that you bring more pressure on the long rate by making it seem as though the restriction will continue for longer, for instance?——We would not be putting pressure on the long rate as against the short. If we are bringing pressure, it is pressure on the market.

9782. You bring pressure on market expectations?——Yes, but it would be on the market as a whole.

9783. Would you deliberately seek to influence the long rate by making it apparent that the change in the credit situation was one that had come to stay for some time?——If you mean: "Would you influence the long rate by talking about it?", I would hope that we did not. That would probably give a bigger movement in the rate than would correspond to the supply/demand position, and we should find ourselves with more credit out than we had expected; we should find that it was a false move.

9784. I do not quite understand what you mean by the supply/demand position, because the bulk of the supply comes from stock?——We deal basically with the reserves of the member banks; that is what we control and influence.

9785. Is not Federal Reserve activity much wider than that? The prices which are reached in the market for different types and maturities of bonds depend on the expectations of a very wide variety of potential sellers, and these expectations cannot but be influenced by the action you take?——If we are putting money in the market, that spreads in some degree throughout all the markets.

9786. It is not just the money you put in the market, but how you put it in?——We try to be as neutral as possible on that; the most important thing is the amount we put in, and the amount we take out, and to the extent that we get results through anticipation of what we are going to do, they may well be spurious results.

9787. But some of the results must be spurious results?——There can be an expectation that we are going to be very tough, and bond prices will drop sharply.

9788. *Professor Sayers:* At the long end?——Yes, because that is where they would. That would simply mean that borrowers would borrow at the banks to build, and we would have fooled ourselves but not affected the business situation. The more we can operate through changes in the actual availability of funds (and the more movements in interest rates express changes in actual

availability), the better we are able to affect the economic situation, and the clearer view we have ourselves of what the economic situation is. That is always the most difficult problem of all.

9789. Are the banks and other lenders in the market completely ready to move into long term lending? If bond prices go down and yields at the long end go up, and borrowers who are holding money for long term purposes therefore go to their banks, the banks will lend to them for these purposes?——Yes.

9790. With complete freedom?——Relatively, yes. Take the public utilities: the utilities have a big expansion programme going on parallel with the growth of the country, which is very steady. They come to the market to borrow long periodically. Irrespective of rate to a considerable extent they are in the market every year. But nevertheless if you watch the figures of bank loans to public utilities, you will see they have quite a bit of fluctuation. Utilities do borrow from the banks short, and then choose their time to come to the market to restore their capital structure. That is very common.

9791. Are small corporations in industry equally able to get long term capital from their banks?——It is not so easy to tell whether this is long term capital or not. If a firm is maintaining a balanced financial structure it needs in general certain proportions between long term capital and short term borrowing. It has customer relationships with its bank; once in a while the problem will come up very definitely whether it is borrowing short for a long term purpose, and the bank may or may not accommodate its customer, depending on the whole gamut of relationships between them. But frequently the question will not come that way; it will appear that the borrower is simply supplementing working capital, although actually he is engaged simultaneously in long term outlays, and in a different market context might have come in at the long end to borrow.

9792. So that the shape of the rate structure is a matter of indifference to you?——It is a matter of intense interest. We watch it constantly; that is how we learn what is happening.

9793. *Professor Cairncross*: I would like to go back to some of the things you were saying about the condition of the American market, which clearly differs a good deal from ours. Your view is based to some extent on the experience of the past two or three years, although I imagine not exclusively. If you take the experience of that period, the market seems to have been able to switch into bills to a quite remarkable extent at a time when credit was being restricted. This would strike us as a little odd. Non-bank holders of bills bought about $4,000 million worth in about a year or eighteen months during a period of credit restriction. Would this seem abnormal in the conditions of the United States?——It was interesting, but not abnormal, I think.

9794. If you take the behaviour of the banks in conditions at which bond prices were falling, they appear to have disposed of a very large fraction of their total holdings of maturities between five and ten years; their holdings of those maturities declined by $10 billion worth inside a little over a year. That must have been rather unusual?——This was the first long period of serious credit restriction since the war when the banks acquired such an enormous volume of Government securities and when there was an additional enormous volume of Government securities in the market. The degree to which they sold securities, and the degree to which the banks sold securities and sacrificed liquidity in 1955 and 1956 was a matter of concern to us, and still is. They may have been relying a little too much on borrowing from the Federal Reserve to maintain liquidity.

9795. But the important thing from our point of view is that they were able to sell; did they find a market for $10 billion worth?——The specific decline in the "five-to-ten year" category reflects the fact that with the passage of time a large issue moved into the "under five year" category. In a broader sense, however, it was remarkable that the banks were able to dispose of as large a volume of securities as they did in 1955 and 1956.

9796. Have you any view as to who was prepared to buy such a large load of bonds at that time?——I have not the figures here, and I shall have to check this later; but as I recall it one of the big buyers at that time was increased its purchases quite sharply was the category of foreign governments and central banks; they took a lot of those bills, I think, in that period. It is quite an interesting question. Then the period was one of large security flotations.

9797. Does it not mean that your commercial banks are now in a position much nearer to the position of our commercial banks: their interest in government securities is far more heavily concentrated on the short end than it used to be?——I think that is true. The purpose of the Accord was to discourage their interest in the long end. If they assumed that we were going to peg indefinitely, obviously they would not hold any shorts; they would only hold longs, because they could get the advantage of the higher rate. More and more of them were getting to think in those terms in 1950 and 1951. That was one of the reasons why we had to force the issue and drop the pegging of bonds. So ever since the Accord in 1951 it would be logical for the banks to be less interested in the long end. On the other hand, when the Treasury came out with a 4 per cent. issue last summer, interest was very acute throughout the market in that issue.

9798. Do you believe that you could repeat an operation that meant a large cut in the holdings of long bonds by the banks in a year? Is not this the sort of response that is really rather unusual even in American conditions?——I do not know. We would look at it rather differently; we would look at whether we could repeat an operation that would have as much restrictive effect on banks' activity, irrespective of the form that that took in their portfolio; and I would think we could. I would think that our ability to restrain expansion of bank credit is improved, if anything, after the experience which the banks went through this last time. They learned something from this too; those banks that hesitated to adjust their position after they had run out of short maturities found that in the end they had to adjust anyhow by selling longer securities, and had to take very much bigger losses than if they had adjusted earlier. Another time I do not think that we would find as much attempt to borrow from the Federal Reserve or resort to the Federal funds market; I think they would restrict advances or take their losses earlier.

9799. You do not think that the effect might be different; that the commercial banks might begin to think they should stay out of the long bond market altogether, in which case your control would be, to some small extent at least, weakened?——I would not think they would.

9800. *Professor Sayers*: But suppose that the banks confined themselves to under five-year bonds, and had such a high proportion of business loans to total assets that they thought they ought to have most of their government paper in the under-two-year range, then would there not be two effects: (1) the banks would not be continually in and out of all parts of the market, but their operations would be limited to the short end of the market, and (2) if you forced them to unload, you would not force on them the losses that they had to take in recent times; they would therefore not be so frightened of expanding their loans up to the hilt?——No. Under your original proposition the banks would not be so liquid. They would have a smaller volume of liquid instruments, so they would, I would think, be affected more quickly by our restraining action. The connection of the banks at the long end is not only through their own purchases; it is their financing of the whole capital market, which is also very important.

9801. You mean that the supply of bank deposits in the country as a whole has its bearing on the capital market?——I mean the banks' loans to dealers and underwriters. There has been a recent terrific expansion of bank investments since January this year; they have increased about $6,000 million, and their loans to brokers and dealers in securities by about $2,000 million. Both contribute to the activity in the capital market, and to the lowering of the long term interest rate.

9802. Coming to the development of the last six months, has the long term rate come down as quickly as you wish?——I do not wish. The long term market has been extremely satisfactory in the total volume of securities it has floated, the amount of funds that have been made available through the long term market to final users. That was something we wished for; that was an object of policy, and that has been achieved in larger degree than we expected. We have been surprised at the volume of long-term funds provided there.

9803. When you were arguing in your paper about the effects of intervention by the Federal Reserve in the long term market, if it did choose to intervene, you suggested that one of the undesirable results would be that the market would sometimes go too far in response to your actions, that you would produce exaggerated effects that you did not want?——Not effects that we did not want; effects that would mislead us.

9804. What effects would be misleading?——They would make us think that we had tightened the market more than we had, or had eased it more than we had in fact eased it. We actually ease the market through the amount of reserves we put in. If we get sudden changes in rates based on expectations of what the Federal Reserve is going to do, it takes away data from the Federal Reserve essential to tell them how much more they should do.

9805. *Chairman*: I have still in my mind the very firm answer you gave a little while back to Professor Sayers, that you were vitally interested in the structure of interest rates, because that told you what had happened; but from your earlier answers I had the impression that you would not say that it was part of the function of the System to try to establish a pattern of interest rates?——If you mean by establishing a pattern of rates making short term rates lower than the long term rates, or *vice versa*, in some precise way, I would say that it is not part of the System's function to do that. If we tried to do that, we would not have the data to judge what we had done; we would be pegging the market in some sense or other and we would not know what we had actually done, and what the conditions actually were.

9806. If that is so, it seems to me to throw the emphasis in all that you do on your decision to change or not to change the level of excess reserves at any one time?——Fundamentally it is the biggest thing we do.

9807. That is in your view the fundamental thing that you concern yourself with doing?——That is so; the discount rate is mainly a disciplinary instrument by which we keep discounting from being attractive to the banks at a time when reserves are deficient. I do not want to be categorical; I know the discount rate is a lot of things. It is a very overt statement to the public of attitude; but basically the supply of reserves is the thing we are concerned with, and I would think the most important aspect of the discount rate is the degree to which it maintains the discipline of the discount window in providing this supply of reserves.

9808. It is a way of controlling the adjustment of the banks to what you have done with their excess reserves?——And if the banks borrowed freely at whatever the rate was, it would lose that characteristic; but they do not.

9809. If I follow you so far, your emphasis is upon the availability of funds at any one time to the banking system?——Yes.

9810. And you are comparatively indifferent to the interest structure that that availability throws up?——No. If you are talking about the level of the general structure of interest rates, we are not indifferent to that at all, we expect results to follow from changes in availability. That is the way these changes work their effects. Of course higher interest rates act as a deterrent to borrowing; they also lower the capital value of existing securities and other assets. That also exercises a measure of restraint. They do all of these things, and we are interested in all of these things; that is how we get our results. But the way we get these results is by actually restricting or expanding the supply of reserves. That is what a central bank is all about—controlling the supply of reserves.

9811. *Professor Sayers*: What you said just now on the use of the re-discount rate as part of the discipline at the discount window surprised me; I thought that the discipline of the discount window depended very much more on the traditions against continuous borrowing?——It does. What I meant was that, if our policy was to restrict, and we used open market operations solely and left the discount rate at, say, its present level of 1¾ per cent., that would impair the discipline or make it much more difficult to enforce. For example, suppose that we used open market operations to establish a climate of negative reserves of $500 million and did not change the discount rate, the bill rate under those circumstances would probably go to something like 2½ or 3 per cent. It is very hard to get the bill rate up much over one-quarter per cent. above the discount rate; with the discount rate at 1¾ per cent. and a bill rate of 2½ per cent. we could not enforce the discipline of the discount window; it would just be too profitable to borrow from the Federal Reserve Banks, and the discount authorities would have almost an impossible job. Banks can make quite plausible cases for discounting if they want to. So the discount rate would have to be raised to prevent too much of a margin of profitability developing. In that sense it is a disciplinary measure.

9812. That reminds me of your book of thirty years ago, which I read when I first studied the System; I gathered from that that the movements in the discount rate were movements of a rather passive kind, to match the conditions in the market that are produced by open market operations?——The analysis in the book is similar to that I have been giving you.

9813. The system does work now?——It still works.

9814. So that the movements made in the official discount rate are movements in response to market conditions?——Usually; not always. I cannot be categorical about this. The lowering of the discount rate last November, was not in response to requirements of the market; it was an initiation, and an indication of a sharp reversal in policy.

9815. *Sir John Woods*: Does that mean that to lower the discount rate may be different when you are restricting from when you are relaxing credit?——It may be different from time to time too.

9816. *Professor Sayers*: Surely the pace at which you bring the discount rate down, as during the last six months, is a matter that is under the control of the Federal Reserve System; it is not just a matter of letting the market go?——The analysis I gave you a little while ago is the predominant one. But that does not mean that the discount rate is a passive instrument which is moved automatically when market rates go to a certain position. There is always initiative as to when the discount rate should be moved.

9817. The Federal Reserve does take a view not merely on whether things should be tightened or relaxed, but also on what the level of rates should be?——Through the discount rate? To some extent, yes. I do not want to be categorical on any of these things, because we are always dealing with a living and moving situation.

9818. This is an important qualification of the general point that you operate to make the supply tighter or looser?——The fundamental thing we do is operate on the reserve position. If we ever forget that, we are gone.

9819. You do also take a view sometimes on how quickly rates should change?——One of the many ways we operate it is through the discount rate, because that does affect the willingness and alacrity with which the banks will borrow reserves.

9820. *Professor Cairncross*: We have been discussing interest rates without talking very much about availability. When you take action to reduce the credit offered by the commercial banks, are you interested in the effects on particular assets of the banks, or do you think that does not make very much difference?——We watch the effects on particular assets of the banks; that tells us what we are doing. But we cannot do very much about it. We are restricting credit to the banks; it is up to the banks to decide in what way they are going to adjust to that situation. We would have liked it very much if the volume of consumer credit had not advanced as rapidly as it did in 1955. That was a matter of great concern to us; it showed itself almost impervious to contraction in other areas.

9821. You do not attach special importance to the way in which the banks reduce their assets, whether they sell bonds or contract loans to customers?——We could not do anything about it. It is not that we do not want to do it, it is that we do not have that power.

9822. You take the same view of the other financial intermediaries: you have no power over them, but you operate through the commercial banks. When you operate through the commercial banks, you may be obliged to take sterner action in relation to them because of repercussions from the rest of the financial system?——I am not sure.

9823. Take the case of instalment buying, for instance; you would not now be in a position to exercise control over that, and if it showed signs of increasing you would only be able to counteract the effects of the increase through pressure on the reserves of the banks. Might it not, in some circumstances, be preferable to take action at a point where the action would have an immediate real effect on the activity of the economy?——You mean through selective credit controls. My answer is an absolutely personal one, because there are great differences within the System: but I personally think that there is a case for them.

9824. May I pursue the question in relation to the other financial intermediaries? May not loan funds and insurance companies, other agents, and particularly finance companies of various types, be in a position to supply an extended range of customers because of the pressure on the commercial banks? Does not the action that you are taking affect the competitive position of the commercial banks in relation to other financial intermediaries?——As I said in my paper, most of these agencies either deal with their own funds that they borrow directly, or they deal with funds which they borrow from the banks. To the extent that they are dependent on funds borrowed from the banks, our actions reach them.

9825. Through higher interest rates?——Through higher interest rates or the unavailability of credit, or more difficulty in getting credit. But to the extent that an insurance company is operating on its own funds, our actions do not reach them, and I do not think we want them to. What we want, it seems to me, is that the savings of the community entrusted to the financial institutions should be invested; as long as those institutions are actually investing savings and not creating money I do not see that we have a problem.

9826. This is based on the proposition that these other agencies are not creating credit. What happens if they are able to enter into debt with a view to extending credit?——I think the extent to which they create money substitutes does have an effect on the demand for bank credit. It is one of the things we have to take into account; but I do not think that at present it seriously impedes our ability to establish the overall situation.

9827. If you could bring pressure to bear on other financial intermediaries in the way you can on the commercial banks, would not the degree of restriction you would have to exercise at one point on the commercial banks be to that extent diminished?——It may be; but I do not see how we would deal with the intermediaries. I have never been able to get a picture of just what we would do, and consequently I do not think I would want the authority. As I said when we were talking about selective controls, I would rather see those in certain areas; but I am not very sympathetic with the general thesis now being discussed of putting the financial intermediaries in some sense under the central bank. I have not been able to visualise how we would handle them operationally.

9828. Do you not have in the United States some powers over mortgage rates and mortgage operations, not through the central bank but through government?——There are two mortgage loan programmes provided by the Federal Government, the Federal Housing Administration programme and the Veterans Administration programme. These administrations can establish the terms—down payments and maturities—and also the ceiling rates to which eligible mortgages must conform. The great bulk of the actual lending on these mortgages is done by private investment institutions operating in the capital markets. Generally, the ceiling rates (in times of pressure on resources) have been below market rates. I personally would not want to operate to restrain or expand mortgage lending by manipulating a ceiling rate. I think it would be very unwise. The mortgage market is the largest and most important financial market in the United States; there are over $100,000 million invested in home mortgages. The market has an elaborate organisation because the technique of mortgage lending is complicated; it requires many people to appraise property and to record mortgages. In view of this large apparatus, it is particularly serious if the result of a ceiling rate is to keep borrowers on the Government programmes from competing for mortgage funds in the capital markets. With the supply of funds dried up, the people running the organisations have to be discharged. That actually began to happen; the Veterans Administration bad a 4½ per cent. ceiling rate when the market rate was 5 per cent. and the Veterans Administration's mortgage business just dried up; nobody or almost nobody would buy a Veterans Administration mortgage. If that market were to be handled properly, the rate should always be left free, so that anyone who wanted to borrow could be free to contract a loan if he were willing to pay the competitive rate. So far as central bank influence on the market is concerned, I personally would try to affect the market by changing the availability of bank reserves and thus changing the availability of funds in the capital market as a whole. In addition, I would tighten terms for down payment and maturity in periods of over-activity when it was important to restrain aggregate demand, and I would relax these terms in periods of recession. But I would limit direct interference to these changes in terms. I would not recommend what has in fact been done, the manipulation of permissible ceiling rates of interest.

9829. The powers you would take, speaking personally, would be similar to what you may envisage for control of consumer instalment buying?——Yes.

9830. *Professor Sayers*: Do you regard these financial intermediaries as serious competitors of the banks?——No. They are a channel rather than a source of finance. The finance companies are the most interesting. They started the instalment finance business and borrowed from the banks to finance themselves, and the banks later on began competing with the instalment finance companies; the banks are the new entrants into that field.

9831. *Sir John Woods*: Do any of the finance companies take deposits?——No, they would not be allowed to.

9832. *Professor Sayers*: They are prevented by law from taking deposits, and there is no way around that?——I do not think so; that law is supposed to be tight. I have not seen any loopholes since it was tightened last in 1933. The finance companies sell commercial paper in the open market; they sell a great range of maturities.

9833. Here we have finance companies which take deposits, and there is no restriction by law. Would you say that your experience affords support for the view that a law restricting the taking of deposits could be effective?——I would think so.

9834. Have the financial intermediaries been growing relatively to the commercial banks?——Yes, I think they have, probably; I think that is normal.

9835. If the banks did not take the very elastic view of the kind of lending that they do take, one would expect to see the financial intermediaries gaining ground relatively to the commercial banks?——Gaining ground in terms of the kinds of customers they served, but I would not think in volume; the determination of the volume of bank credit outstanding would not be affected a great deal. It might be affected a little if the intermediaries offered a substitute for cash that became acceptable. In general I would expect any switch from bank credit to be limited by the demand for cash balances.

9836. In coming to that conclusion, I imagine a critical point in your argument is that these financial intermediaries are not allowed to take deposits?——Yes. In the 1920s the brokers' "loans for the account of others" became very close to demand deposits. That was the most serious development in that situation; the growth of brokers' loans was huge. They were essentially similar to deposits; in some senses they were a substitute for them, and quite a danger. That hole has been plugged. We are always on the watch for some further evasion, but I know of no evasion that has developed yet.

9837. Would you say, in view of that experience and of experience since the war, that the restriction on the power to take deposits is one of the important parts of the foundation of the Federal Reserve's power over the financial situation?——Yes. If there is not an ultimate control over the source of cash or cash equivalent, then the central bank is gone. It has to have that.

9838. *Professor Cairncross*: I would like to ask you about your views on the finance of industry. In the United States a good deal of use is made of accounts receivable, and you have factors, to whom there is no very clear counterpart in this country. The rates of interest

charged are very high. Do you feel that from your knowledge of circumstances in this country any development along those lines would be worth pursuing?——I do not know at all; I do not know the situation here.

9839. The banks in the United States, in making their loans, are prepared to lend at quite a wide spread of rates, I believe?——There are different rates in different markets.

9840. I am thinking now of advances to firms?——In general, if they are lending on instalment finance contracts, the rate is very much higher than if they are lending on a direct note; and on occasions a loan from the same bank to the same borrower could be either one or the other. Those obviously would be irrational situations, but cases do arise.

9841. Do the rates of interest vary with the risks involved?——Not really. The rate of interest charged to a customer is essentially dependent on the market in which he is borrowing, and on his access to other banks or other lenders; it is a conventional rate in the end. The prime rate does not apply at the smaller banks; the top rate is conventionally 6 per cent. at most. In the south and west it might be higher. They simply will not lend at all to borrowers where a higher rate would be required because of the risk. Borrowers who are able to shop around to a larger city or a larger bank can often break the 6 per cent. rate.

9842. The small borrower may be a new firm, and he may not be judged as creditworthy by the commercial banks; but he can still have recourse to other types of lender in America. I suppose these other types are often institutional?——They may be. That is where one comes to accounts receivable financing, and other lending techniques of that sort. There are lenders who specialise in a special technique and can control their risks and take on loans that a bank is not capable of servicing properly on account of the risk.

9843. Do you think that that form of finance has been useful to the smaller growing companies in the United States where the risk is high?——I think accounts receivable financing has been useful.

9844. *Lord Harcourt*: Is the prime rate a universal rate throughout the United States?——Yes. The prime rate is the rate charged by the large banks who are prepared to make loans to large industry; those large industries that deserve the most favourable rate.

9845. How is that rate arrived at? Who settles it?——Not by collusion; that is very important in view of the anti-trust laws. When credit conditions are changing, either tightening or easing, discussions will begin to arise, and people will say: "What about the prime rate? Is it not time the prime rate was moved?" And then one will hear reports, if conditions are tightening, that the banks have not changed the prime rate but are not extending credit as freely, and certain customers are no longer considered eligible for the prime rate. One will also hear, in the reverse situation of easing, that certain customers are getting concessions from the prime rate. That may go on for a long time, and there may be a great many rumours about the prime rate, about possible changes, and about what bank is likely to change it first. Finally, some bank will take the plunge and change the prime rate; and then all the rest will follow in a day or so. No bank likes to take the initiative to change the prime rate; it is not done until something arises in the credit situation. It may be, in a period of tightening of credit, that some bank gets so many demands from its big borrowers for loans that it wants to shuffle some off to another bank, and it raises the prime rate; or, in the opposite situation, when the rate is cut. It was different this last time; what actually moved the prime rate this winter was the acceptance rate, as I understand it. As the open market eased, acceptance financing came to be cheaper than financing at the prime rate. That set up a situation where finally the prime rate was broken. One of the banks announced that the prime rate was broken, and others immediately came out and announced the lower rate.

9846. The prime rate is not fixed and not agreed, but it is always the same?——As soon as one changes it, the others also change.

9847. *Chairman*: I would like to get your view on two points, one arising out of the other. The end product of your activities is to affect the economic activities in the United States; I would like to get an idea as to the time element involved in the operations. Your basic instrument during the whole operation is excess reserves. You pointed out to us that there are several protective reactions that banks can take to prevent your putting compulsion upon them to affect the volume of their investments and loans. First of all, they can borrow from each other, as far as there are spare excess reserves. Is there a market for that?——The Federal funds market.

9848. That is, I suppose, a mobilisation throughout the banking system of a pool, comparable to our call money in the London discount market?——It is a somewhat similar pool; it is participated in mostly by the banks and also by the dealers.

9849. Then they can, under discipline and the understanding which you outline, restore their reserves by borrowing from the Federal Reserve System under discount. When they have done what they think right or can do about that, they can still protect the volume of their advances to industry by realising their investments. Are not those three quite considerable defensive mechanisms?——When they realise on investments they are decreasing the money supply. We think that is probably the most important action.

9850. Do you find that there is a considerable time element involved in obtaining your results, because they have these defences?——It will vary accordingly to the situation. In our last boom, in 1955, the big problem arose in a different way, and the delay was serious. In 1954, during the period of easy money, the finance companies increased their lines of credit at the banks very considerably. The banks at that time considered that it was nice to have these big finance companies as customers on their books; they did not think they would be likely to be short of funds again, and consequently they were rather liberal in extending lines of credit to finance companies. The large insurance companies were also very liberal in extending commitments to take up V.A. mortgages. Their experience up to that time had been that of the commitments made about 50 per cent were taken up, and they consequently extended commitments to about twice the value of what they expected to take into their portfolio when the mortgages were delivered. It happened that the boom in 1955 was concentrated in automobiles and housing; two-thirds of the expansion in bank credit for that year was in mortgages and instalment paper. That was the place where the boom really got under way. These two areas lean heavily on finance, and in both cases the financing had essentially been contracted in 1954 in the period of easy money, so that in 1955 our efforts at restraint, which I think were inadequate and backward, still faced the problem that they could not touch directly the two fields which were expanding most strongly, because of prior commitments. I hope that situation does not arise again.

9851. Given a system under which you have certain understood powers to produce results, and you are currently explaining to everybody what you are doing and why, and they have certain defences with which they, for the time being, can prevent the result being effective, what is the place for what is called moral suasion in a system of that kind?——Very little. There is a feeling against moral suasion in general. We feel that it is an incorrect tactic; that by itself it is useless, and that it is proper only if it is backed by action. Our explaining the policy of restraint is, in a sense, moral suasion; in that sense it is proper and appropriate. But we would eschew it under certain circumstances. Circumstances might arise where we would have to go very carefully. In any case taken alone we would not think that it would be very effective. Of course, in the American system we have supervisory authority over the banks; that gives an opportunity for expressing judgments about the soundness of credit and about the developments that can turn out badly. One of the things that was done in 1955, in view of the tremendous amount of instalment paper which the banks were financing, was to ask the examiners to be particularly careful in evaluating the soundness of that paper. Perhaps you might call that action moral suasion.

9852. Is this a general view in your country, that if the rules are defined, then people ought to be allowed to operate according to the rules, and you ought not to ask any particular person at any one point not to take advantage of something?——It would probably not be effective if you did.

9853. *Professor Sayers*: Might I ask a question on debt management? If the United States Treasury take the view that most of the debt should be in long-term form, would you say that in any but the most extraordinary circumstances there is a rate at which the Treasury should be able to carry through its sales of long-term securities?——Usually there is a rate at which a long-term issue can be placed. In 1957, in the early part of the year, the Treasury gave up plans to issue long-term securities, on the ground that there was not any reasonable rate at which to issue them. It was a peculiar situation at that time. The actual yield in the market was about 3½ per cent., but the dealers and the investment bankers said that the Treasury could not get an issue taken even at 3¾ per cent. The Treasury took that advice and did not issue; but later in the summer, when rates were even firmer, they came out with a 4 per cent. issue. It was not a long issue, but they went out of the short market at a 4 per cent. rate and had a very good subscription. The experience at that time seemed to corroborate the judgment that they could have financed outside the short market earlier if they had paid the rate. But there may have been a difference of opinion about that.

9854. There may have been a difference of opinion about the rate?——On the ability of the market to absorb an issue at that rate. Looking backward now, we would say that the market showed more absorptive ability than we probably thought it had at the time when these decisions were being made.

9855. *Professor Cairncross*: Could you tell us when you think the Government should borrow?——It is very difficult to say. Our ideas have ranged all over on the problem of debt management. In my own thought at present, I would settle with great joy for a pattern of more or less evenly spaced maturities that was maintained. I would like an adequate amount of bills at the short end to provide for the liquidity needs of the market and the rest of the debt to be outstanding with evenly spaced maturities. I would not worry much about other debt management considerations, such as the proper occasion for funding, if I could have that. I would be willing to take the fact that funding fell recurrently in periods both of boom and recession without too much worry over theoretically unfavourable cyclical effects, because, with a debt outstanding with evenly spaced maturities, the central bank would be more free to operate promptly in a contracyclical manner. Its actions in easing or tightening bank reserves would have the effect of increasing or decreasing the liquidity of the whole market. In a period of ease, all maturities would become more liquid, because obviously, if people hold securities above their acquisition cost, they will be more ready to dispose of them to finance a new undertaking, and conversely, in a period of boom, when people hold securities whose market is below their acquisition cost, they will feel less liquid. To repeat, as against the attempt to float only short-term issues in a recession and long-term issues in a boom, I would personally settle for a debt management pattern that would provide for regularly staggered maturities plus an adequate volume of short-term issues to provide for the minimum liquidity needs of the community. With such a pattern, the central bank would be able to function effectively. We have had some very unfortunate experiences trying to choose the time to offer securities. It has not been a happy experience.

9856. The position is never static; there are always opportunities arising, and there may be periods when, on credit grounds, you do not want to take advantage of a re-financing to produce an equivalent extension of the debt?——Our problem with regard to re-financing is that it always means tension to some degree in the money market. For a period of a month or so it seriously inhibits our policy. We have to take considerable thought before changing discount rates or changing the reserve position much, when a Treasury financing is approaching; and they approach all the time. It is a very serious problem for us.

9857. The last big funding operation that you referred to in the paper was early this year?——We have had one since then.

9858. The one you describe in the paper involved an increase in the long-term rates?——There was a slight reaction.

9859. Would you think it more appropriate to conduct operations of this kind, if it were open to the Treasury, in conditions of boom?——Yes; the theory is that one should fund long in periods of boom and short in periods of recession.

9860. Do you think that that is technically possible? Do you believe that if the bond market is very weak in conditions of boom, a funding operation can be carried through without difficulty?——The Treasury was very anxious to fund; but actually they did not fund much after 1955. In September 1957 they issued these 4 per cent. two and four year issues, that went very well, but that did not represent very much funding. They were very short. I think that, if the Treasury had a regular pattern of maturities, if it were understood by the market that they would be getting out $2,000 million of long-term bonds a year, they could probably work out a manageable system.

9861. You are speaking now of circumstances in which the total debt is not increasing much, so that there is not an annual quantity of bonds to be put on the market; but is there not a technical difficulty, in that it is far more difficult to fund in a boom and far less advisable to fund at any other time?——That is what we are up against. The actual record is a poor one from the point of view of those standards.

9862. In point of fact, looking at the figures, did not the Treasury during the boom in the United States move over into shorts to some considerable extent?——Yes.

9863. Must that not have got in the way of the credit policy?——I do not think the effects of the actual amounts of short securities were too severe. Before the Accord we had expected that we would be seriously handicapped in effectuating monetary policy by the sheer volume of short-term debt outstanding, but it has not worked out that way so far as I have been able to observe. What has impeded credit policy is the constant recurrence of refinancing operations. There are sometimes $10,000 millions of securities outstanding in the hands of the public that are refinanced in one operation. That is a big operation. The first problem is the choice of a coupon on the new issue that will insure its success. Then the coupon chosen and announced must still be acceptable when the subscription books are open. That means that it would be better if credit policy could try to maintain conditions in the money markets as calm and unchanged as possible as a period of refinancing approaches. It is better to avoid changes in discount rates, if possible, during these periods. The endeavour is to maintain an even keel in the money position from the time the new financing is announced until the operation is finished. That cannot always be done but it is the aim. When refinancings are fairly continuous and recurrent, it is difficult to operate in this manner and also take into account new developments in the economy.

9864. Would it be right to assume that one of the reasons why funding was not undertaken between 1955 and 1957 was the problem of the falling market, that it would have been difficult to have had a large bond issue in those conditions, or is this something that does not trouble the American authorities?——No; the Treasury wanted to fund all along, but the advice it received from its market advisers in the market was that the issues would have to be small and would have to be priced very high. Having received that advice, it did not in fact go forward with the plans.

9865. It was not that it would be technically impossible but that it would be a costly operation?——It was not tried. Some of the advice was that it would be impossible to get more than so much (and they gave very small estimates of the amount) and that the rate would be high

9866. How do you reconcile that with the picture of the balance of the bond market, under which an adjustment at one end is very rapidly brought to bear at the other? The impression left by your curves on my mind is that you have a very wide market?——Yes, but we are talking of issues of as much as $2,000 million at one time.

9867. You might in other circumstances have to do that every year?——I think that, if a regular pattern were worked out, if the market expected such an issue every

year, it would be able to take one in that volume; there would be plans made for absorbing it on the part of investors, provided the rates were favourable.

9868. In your Chart V you show that, in the case of the funding operation at the beginning of this year, although there was some appreciable rise in long-term rates, it was possible for the market to absorb a very large total quantity of bonds?——But that was an exchange, not a new issue.

9869. Would you have expected a different outcome in 1956-57?——With the same data the outcome would have been the same, except in this sense: in 1957 the actual yield curve, rising to 3½ per cent. at the long end, was way below the rate at which new utility issues were coming out, so that market advisers at that time all said that the real rate for a new Treasury issue would be around 3¾ per cent., not 3½ per cent. I just do not know how to explain the fact that the yield bung down where it did so long. I think that, if the Treasury had issued any long-term bonds at all in 1957, the yield curve would have moved up into a more customary relationship to the yields on other issues.

9870. Does the market ever get completely jammed? You mentioned just now the existence of a premium on cash, a difference between the new issue price and the prices of current issues. This applies, I take it, to public utilities and other types of bond, even Government bonds. Are there circumstances in which it is in the American market technically impossible to bring out large issues?——It is a question of the size of the issue. I think at a price you can possibly always bring out an issue. The size of it would vary; in a really tight market it would be hard to bring out a large issue.

9871. But the government, as the largest borrower, would not be prepared to take a big cut in the price of its bonds, because that would reflect, presumably, on its credit as a borrower?——It would not want to take too big a cut.

9872. *Professor Sayers*: If one looks at the movements of the discount rate in New York and in London, the movements in London are very much bigger. What is your view as to the difference between the two centres? Do you regard this as an inevitable difference, something that arises from the nature of the two markets, or is it to be related to the problems they are facing, or what is it?——I am not too conscious of the difference. We really have not decided with any firmness as to what the appropriate amount of a change in the discount rate should be. We used in the 1920s to change by a half per cent. usually; then, after the Second World War, and the Accord, we changed the rate by one quarter per cent. When the rate was down around 2 per cent., one quarter per cent. seemed the proper proportionate change; one half per cent. would have been too much. As rates got up towards the 4 per cent. level, we did have some half per cent. moves. We do not really have any fixed philosophy on that problem as yet. So far as there is an explanation, I would say the fact that we are watching very closely this relationship between the bill rate and the discount rate is important, and a one quarter per cent. move usually does just about what we want to do in that respect; but we might change our pattern on that almost any time.

9873. One point of explanation might be the relative importance of the discount rate in the discipline of the market?——It is very hard for the bill rate to go more than one quarter per cent. above the discount rate; if that happens discipline tends to break down, and banks can be expected to borrow rather than sell bills. By raising the discount rate more than one quarter per cent., we tend to restrain the use of the discount window.

9874. That point is related to the steps by which you move. Over a period London bas had much bigger swings than New York. How do you account for that?——The general demand for capital of Britain's economy implies a higher rate of capitalisation than the U.S. We are a capital-exporting country. We have high savings, high capital exports, and our interest rates are naturally lower.

9875. Is it a matter of where the range is?——Our range will go down to almost zero. Our range cannot help but be narrower than London's, because the top is lower.

9876. *Sir Oliver Franks*: Might I ask one or two general questions? I find the view which you have put forward in its simplest outlines very attractive and very puzzling, because it seems to depend, when you are dealing only with this fundamental aspect, on the significance to be attached to modifying the supply of money, that significance working out in changes in the broad pattern of interest rates. You see those changes in detail on any occasion when it works out, but what you determine is a trend up or down. You also assume, I think, a very considerable degree of perfection in the market for bonds, so that these effects are transmitted. I think that you must also presuppose that at least over a time these changes in the general pattern of interest rates up or down, as they work out, affect the market. Now I have in front of me a paper submitted to us by a group of economists which contains this sentence:

"A policy of credit restriction continued over a long period is unlikely to have any significant direct effect either on consumption or on investments in stocks. Its only significant effect is likely to be on fixed investment, and here the effect would probably be very small."

I quote this sentence because there is a school of thought which attempts to argue that monetary measures cannot really affect demand unless the measures are so drastic as to be intolerable in a modern political society. You clearly do not hold these views. I should be very grateful if you would be prepared to amplify what are the reasons why you hold the views you do hold on this crucial subject?——That is interesting. That statement obviously reflects the view which became quite dominant during the depression, that interest rates do not affect saving, and consequently that they do not affect consumption. I have felt more and more, watching the situation in the last few years, that we were getting some very interesting effects on consumption. We are now working very hard to develop the savings statistics in a form and variety that will tell us more about this. One thing I have observed: once interest rates became sufficiently remunerative so that banks and savings and loan associations (building societies) and others could make real money by attracting a larger volume of savings deposits, these institutions that specialize in the management of savings became more and more competitive with each other. They offered higher rates as well as other inducements to open up or expand savings accounts. Certainly there was a high response to the increase in rates in the total amount of savings entrusted to the institutions that competed actively for savings.

I personally feel that an understanding of this response may be found from certain analogies in the business of life insurance. My friends in the life insurance business swear that life insurance has to be sold. They say they could open offices and advertise for clients to come and buy insurance but that nobody, or very few, would take the initiative to buy life insurance voluntarily; in other words, it needs salesmen, it has to be sold. Life insurance is one form of saving, of course. I think that possibly the success of banks, savings banks, and other savings institutions in stimulating saving also may depend on the amount of sales effort put forth. If that is so, higher levels of interest rates may have acted to stimulate voluntary saving and curtail consumption, by making it more remunerative for savings institutions to sell the idea of greater saving to the public.

I am sceptical about how much response there is to interest rates in so far as the holding of inventories is concerned. There is some, of course. If credit is tight, certain entrepreneurs will not be able to get credit to hold stocks they otherwise would hold. But in my own thinking I have never put great stress on that. Certain types of long-term investment are obviously crucially dependent on the rate of interest. The easiest illustration is the expansion of toll road investment in 1953-54; as interest rates went down, it became feasible for special public Authorities to be formed under charter from the state legislatures to build toll roads. They raised money in very large volume at the lower interest rates and built the roads, really super-highways. Many of those roads would not have been constructed at all if the financing had required higher interest rates such as prevailed early in 1953. My own view is that the effects of higher or lower interest rates and tighter or easier conditions on availability of credit are much broader and more pervasive than can be summarized in any simple statement such as that there is this or that effect on inventories or on long-term investment. There is the whole problem of capitalisation to be considered: at lower interest rates it becomes profitable to scrap plant and equipment and build new plants, whereas at higher interest rates it is more profitable to modernise and repair.

9877. Would you say that in general, when you are dealing with a fairly strong tendency in the economy, whether you wish to restrict or to expand, that it takes quite some time for the policies of the System to work through into active expression in increasing or decreasing demand?——Yes, partly because it is difficult for the central bank to judge how much to do. It is very difficult to assess the problem quickly.

9878. Would it be your opinion that the balance of payments creates a special problem for the United Kingdom? At a time of over-demand on the economy, we have our difficulties with the import bill reserves, and therefore a compulsion from that angle to act. Would you say that the kind of view which you have outlined might well not be able to be put into force in its normal fashion, if this interrupting factor is always liable to intervene? Do you think that the particular situation of the United Kingdom in regard to the balance of payments makes a fundamental difference to the sort of situation which you have outlined?——We have always thought that the British had a little advantage over us, in the sense that the balance of payments has forced them to recognise a developing situation and act more promptly on it than we do. We can be lulled into not doing our job properly because we have not the sharp discipline of the balance of payments position.

9879. That would mean that the fact that we have to take our medicine earlier makes for good health; but the theory as stated by you would remain applicable, in your view, in this country?——I think so.

9880. There is some discussion on whether the fixed element which the authorities should seek to vary up or down is cash or another measure of liquidity. If the second view is taken, the argument becomes an argument about liquidity ratios. Do you see a difference in principle or in advisability between one and the other base as the subject on which you choose to operate, or do you think that it is not so important which you choose but that you must choose one?——If the central bank is going to get effects, it has to have a base within the control of the central bank, and not one which the market can manufacture. I am not sufficiently familiar with the proposals here to understand exactly what is proposed in Britain, and therefore nothing I say applies specifically. But the idea of security reserve ratios was canvassed very broadly in the United States in 1947-48; in fact the Federal Reserve Board at one time proposed them to Congress. I did not agree at that time. One danger of a security reserve ratio, as I see it, is that the banks will be able to buy from the public whatever they need for the security reserve, bills or something else, and it will consequently be within their power to go on expanding indefinitely. Another danger is that the market might produce more acceptances, which would meet the definition of the security reserve. In that case again the central bank would not have control of the money supply. Whatever is used as base the central bank has got to control that; the point is simple: it has got to control the volume of assets eligible for reserves and to be able to say that the banks cannot add to the volume unless the central bank gives them the wherewithal.

9881. That leaves you with the conclusion that there are strong arguments for the use of cash?——Yes.

9882. Would you go as far as to say that you do not see how an effective monetary policy could be operated, nor how a list of measures could be found to be effective, unless the central bank were in a position actively to operate upon the cash basis?——That is the basis of my whole experience and knowledge and feeling about it.

9883. *Professor Sayers*: You would add that there must be some restriction on the power of people outside the banks to take deposits?——Yes. There must not be a money substitute, or the money substitute must be so small as to be negligible.

9884. Do you think that, looking over a long period, the invention of adequate substitutes can be kept down by law?——*Mr. Riefler*: We have to be alert all the time. After all, money is what people use for money; we ought to be alert and not be caught by words or definitions.—*Sir Oliver Franks*: You do not allow banks to be what people use as banks; it is what you say are banks!

9885. *Professor Sayers*: In your country you in effect say by law what people may use as money. In this country we have no such rule. Do you see any danger of the development of money substitutes outside the banking system?——We also may be getting into that problem. The savings and loans societies are coming along very fast. Their savings liabilities approximate those of the member banks at the present time. I believe that their rate of turnover is increasing. If they ever got into issuing a liability resembling a demand deposit, obviously we would have to move fast and do something to try and stop it, because they are now very large institutions.

9886. *Sir John Woods*: Suppose that you had a situation of strong demand, an inflationary situation in fact, and business expectations of profit were very optimistic; in those conditions are you content to rely on the monetary measures which you describe, directed at the availability of credit, and therefore raising rates of interest, or do you think it is necessary in such conditions to use other and supporting measures of restraint, such as, for example, fiscal measures?——I would certainly welcome a surplus in the Budget. The fact that the Treasury was running on such a small surplus in the last three years definitely complicated the problem of the Federal Reserve in trying to handle our boom.

9887. Do you think you get pretty good results by the monetary measures alone?——We will get results, but not as good. We have to act more heavily, and if we act more heavily we are more likely to make an error, and if we make an error it is more serious. Obviously it is an advantage to have fiscal support.

9888. You would not take the view that, without supporting measures of that kind, the monetary measures are relatively ineffective?——No. To say that we cannot do anything because the Treasury is not doing what it ought to do would be to throw up the sponge and not meet our responsibilities. The monetary authority has to operate more strongly if the Treasury is not doing anything.

9889. *Professor Sayers*: I have one more question, as a rider to what you said in answer to Sir Oliver Franks when you spoke about toll roads. Would you not say that the high responsiveness in the American economy to monetary measures depends in part at least on the importance of a housing market that responds quickly to changes in mortgage terms, and the fact that the banks themselves are actively in the mortgage market?——Banks are not so active; they are in it, but not in the responsive end of it. They are mostly in conventional mortgages. The big responsive element in the mortgage market is really the insurance companies. The insurance companies will switch about between three major outlets for their funds: they have the open capital market; they have their own private direct placements, that are probably the most profitable outlets they have; and they have mortgages. They will re-allocate funds to the mortgage market when placements go down, or change the other way. That is where the responsiveness comes in.

9890. Would you agree with the first part of my statement, that the responsiveness of the housing market is very important?——The responsiveness of the private housing market certainly is.

Chairman: I think that that concludes our question, Mr. Riefler. I should like to put on record how very grateful we are for your help.

(Adjourned until Tuesday, 1st July, 1958, at 11.00 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTIETH DAY

Tuesday, 1st July, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

A. C. L. DAY, Esq., Reader in Economics at The London School of Economics and Political Science, called and examined.

9891. *Chairman*: Mr. Day, we are grateful to you for your memorandum* and for coming here this morning. We should like to follow up one of two of the main lines of the memorandum with you and we will take them in order.—*Professor Cairncross*: You express a view about British investment overseas; as I understand it, you feel that we have been investing more heavily abroad than is in the interests of the country. I think that this view arises because you feel that the pressure on British resources under conditions of inflation is so great that we cannot invest at home as much as we should when we are investing abroad as much as we have been trying to; although, as I understand you, you also feel that investment abroad is taking precedence over the rebuilding of reserves. Is that a fair statement?——*Mr. Day*: The problem that arises ultimately is simply the problem of choice. We have limited resources available, and that shows itself particularly in present circumstances as a tendency always to push into inflation. That in a sense is the cause of it, but ultimately the cause of it is that we have not resources available to do everything we should like to do; therefore we have to choose. I would be inclined myself to increase total investment as a proportion of national income; I would believe that a more rapid growth of output is a desirable thing. But even with this total of investment I would want to switch the balance towards a greater emphasis on home investment and the inevitable repayment of foreign debts and rebuilding of reserves, and less emphasis on new foreign investment.

9892. You put it more strongly, I think, in your paper. You imply that there is some merit in home investment that foreign investment does not possess. Are you not thinking primarily of industrial investment in this country? You always mention factories, and not houses, power stations and other forms of investment which are by far the larger fraction of investment?——The word "industrial" is a dangerous one. I should like to lay emphasis on *productive* investment at home in the sense of railways, docks, power stations and industry, as opposed to *private* investment, such as housing. That is my personal predilection in terms of the general internal structure of our economy.

9893. Would you not agree that most of the case for new investment in things like power stations arises out of the growth in the national income, and has nothing or very little to do with the adoption of new techniques? A lot of the power consumed in this country, for instance, is simply used in the private house?——Yes indeed. What we are planning for ultimately is a rise in consumer standards of living; that is the ultimate aim. I believe that we have been living far too much on past capital which is extensible, in the sense that it can be pushed further and further at the cost of diminishing, but not impossibly diminishing, returns. The over-strain on our railway system, our road system, and on the docks, has been developing steadily over the years since the war. Getting these things in a reasonable relationship to national output as a whole is a very considerable problem, but if we do not do that we are going to find diminishing returns becoming stronger and stronger in those particular lines and we are going to hold back the whole expansion of our economy; and expansion, we agree, is expansion for the benefit of the consumer.

9894. Is it your view that since the war shortage of capital has been growing rather than diminishing?——I should find it difficult to prove, but I agree.

9895. You agree that investment in this country has grown out of relation to output whereas in the United States the reverse is true?——I dislike comparison with the United States in this context. I think that the supporters of high investment have made tactical mistakes in laying emphasis on comparisons with the United States. The great difference between us and the United States is that they are starting at a level of investment per head something like half as high again as ours; therefore the growth of progress in the United States is reasonably tolerable. I would be inclined to say that we must have a more rapid rate of growth in this country in order to get nearer to the absolute level that the Americans have achieved long ago.

9896. When you say "must", are you thinking that there is a large demand for capital which is suppressed at present, particularly in the industrial sector, and which would find expression if we cut our foreign investment?——I think that there is a demand which is suppressed administratively, in that there is a real need for, and there would be considerable returns from, investment in basic things like the roads, railways, the docks. Beyond that there is probably not very much suppression of demand for industrial investment; but a more rapid rate of growth in itself creates the greater demand. We can either have an equilibrium at a slower rate of growth, where demand for capital is in line with investment, or we can have an equilibrium at a higher rate, demand again in line with supply.

9897. You are rather identifying higher investment with rate of growth. Is that not something different?——There are other elements. I would not say that it is only rate of growth, but I would say that it is a likely way of getting it in our economy at the moment. I am not thinking simply of the direct effects on the economy of investment in new factories. There are produced from that indirect effects in shaking people out of the old ways of doing things, and shaking people into thinking of a complete reorganisation of methods of production, which they will do if investment is going on on a large scale, whereas if they are simply replacing old equipment they would be rather inclined to do it in the old way. I would not go to the extreme of saying that to double the rate of net investment would double the rate of growth; I do not think that is true. But I think that doubling the rate of investment would have a specific effect on the rate of growth.

* Memoranda of Evidence Part XIII No. 8.

9898. Your emphasis is on the adoption of new techniques more than on the accumulation of capital, and you think that the second is the means to the first?——I would not say either was the predominant thing. I would say they work together. The more we do of the one the more we have of the other.

9899. We might do a great deal of improvement by way of the adoption of modern techniques, without necessarily having a higher rate of investment?——We have tried. There has been a great deal of propaganda by the productivity teams and the rest of it, and I am sure it has had some effect; but all these things are cumulative: more of one gives more of the other.

9900. Might I ask you about the feasibility of curtailing overseas investment, if you think that is straining our resources? A large part of our overseas investment takes the form of re-investment of profits. Would you think it right to interfere with that investment? Do you think it possible?——The questions of "right" and "possible" are distinct things here. I see no reason why it should not be right. The exchange control would have to be administered with some degree of liberality, as undoubtedly at was for British firms operating in the dollar area and non-sterling countries in times when exchange control was imposed fairly strictly. I think that it should also be possible, because we did it for non-sterling countries quite strictly; but it would be possible only on the assumption that the structure of the sterling area is substantially different from what it is at the moment. I do not believe that we can restrict capital flows to the sterling area and continue to enjoy the other characteristics of the sterling area precisely as they are at the moment.

9901. Do we not in fact restrict investment in the sterling area?——There is the capital issues control, but beyond that there is no restriction on private flows of capital. It seems to me that we adhere a little too firmly to the principle of the sterling area that it means freedom of capital to move from the U.K. to other members.

9902. *Chairman*: I am not clear what "right" means in this connection: something that deserves priority for the economic health of the U.K.?——I think that is a fair definition.

9903. *Sir John Woods*: I wonder if I might follow Professor Cairncross's question with a rather earthy and simple-minded argument. I see the drift of the argument; but is it not the case that there are a number of industries in this country whose capacity to produce capital goods is far in excess of the capacity of the home market to take what they produce: for example, heavy electrical industries, steel making, constructional engineering, heavy engineering, I should suspect chemical engineering, railway equipment, and so on? If you apply your argument as very categorically stated here, all you would do by restricting overseas investment would be to create over-investment at home?——I doubt it for two reasons. Firstly, we should be switching the whole of the investment resources to home, and the electrical equipment that is not put into Australia would be put into greater expansion of investment here at home, so that demand would very largely be switched from abroad to home. Secondly, we should continue to export capital equipment on a very large scale, because the overseas countries would be continuing to invest in capital equipment on the basis of their own financial resources or on the basis of financial resources they could get from other countries in a stronger position to provide overseas investment, the United States in particular. I do not see any difficulty at all.

9904. *Sir Reginald Verdon Smith*: Does not that depend to a very great extent on the attitude of the other sterling area countries? Does it not mean that your idea of what may be right for the economic health of this country has to be mandatory in the case of Australia, South Africa or elsewhere, where the promotion of domestic capital investment sponsored by producer countries is a matter of national policy? When you have the sort of capital goods situation that Sir John Woods described just now, surely it is not possible, even if it were desirable, to isolate ourselves from the economic policies of the other sterling area countries who are such important customers?——It is quite impossible to isolate ourselves. What I am suggesting is that we give higher priority to our own selfish needs. We shall continue to trade with these countries and send capital equipment to them on a large scale.

9905. If we can?——Are they going to stop buying from us because we do not lend there? We have not been lending very much until recently to countries outside the sterling area but we have sold a great deal of capital equipment in competition with other countries. Exporters in Europe who do not lend very much long term to the sterling area still sell a great deal of capital equipment to the sterling area.

9906. *Professor Cairncross*: But you would agree that there is a point where a little additional investment abroad would improve our chances of finding export markets, and that these export markets might be enduring and continuing export markets: the advantages might remain with us when it came to supplying spares at a later stage?——It can happen. But that is a reason for thinking carefully about any particular piece of restriction on capital export that may be decided upon in the process of the administration of the control, rather than an argument for letting all investment go out perfectly freely.

9907. You appear to take a rather lighthearted view of what our export prospects would be if we gave up foreign investment. You do not feel, as I understand you, that this would have any serious repercussions on our export prospects in the sterling area?——Not repercussions of the same order as the amount of money we are going to save on the balance of payments through reducing the investment. If we reduce investment by, say, £100 million, we undoubtedly lose a certain amount of exports; the net saving is appreciably less than the gross saving. But there is a net saving; I should find extremely difficult to guess how much, but I would imagine in most cases well over a half, which is well worth having.

9908. Is it your contention that, if we gave up investing in these countries, some other country would take up the burden and undertake the investment?——I think it would mean that some of them would have to carry out investment on a smaller scale than they have been doing; certainly that would be the case with Australia.

9909. Might that not be of some importance to our future as an exporter and our future also as an importer?——Investment in Australia has had very little effect on us as an importer. Very little of it has been in the sort of goods we want to import. It has nearly all been in lines competing with our exports. I go back to my original point: the real thing that determines our position as an exporter is how competitive we are. We are more likely to be competitive if we are producing up-to-date things. That is the only way a country like ours can keep going; and the best way of doing that is to invest a great deal in our home economy and get our home capital equipment up to the mark.

9910. How far nowadays do our exports take the form of engineering products? When you are supplying the world with engineering products it is important to maintain contact with markets abroad, to cultivate goodwill. Do you think that if we surrender our goodwill as an exporter of capital we would be as successful as, say, the United States?——On the relative importance of engineering goods, I do not have the precise figure, but it is a very substantial proportion. If we reduce lending overseas, inevitably we lose something on our exports, simply because the countries overseas have less finance to pay for goods; it is in the nature of things. But as I said before, on balance it improves our balance of payments position, although not as much as the gross figure would suggest.

9911. Let me move to a different point. It would seem to follow from what you say that, if the pressure on our own domestic reserves were to become less, whether through policy or in some other way, you would not raise the same objection to lending abroad?——I do not believe that we are ever going to get to a situation where there are so many resources in our economy that extra expenditure is an economic good. There is always going to be competition for resources. If we have spare resources available, there is always going to be the question whether they should go to the consumer, to extra Government expenditure, or to investment. The problem of choice is always going to be there.

9912. Would you hold this view even in conditions in which our total exports were falling? Is that not an appropriate time to start repaying some of our sterling liabilities, which is a form of investment?——It is indeed an appropriate time for repaying sterling liabilities. That is what we have been doing lately, and what we might hope to continue to do for a few more months to come. But, as I understand it, we were not talking about repaying the sterling liabilities at this moment; we were talking about new long-term investment overseas. I would say that the present situation is an admirable one for repaying as much of the sterling balances as we can, but a questionable one for new investment.

9913. You would draw a distinction between the two? ——I would indeed.

9914. You do, I think, attach some importance to rebuilding reserves as a result of having a smaller volume of foreign investment to cope with; you would not expect that to follow from lower investment in the sterling area countries? You seem to have in your mind that a lower level of foreign investment could serve either to improve the level of home investment and the rate of development of the economy or to improve our reserves position?—— In the last few years we have not been earning a balance of payments surplus adequate to cover all our commitments; the commitment for long-term overseas investment, plus the extreme likelihood of having to repay sterling balances on quite a big scale, plus the need to improve the reserve-liability ratio. How this is done, whether by increasing the one or by reducing the other, is a secondary consideration; the important thing is to improve the ratio. The consequence of this is that we are always in danger of running into crises of the kind we have had in the last few years, that if we continue present policies we shall have to find additional resources in order to bring the balance of payments surplus on average up to the £400 mn. level. That is the thing we have to do if we continue present policies.

9915. Why must we do that? We have not done it in the past, and we have survived thirteen years?——The colonies have been helping us out for most of the post-war years up to a year ago, but we must now expect them to start drawing down their balances. There is a real danger of many of the sterling area countries switching reserves over to gold and dollars rather than leaving them all in gold and sterling. Long-term investment overseas is probably tending to grow with the general growth of the world economy. All these things together are reasons why the rather unhappy experience of the last few years, doddering along from crisis to crisis, is not likely to be continued into the future, with an average surplus of the order of magnitude we have had in the last few years.

9916. You say that the experience of the last few years has not been particularly happy; but have we not succeeded in paying off about £1,000 mn. during that period in terms of sterling liabilities to non-sterling countries and accumulation of gold and dollars?——My memory of the figure for the non-sterling countries is that it is appreciably less, from about £1,200 mn. in 1950 down to about £500 mn. to the end of last year; although that is a very substantial figure.

9917. To that we have to add additional gold and dollars accumulated; the total is of the order of £1,000 mn. That is surely not something that we need fear in the next few years?——We have to fear the possibility of some further withdrawals by the non-sterling countries; and, as I say, I think we have to fear the reversal of what has been happening over that period with the colonies. The colonies built up their balances very substantially over that period; that is not going to continue to happen.

9918. That might well not happen, I agree; but is there not something to set on the other side of the picture you have been drawing? We have succeeded in coping with this period, and each successive crisis has been less severe than the previous one; the balance of payments has been more favourable on each occasion than the last?——It depends on how you judge the seriousness of the crises. I find it difficult to believe that the 1957 crisis was less serious than the 1955 or 1956 crisis, though the balance of payments was in surplus last year. I still come back to my point that in relation to the commitments we have the balance of payments has not been adequate, and the inadequacy has shown itself in this recurrence of crises which have made it necessary to be unduly restrictive on our internal policy and which create this atmosphere of bankruptcy and of economic meanness in the country which is not really justified by our true wealth. This risk of bankruptcy because of the international banking business colours the whole of our approach to the whole of our economic policy, when the truth of the matter is that we are quite a rich country.

9919. Your main point, if I understand correctly, is your fear about the adequacy of the reserves to cope with future situations in which the country is likely to find itself. That brings me to quite a different part of the paper, in which you discuss the adequacy of the reserves and the world problem of liquidity. When you talk about overseas investment you are speaking exclusively of the British balance of payments, not of the sterling area balance? ——Yes, the United Kingdom balance.

9920. At other points in your paper you lay emphasis on the dollar problem and on our position as a banking centre in relation to New York and other financial centres; and it is your fear, if I understand you, that the present position, with two important financial centres, is a dangerous one, particularly when there is increasing pressure on liquidity?——Yes, you understand me perfectly. I would add to that that the position is dangerous when we are in the situation where discrimination has been more or less abandoned. The two centre system was much more workable in the early post-war years, when the sterling part of the system, which to some extent included Europe, was discriminating against the dollar part of the world system. Now we have a unified system with very little discrimination, which is a system from which it would not be easy to withdraw, particularly in a critical situation, and therefore the potential strains on the United Kingdom are very large. So there are two things: the non-discrimination and the lack of liquidity.

9921. To some extent these strains are inevitable if we are a large debtor whether on short account or long account?——Yes indeed; but we are in a very much more manageable position if our debt is on long-term account, as it would be under the I.M.F. scheme I suggest towards the end of the memorandum. Still it is absolutely true, unfortunately, that if you are a debtor you have to do something about it.

9922. I would like to come to that a little later if I may. I am not sure what you have taken as the aggregate of world reserves, but I had assumed that they were of the order of \$60,000 million, and that therefore the accretion to the gold supply is much less than sufficient to sustain the 2½ per cent. per annum increase in world trade that you refer to in paragraph 10?——I think the explanation of this is that I am assuming no addition to the net reserves of the United States in making this calculation. I am excluding American reserves completely from the picture. If you assume that America wants to increase her net reserves position in proportion with the increase in her trade, 2½ per cent. is, as you say, far too optimistic a figure.

9923. That was in my mind in asking the question, because you say in paragraph 10 (*b*) that there will be little risk in the United States allowing her liabilities to increase substantially?——Yes. I was assuming, simply for the sake of the argument, that the United States would be content to stay at the same net position in absolute terms, that she would be content to stay with the same absolute difference between external dollar liabilities and gold holdings. That, of course, does imply that her net overseas position deteriorates as the percentage of her trade expands.

9924. Are you taking account of the fact that the net reserves of the U.S., deducting the short liabilities from the gold holdings, have gone down by about \$10,000 million from \$16,000 million to \$6,000 million in the last ten years?——We have to accept that that may well be as far as American opinion will allow things to go; conservative banking opinion is starting to say this is a risky situation. I do not really believe it is; I believe that a liberal policy in the United States would allow the net position to get a great deal worse than that. But we cannot rely on the liberal policies winning out.

9925. To the tune of another \$10,000 million? Is it likely that the Americans, even if they are liberally disposed, will wish to see their quick liabilities rising substantially above the gold reserves?——I do not see that as any risk to the American economy, but I do not think

that the Americans are likely to do it. If I were giving evidence to an American monetary commission I would say: "Let the thing go to a negative position for the sake of the world"; but I doubt very much whether the commission would take my advice on that.

9926. I would like to ask you something about the dual financial centre thesis which you follow here. How seriously do you rate the danger of a switch from sterling into other currencies, particularly into dollars. Last year the switch was into other currencies generally, not specifically into dollars; it was not simply a dollar problem that was in evidence. Would you agree that it was not the non-sterling holders who were doing the switch, or at least that they were not drawing on their sterling balances for the purpose?——That is rather a subsidiary question. As I understand the figures that were published only about a couple of months ago, there were quite substantial reductions in the non-sterling balances of the non-sterling area countries between the end of June and the end of September of last year, and then they went up again between the end of September and the end of December. This too comes after crediting for the special factors such as the German government debt. My memory from those figures is that the O.E.E.C. countries and the dollar countries both reduced their sterling balances by about two-fifths in the third quarter of last year after crediting. But this is a statistical matter. Your main question was how seriously I judged this risk of a switch. If I had to lay a bet on it, I would lay short odds against it happening; but my odds would not be sufficiently long for me to take the risk that this would not happen. I would say that it probably would not happen; but it is a possibility.

9927. Would you agree that the switch might not necessarily be into dollars? There is a tendency in the way you put your points to assume that a switch to either banking centre is involved, rather than a switch by a purely commercial route?——I agree; but when I talk about the switch of loyalties in paragraph 13 I am thinking of the central bank reserves, the official monetary reserves of overseas countries, rather than a great deal of commercial money which, of course, is always lying about and is liable to be switched in a much more volatile way. When I am thinking about a switch of loyalties I am thinking of the possibility that a country which is in the sterling area decides it would be preferable to hold a certain proportion of their reserves in gold or in dollars or conceivably even in European currencies rather than in sterling.

9928. I notice you said sterling area rather than non-sterling area. Would you agree that the big danger is action on the part of the sterling area banks?——As far as central official reserves are concerned, with the single exception of Japan, I do not see much danger on the part of non-sterling countries, because apart from Japan there are very few non-sterling countries which hold official reserves in sterling. Japan does, but Japan is getting out as fast as she can under the block agreement. The only other cases are principally the Soviet bloc countries, which no doubt have special political reasons of their own for preferring sterling to dollars.

9929. The force of this is that, if we were to act in a way that made sterling area countries less disposed to hold sterling, for example, by loosening some of the relationships within the sterling area, we might conceivably lose unless at the same time we took action to set up some kind of international solution such as is described later; is that correct?——Yes. We are in the position of a confidence trick; if you reduce confidence without doing something else about it you find yourself in a dreadful position. As I say in the paper, we cannot loosen the bonds in the sterling area by restricting capital movement without doing something else at the same time.

9930. May we then take the positive suggestions made towards the end of your paper, which I think are extremely interesting? You make two suggestions, one relating to the future of I.M.F. and the second a perhaps more immediately practical suggestion about the building up of a European/Commonwealth bank. Let me take the first one to begin with. This is in effect a proposal for the partial internationalisation of reserves through the I.M.F.?——Yes.

9931. Has not your proposal a good deal in common with the suggestions put forward by Lord Keynes at Bratton Woods?——This sort of approach is very much the Bretton Woods sort of line. When I was trying to think about these things, I went very much back to Bretton Woods and was amazed by the degree of foresight of these problems that Keynes seems to have shown.

9932. Would you allow an unlimited right of access to the balances in future to be held with the I.M.F., or would you visualise only conditional access to those balances?——Unlimited right for all.

9933. To what limit?——To the limit of the amount of the respective current sterling balances. The current sterling balances would become a credit at the I.M.F., and would be freely usable as international currency.

9934. But not in excess of that?——I would continue the present I.M.F. drawing rights system in addition, but no more than that.

9935. What policing rights would the I.M.F. have over the members, if it felt that they were running cumulatively into debt or drawing too rapidly into holdings or on their drawing rights?——I would not see the I.M.F. as having any policing rights over countries choosing to spend their own money. It is their own money to do with as they wish. It might be necessary to impose the scarce currency provisions if drawings should result in an excessive dollar problem. But as far as the expenditure of these balances by the country concerned, it is theirs; they are entitled to do what they will with them. I do not see any possibility of imposing any rules to prevent them doing it.

9936. How would the sterling area liabilities be handled under an arrangement of this kind?——I am afraid I do not see any problem. These are assets of the sterling countries, currently liabilities of the U.K., which we have no effective power to prevent them spending. After the institution of this new organisation they would be liabilities of the I.M.F. which the individual countries concerned could spend as they wished where they wished, unless it became necessary to impose scarce currency provisions.

9937. *Professor Sayers*: Are you suggesting that the transfer of the asset to the I.M.F. would itself increase the usefulness of this reserve, because there would be less danger of London having to clamp down on the diminution of reserves of sterling area countries, or are you suggesting that the transfer would itself involve no increase in liquidity?——It would increase the usefulness; it would increase the total amount of effective liquidity in the world, because there would be no real danger of a run on this single central bank, whereas there is the danger of a run on the London international central bank.

9938. *Chairman*: Which sterling liabilities do you envisage being taken over by the I.M.F. or other institution?——The countries would continue to hold some working balances in London as a part of such continuation of our commercial banking business as was reasonable and as we could successfully do. They would continue to hold very substantial working balances here, just the same as countries generally hold working balances in any other country with which they do a good deal of trade.

9939. But are the liabilities you want to expatriate what could roughly be called the capital liabilities representing official central bank assets of the individual sterling countries rather than the current working balances of commercial banks?——That is a very easy distinction to make; a substantial part of Australia's commercial bank reserves can reasonably be regarded in a sense as being part of their central assets; I interpret central assets pretty broadly for this purpose. I would say that much the greater part of our sterling liabilities would go over to this new institution.

9940. *Professor Cairncross*: So the I.M.F. would acquire a great deal of sterling in this way?——Yes, but it would own it in the form of a long term claims rather than short term claims against us.

9941. *Chairman*: That is, it would be funded?——Yes.

9942. But you would be faced with the problem of what gold and dollars we were to transfer to the international institution out of our existing reserves?——Yes. The question of how much we should have to transfer would depend very largely on how many other countries

we could get to play this game. We would need a very substantial part of the world to come into this for it to work successfully. The new international institution would have to have sufficient reserves in relation to its liabilities to look a reasonable sort of banking picture, although it could in fact work with a relatively low reserve-liability ratio, simply because there would be no real danger of a run on it.

9943. To put it crudely, we should be persuading them to pull our chestnuts out of the fire for us?——I hesitate about putting it that way. I know it looks like that. I think there is an element of truth in that, but I think that it is more than merely our chestnuts. It is a matter of keeping the world payments system working smoothly.

9944. I am not suggesting that that is any reason why it should not do it; but I should like you to tell us how, if you were leading the delegation, you would put the case most persuasively for us?——I hesitate to imagine myself in that position; I should like to see a Lord Keynes leading the delegation. But I should present it in these terms: "Here we have an international payments system which is working, but not working terribly satisfactorily. It is a system which puts very big strains on us, the United Kingdom, in relation to the benefits we get out of it. We do not want to see this thing collapse. We believe that if we run things properly we can prevent it from collapsing, but we believe that it would be much better if we all got together and made a system where the burdens and the benefits were more equally shared and where the risk of any sort of failure is non-existent". I should have to tone down much more on the "collapse" idea; that would probably have to be expressed in the *couloirs* rather than in the public speeches.

9945. *Professor Cairncross*: To go back to the technicalities, is the detail of the scheme that each of the countries concerned would make a deposit with this institution? Would the deposit take the form of sterling assets held here?——No, the deposit would be in the form of a claim against this institution. It might be gold certificates, or dollar certificates; or it might be given a new name. Call it bancors if you like; it does not matter.

9946. *Professor Sayers*: Is not the technique simply that, say, the Commonwealth Bank of Australia would pay to the new institution some sterling from its balance in London, and that the new institution would have negotiated or would proceed to negotiate with us the terms on which we would be prepared to convert that amount of sterling into gold or whatever else the institution wants to exchange the transferred sterling into?——Yes. The question remains how the Commonwealth Bank of Australia's claim against the institution is described. That does not seem very important. It is the rights attached to that claim which are important, and those rights would be in effect the rights of a gold certificate.

9947. *Lord Harcourt*: Equivalent to their sterling balance on the day of inception?——Yes, the current value of their sterling balance.

9948. *Professor Cairncross*: Does this imply that the United Kingdom would then have an obligation expressed in the international units of account to the new institution?——No. The United Kingdom could negotiate terms for a sterling debt to the institution.

9949. *Chairman*: I thought that was to be in effect convertible though on a long-term basis?——In a world of convertibility, assuming that the scarce currency provisions are not invoked, repayment of that debt to the institution would ultimately be through a United Kingdom exports surplus of goods and services. This seems to me to be a problem of names rather than a problem of any matter of substance; but perhaps I am misunderstanding the thing.

9950. *Professor Cairncross*: I do not think it is just a problem of names. At the moment we have an obligation to Australia which is in sterling. If sterling becomes inconvertible it remains in sterling. If we adopt a scheme under which our obligation to Australia is mediated by an international institution, does it not then become inevitably a gold obligation?——Suppose that we agree to repay to the institution £100 million a year; this means that our deposit at the institution is automatically drawn down by £100 million on a particular day each year. In order to prevent this from exhausting our reserves we have to earn an export surplus in a world of multilateralism. This means that we have to pay in a generally internationally acceptable currency, which ultimately means gold, dollars, or certificates of this institution. But that is no different, as I understand it, from the situation at present where we are in effect in a non-discriminatory world anyway. If we were not in a non-discriminatory world, then we would still repay to the institution this £100 million worth a year in gold or dollars, but of course they would be gold and dollars rather too easy to acquire because of people discriminating in favour of our exports.

9951. Is this not putting some faith in the scarce currency clause?——It is, yes.

9952. Apart from that it is also limiting the power of our present creditors, in the colonies particularly, to draw on what at present in theory at least they can draw on quite freely. It would not be open to, say, Nigeria to draw as much as she could from us, from London, through the new international institution?——I should see no difference between the current situation with Nigeria, or, let us say, Ghana, a country which is independent, and the situation which would arise in this scheme. Ghana at the moment can, if she wants, draw out sterling reserves and spend them perfectly freely wherever she likes as India has done. In the proposed institution Ghana could still draw on her reserves which are now liabilities of the institution and spend them where she likes, unless the dollar problem reappeared and the scarce currency provision had to be invoked. You say that I am laying a fair amount of reliance on the scarce currency provision; but there is the I.M.F in this system, which would have far more of an incentive to organise the world market system if the dollar problem started to appear.

9953. *Professor Sayers*: Under the existing arrangements there is in your view a quite serious danger that we would have to impose a scarce currency clause on the sterling area, discrimination would have to be re-imposed to protect sterling reserves; under your scheme the necessity for the institution to resort to a scarce currency clause would be no bigger than the risk we at present run and it might very well be less. Is that right?——That is right, adding to that that the administrative and economic problems of discrimination would be decided by the world-wide institution rather than arbitrarily imposed by the United Kingdom. I would say that those administrative and political problems would be so much less. I would look with horror at the prospects of trying to impose a discriminatory system now; after all that has been done since 1952 it would be extremely difficult to reverse engines and try and reintroduce a discriminatory system based on sterling.

9954. *Professor Cairncross*: But you do, I suppose, foresee some difficulty in getting every country to toe the line, even if I.M.F. ask them to do so?——Yes. This is not a perfect world; clearly the people who are going to be persuaded to discriminate are going mainly to be those aiming to have dollar deficits of their own, and the countries with persistent dollar surpluses are going to be much less willing to impose any sort of discrimination.

9955. This makes me ask how you view your alternative proposal, which at least is confined to a group of countries that might see their own economic position in a similar light. Do you think that the scheme you suggest for a European/Commonwealth bank is more feasible than the other scheme?——I would regard it as more feasible, simply because negotiations are taking place on this common market/free trade area basis. It is accepted that some monetary arrangements will have to be made within that group of countries; the question is largely being put aside for the moment, but the monetary arrangements have to be made sooner or later. The advantages of getting in on the tide of events are immense. With the world-wide I.M.F. type of scheme we should be running into great difficulty. It does seem that most Americans do not see the world liquidity situation as a real problem. They do not really see the sterling problem as anything more than simply a problem of running inflation. So I would say that the European/Commonwealth sort of scheme is more feasible, particularly if the

trend of negotiations brings the Commonwealth into closer relationship with Europe on trade and tariff matters, as I suspect is very likely.

9956. You base this view on the need to re-negotiate the European Payments Union, or recreate some other institution to take its place?——Yes, on the belief that the European Payments Union as it is at the moment is not going to be a satisfactory mechanism for the common market/free trade area, a belief which, I think, is shared by most of the people involved in these negotiations.

9957. Would it not be difficult to get the Commonwealth countries to adopt a common attitude in conditions in which a dollar problem began to show itself severely. Would you not think that experience in the European Payments Union might make it in some ways easier to get the countries that were members of the existing scheme to adopt common policies?——I think that a European/Commonwealth grouping is far and away the best hope for organising discrimination against the dollar, if a dollar problem should reappear. I think the sterling area is too narrow for this purpose, with just one industrial country in the group, and therefore no competition in supplying industrial goods. The overseas sterling area countries are going to say to themselves: "This is simply favouring the U.K. as a manufacturing producer." How can we say that the U.K. will not get hopelessly uncompetitive behind these barriers, whereas if it were the U.K. plus the continental countries there is a good deal of competition to prevent this being a very soft feather bedding.

9958. Increasing liquidity generally has as its counterpart some obligation on the part of those profiting from the increased liquidity. Do you not think a bank or union or institution of this kind would want to be satisfied about the domestic policies pursued by its members after they had exhausted their own balances?——Clearly, if it gets to the point of the union having to provide a substantial overdraft. The overdrafts would have to be conditional. That is one of the changes away from the present European Payments Union system which is implicit in all the present developments of European monetary problems, that assistance will largely be conditional on appropriate internal policies rather than completely free. This new international institution will want to watch internal policies very carefully.

9959. *Chairman*: I think you said at one time that we could not contemplate a very wide scale reduction of our overseas lending in the Commonwealth unless we could offer in exchange to those countries some such scheme as that of getting their sterling liabilities converted into impeccable liabilities in international institutions. Is it also your view that we may have to face by force of circumstances, without the arrangements with the international institution, some deliberate reduction of our overseas lending in the Commonwealth, and that we may then have to decide on what basis we are to restrict the payments?——If we get to that position we really are in an extremely awkward dilemma. That is the reason why I want to push hard for some sort of international arrangement. That is precisely the situation where we deprive them of something and give them nothing in return, and where they can retaliate very easily by being nasty to us.

9960. So any intermediate situation is extremely difficult to achieve?——Extremely difficult. That is the dilemma towards which the whole of our policies over the last decade have been leading us.

9961. I was asking you that point, because at one point in your paper you talk about some countries, such as India, having a claim upon our overseas lending being maintained, whereas others you mention, such as Australia, as not having a comparable claim?——That is ultimately a moral judgment which is going to be extremely difficult to impose. Clearly the Australians would not like it at all. I think there is a perfectly good case for it: Australia is a wealthy country, quite as wealthy per head as we are, but India is a country which is very poor per head, and the process of keeping development going is such that in that sort of case you need to make a big initial start to get things moving at all. If you move just a little way you will probably slip back to where you were. Therefore those countries have a strong moral claim for external assistance.

9962. You require a very objective approach so far as this is concerned?——This is stating a position which I should very much dislike having to maintain, if I were in the Commonwealth Relations Office; it would be clearly a very difficult job diplomatically. But still I think it is logically a perfectly consistent position.

9963. I did not quite follow the situation you were presenting to us, where in paragraph 22 you say:

"Finally, attention should also be paid to another kind of private speculation which can be serious unless exchange controls over capital movements are very tightly enforced."

Is this an echo of the Kuwait gap?——Precisely. This is showing that in the sort of world we have at the moment, when exchange rates may alter, where political considerations may alter, quite tight controls over private capital movements from securities expressed in one currency and securities in another, may be needed; otherwise completely swamping hot money movements may develop.

9964. *Sir Oliver Franks*: The general analysis which leads you to the constructive possibilities that you discuss later on in the paper really involves taking a long term view of our existing position, and showing that we cannot hope over a long term to be able to go on in the way we have gone on over the last twelve years. In making the analysis you draw attention to a number of different factors: the bifocal character of international currencies; the quick liabilities in terms of sterling which we have; the insufficiency over time of the balance of payments surplus we generate; and the political and economic difficulties you see in trying to reverse that. This leads to discussion of the advantages of investment at home and so on. Now, why do you suppose that over the last few years, when we have come out of the immediate post-war situation and people have been attempting to look a little at where they were going and what they were doing, this view which you have now urged so clearly has not been followed and acted upon by the people in authority with power to act? What are the reasons which have hindered them in seeing the truth, since it is reasonable to assume that they were doing what they believed to be in the best interests of the country?——First of all, inevitably administrators are taking a relatively short view, dealing with the problem of getting over next year and the year after, not with what might happen five years from now. Secondly, there is the reaction against the disadvantages of the control system which met the Conservatives when they came into office; and I have very little doubt that the officials concerned with these matters are very much aware of the positive virtues of a freer system as well as of the idea of the "collective approach," which has this vaguely positive element. Thirdly, there is a tendency to fight the last war and the last peace over again; to look backwards too much to a situation where everything viewed from this distance looks to have been rather nice. In fact, there are plenty of difficulties in any period of the past you go back to, if you look at it enough; but the nostalgia for the thirties or the twenties or a pre-war period is combined with a failure to realise the impossibility of going back on one's tracks and restoring a past situation. Those are the three reasons that immediately come to mind.

9965. Do you think that that means that positive thinking about how one might hope to keep the new Commonwealth and colonies together, which would certainly involve both political and economic considerations, has played a relatively small part, and the backward glance of the Bank of England or of the City has played a larger element in this? One might argue that it was very important to try to work the system which we inherited at the end of the war as far as we possibly could, because it was a main element in trying to keep this multi-lateral experiment going. That would be quite a different reason from arguing that the profitability of the international banking operations conducted in the City was large enough to justify the difficulty. Why do you think that in the past these different views have applied; because it is a situation in which these views took their part?——This is fundamental, and I want to put my fundamental political opinion on this. I do not believe that the Commonwealth idea is much more than a myth, in the accurate meaning

of the word: it is not non-existent but it is an idea rather than a unified institution. It is a common system of thought, a common approach to things and ability to talk together, all that sort of thing; but not very much more. You ask how far concern with the unity of the Commonwealth has played a part in all this. I believe that the tendency in the last few years, in the whole "collective approach" period, has been to imagine that we can hold on to the benefits of the sterling area as we had it left to us after the war and as we firmly established it for a few years in the late forties. Its economic justification was as a tight discriminatory system. There was a belief that that would survive. I do not think, however, that that attitude was justified. When I wrote my book on this problem in 1952 and 1953 I was getting worried about this aspect of the movement towards the multilateral non-discriminatory world of the collective approach, and I still believe that this aspect of the problem which is involved in the problem of moving away from the old type of sterling area and at the same time hoping to get the benefit from it, was not sufficiently realised at that time.

9966. *Mr. Woodcock*: I have one or two questions on your assumptions. You start your memorandum by saying that price inflation, kept to a moderately slow and if possible intermittent rate, is by no means the worst economic evil. Is it fundamental to this assumption it should be moderately slow and intermittent?——Yes, indeed; 10 per cent. is utterly impossible. A 10 per cent. per year rise in prices would, I am sure, cause a hopeless loss of confidence. It would disturb all economic calculations. It is essential that the rise in prices should be of the order, I would say, of not more than two or three per cent. per year on average, and I would very strongly prefer that there should be a fair number of years in which the price rise should be zero.

9967. If you can keep it slow and intermittent ought not you to be able to control it altogether?——I think that it is very much more difficult to stop it altogether. We have in effect, I believe, a choice between unemployment and inflation; either more unemployment and less inflation or more inflation and less unemployment. That is the sort of balancing of choices; exactly how this balancing works out statistically, I do not know. I should not like to put precise figures to it. I am afraid that one of the great failures of economists since the war is that we have not looked at these problems sufficiently rigorously. But there is a relation of that type I am quite sure. Both unemployment and inflation are disliked politically; I would say that it is extremely unlikely that the process of political choice is going to balance out on a situation where the inflation is seen as the major evil and unemployment as the minor evil. I suspect that it is a demand of something of the order of only four or five per cent. of the working population to stop it completely. To substantiate that, first of all there is this ratchet effect in prices. Prices and wages go up much more easily than they come down, so that if unemployment is abnormally large all we get is a constancy of prices. If unemployment is abnormally small, and we are very near to pushing right into the bottlenecks, prices rise. So if we have a situation where the level of employment wobbles, as almost inevitably is going to be the case because administrative processes cannot keep the thing perfectly stable, we shall get prices going up by steps. That is the ratchet. Another illustration is a problem that the Cohen Council pointed out very well, that productivity rises fast in some industries and hardly at all in others, particularly in the service trades. If wages rise more or less in line with productivity in those industries where productivity rises fast which they are very likely to do with any conceivable freedom of wage bargaining, wages in the other industries are likely to be dragged up by them more or less in line. For those sort of reasons I would incline to be very pessimistic about stopping inflation dead.

9968. How much does the rest of your paper depend on your assumption (2)? If there were answers to this question, there would not be the dollar problem. How far does that affect the rest of the memorandum?——If I could see satisfactory answers to that, it would make me much more willing to take a chance on continuing something like the present situation, and much less inclined to push hard for a drastic change. But still I would say that, even if one was sure one could be optimistic on both those things, there is a real possibility that we might run into persistent balance of payments difficulties for other reasons.

9969. *Professor Cairncross*: I take it you would not regard it as sufficient for your purposes if the resources at the disposal of the International Monetary Fund were increased: that might cope with one part of the problem of international liquidity, but you would not regard it as sufficient?——I do not believe that it would be sufficient to cope with the sterling problem. It would mean that we should have greater access to the Fund at times of difficulty, and therefore the dangers of an exhausting drain would be very much less; but we should still be left with all the other problems in the situation we are in at the moment in effect. We have been helped over this crisis by the Fund, but we still have the problem of repaying money to the Fund. I do not see how we shall find that very easy, unless the average yearly balance is very much bigger than it looks to be at the moment.

9970. That seems to go back to what you are saying about international investment. I took it you had two points to put to us: (1) that with the balance of payments in its present condition we should be in for trouble in due course, and it would be appropriate to curtail international investment in order to increase the resources at our disposal; (2) had to do with the cushion to take any shocks. These are quite different points. If we are given credit from the International Monetary Fund, that affects only the cushion and surely does not affect the first of the two contentions?——That was the point I was trying to make in my last answer. Extra resources for the Fund would improve the situation but I do not believe they would solve it, for precisely the reasons you put.

9971. I understand you to be arguing on the subject of liquidity that the principal difficulty is not that we have no cushion to fall back on, but that the size of the cushion will have to be so much larger unless we make use of an international institution which will cut out the danger of switching. You laid a good deal of stress on the danger of switching and the fact that from time to time there might be a need to call on external short-term capital whether from the Fund or some other source?——Yes, but the dangers of a switch are related to people's opinions on how we can survive a critical situation. If the additional sources of the Fund are available to absorb problems of a particular crisis, that does reduce the dangers of the switch and it improves the situation.

9972. That is true, but surely the repayment problem is one that would arise in any circumstances?——Yes. There we get back to the other of the two points you made a moment or two ago; the balance of payments surpluses year in and year out are not to my mind adequate to cover the commitments that we have; nor, I think, in the opinion of Her Majesty's Government. A figure of £350 million was quoted very frequently, at a time when it looked as though we might well get it.

9973. *Mr. Jones*: In paragraph 24 you talk about the risks that arise from drawings on sterling balances. Has there not been a great advantage from the drawing on sterling balances in the past twelve months, in that producers of primary goods in many parts of the Commonwealth would not have been able to take the exports from us they have taken, had it not been for the fact they had been able to draw on credit balances?——The primary producing countries need cushions of reserves, and this has at least temporarily reduced the disturbance; but it looks as though quite a number are going to have to cut down their imports from us pretty sharply very soon. This is an argument for their having substantial reserves but if possible for their having substantial reserves that do not put an immense strain on us; rather with the international institution than with us.

9974. Having regard to the strain over the past twelve months, has it not been a good thing for those particular parts of the world and for us as well?——No, on balance I would say a disadvantage. I think we are going to run into the problem of declines in exports to these countries fairly soon. It is probably happening already. I think that a very soft cushion, as the sterling balances have been, may well prevent us from dealing with the problems quickly enough. It is very difficult to say whether on balance it has been a good thing in the last twelve months: on balance I would say not.

9975. It would be a very happy circumstance from the external point of view for Britain, if we were able to run down the sterling balances substantially?——I very much doubt whether it would be a good thing. It would put a heavy strain on our resources, including our gold and dollar reserves; a lot of this running down is for the sake of purchases from Europe and America. If we get to a situation where these reserves get to low levels that is excellent, but the process of running them down at an abnormally fast rate is a real strain on us.

9976. Your paper indicates that the way to sound economic health for the United Kingdom depends upon one of two factors: the substantial building up of our gold and dollar reserves, or alternatively the running down of our external responsibility in terms of exchanging sterling balances that are owned by countries abroad for a funded debt to the I.M.F.?——Yes. As I say, it is desirable to be in a situation where our quick liabilities are much less in relation to our quick assets than they are at the moment. We shall have ultimately to move towards this situation by repaying debt, but periods when the repayment has to be at a very rapid rate cause general strain on our balance of payments, and cause crises as in last September, when withdrawals were a big part of the crisis. I cannot say that that is a good thing; the over-rapid withdrawals in a particular time are a real strain on us. If we are to get to the situation where withdrawals cannot affect us, that is fine; but we are a long way from that now. Withdrawals at an average rate of £100 million a year would get our assets and liabilities into equality with one another in something like twenty years from now. I do not look forward to the prospect of twenty years of the sort of near-crisis which we have had over the last five or ten years.

9977. You said that, having regard to the future, it was far better to maintain our investment inside this country than our overseas investment in order that we could be in the better position to export the greater degree of commodities abroad. I inferred from your observations on this particular part of the paper that you considered that there was at present too much of a demand upon resources for investment at home and abroad, and that we had to concentrate on investment at home. Have you given any consideration to the necessity of planning the use of resources for investment at home on the basis of what is best for the country and does the best possible service, in terms of exports, for the future?——We do a certain amount of planning of the use of investment resources at the moment through mechanisms like the Capital Issues Committee; and the use of the rate of interest mechanism is designed to see that investment resources go to the potentially most productive purposes. As a personal judgment I would be inclined to make rather more use of controls over investment than we have at the moment. In particular I would be inclined to take control over private house building. But I think it is easy to imagine that controls can do everything; I do not believe that that is possible. It is again one of those cases of a balance of more and less; in this case I would be inclined to go for rather more.

Chairman: I think that ends the discussion. Thank you for coming to give evidence to us, Mr. Day.

(The witness withdrew.)

(Adjourned until 2.15 p.m.)

PROFESSOR J. E. MEADE, C.B., F.B.A., Professor of Political Economy, University of Cambridge, called and examined

9978. *Chairman*: We are very glad to see you, Professor Meade. We have got your paper* which you very kindly sent in in the most convenient of all forms, that is, in a properly bound edition. Perhaps we could have it in front of us. I should like to start with one or two general questions before we get to more detailed points. In a sense this is a development of the argument of the desirability of trying to control or stop the inflationary pressure; I want to concentrate for the moment on the instrument towards which the argument of your lecture builds up. On page 36 of the lecture I think we get the clue:—

"In short, a widespread tax would constitute an ideal instrument of control if only it were technically capable of rapid and frequent change and if an institutional arrangement could be found to make such changes politically possible."

You look forward to two forms of attack on the volume of demand at any one time, either the use of the national insurance contribution, or the use of the income tax instrument through P.A.Y.E. If we are to consider it in terms of what is politically possible, I wonder whether there are arguments that you could develop as to the advantages of adopting one method rather than the other?——*Professor Meade*: I think that each has its advantages and each has its disadvantages, and that it is a little difficult to choose. The national insurance scheme is almost certainly administratively much easier, and it is much more widespread; fewer people are exempt from the effects of it. The main disadvantage is that it is a flat poll tax; if only it was a percentage of earnings I think it would be almost ideal. The P.A.Y.E. device must obviously be administratively more difficult, although I am not an expert on administration at all; and it does not cover so many people. On the other hand, it does not have the disadvantage of being a flat rate poll tax like the national insurance contribution. I would like just to add that I merely put these forward as examples; I think the most ambitious thing will in the end be the right thing to do; to devise something special for this purpose.

*The Control of Inflation (Cambridge University Press, 1958), Professor Meade's inaugural lecture delivered before the University of Cambridge on 4th March, 1958. Since the lecture has been published it is not reprinted in the Committee's record of evidence.

9979. Was the variation of national insurance contributions envisaged by the White Paper of 1944?——Yes, and the possibility of using it is on the Statute Book.

9980. Comparing the national insurance contribution and the income tax contribution, are not the arguments very strong in favour of using the latter, because it is a progressive scheme that adjusts itself to the individual's taxable situation?——I think so. It could probably be done administratively, if it was really thought worth while, and it would be much more acceptable on the grounds of equity.

9981. But if you approached it from that point of view would you not have to recognise that incomes over a fairly large field do not work out evenly throughout the year? Would it not depend very much in which period of the year you made these temporary adjustments?——That is why I say here that there would have to be an adjustment at the end of each year. The Revenue would have to average the rates over the year; they would deduct on a different cumulative schedule each quarter, but they would then have to have an adjustment at the end of each year. Of course, that is going back to some extent on the P.A.Y.E. principle; it is like the old Schedule E adjustment.

9982. Would it not mean an individual assessment of every tax-payer at the end of the year, or after the end of the year, in order to see, allowing for the increased rate of tax which your scheme throws up for one or more quarters, how his total tax bill came out?——One would have to do that because of seasonal variations in earnings.

9983. That would throw up a very large problem?——It would be administratively much more difficult. One could as a compromise use the national insurance contribution but not to any very large extent. Small variation up and down would, I think, be bearable; but then it would not be as powerful an instrument as one wants. What one really wants is something like a pay roll tax, calculated as a percentage, as there is in other countries; a tax on the total wage bill at a small percentage level which could be put up and down.

9984. Does not a pay roll tax fall on the employer primarily? Your scheme does not essentially?——I would prefer it not to, but there is no reason why there should not be a tax of this kind which would replace the

national insurance contribution. It could be divided to fall partly on the employer and partly on the employee, to make up a percentage of the earnings. Then it would not be a poll tax and would be much less inequitable. I do not say it would be totally equitable, but it would be bearable. That is a much more extensive change of existing financial arrangements in order to make them fit this problem instead of the problems which they are made to fit at the moment; but I think it is a problem that is sufficiently big to have its own arrangements made for it.

9985. *Professor Cairncross*: What is the magnitude of the change that you are thinking of, in terms of annual expenditure? Is it the £150 million which you mention on page 37, or were you thinking of some change that might reach even higher totals than that?——We might do something higher, but £150 million plus or minus is quite a lot. If we were really ambitious and thought of 2 per cent. each way, we should have £300 million, which is £600 million per annum from top to bottom; it seems to me that that would be more than sufficient. Perhaps 1½ per cent. would be enough.

9986. If you devolved this right to tax on a stabilisation commission, would you lay down in advance whether it should over the years accumulate a fund or are you thinking in terms of something that would level itself out?——There is a real problem here. I have come to this conclusion about it: I think the people in charge of this special stabilisation levy would have to be told that they were to put it up and down within the permitted limits simply with a view to attaining whatever the object of stabilisation might be (I have suggested a price index, but that is a different point). They would then end by either accumulating a fund or decumulating. It would then be up to the Chancellor of the Exchequer and the Governor of the Bank of England, and other persons of that kind, to say that the special levy was no longer being used as a short term stabilisation device but had become a part of the long term programme, as it were. Suppose that it was found that in order to prevent inflation the special levy had to be set at its maximum level year after year and accumulated two or three hundred million pounds per annum in this fund; I would not regard it as the duty of the stabilisation commission to put it down; I would regard it as the duty of the Chancellor and the Bank of England to raise the Bank Rate and income tax so that in order to prevent deflation the people in charge of the fund would have to put it down. The Government could not hand the job over as a stabilisation device except with the instructions that they should use it to stabilise. That is why I say later that in the end there has to be one person in charge. It cannot really be handed over totally.

9987. *Professor Sayers*: From the point of view of the stabilisation commission bygones will be for ever bygones; they would simply be looking to what was happening in the next three months?——That would be my idea.

9988. This operation might have effects on the size of the national debt which the Chancellor, as manager of the national debt and as tax gatherer in chief, might not like; he would then proceed to deal with that in his Budget. Is that right?——Yes.

9989. *Chairman*: The purpose of this stabilisation commission is really to get away from the cumbrous business of trying to affect demand by the ordinary budgetary process?——Yes. That process is cumbrous constitutionally, administratively, and also, in my view, politically. I am very much impressed by the fact, if I may use an analogy, that when you are driving a car you do not mind giving a little twitch to the left and a little twitch to the right with the steering wheel; you do not wait until you are nearly touching the brick wall before you yank the wheel over. But politics are such that it is almost impossible to drive a stabilisation policy like that.

9990. *Sir John Woods*: You mean the timing is wrong?——Yes, and in the majority of cases Governments are apt to do it a good deal later than they should, partly because they feel that if they move one way this week and in two or three weeks time have to move back the other way, it is a sort of confession of failure, that they have judged the thing wrong. But you do not believe that you have failed to drive the car properly because you are continually doing this; I think stabilisation should be much more flexible.

9991. *Chairman*: I think that is very illuminating. However, to use your own metaphor, it does mean you have two people driving the car instead of one?——Yes, you have a back seat driver who tells you whether you are going to turn to the right or to the left at the next cross roads, and you have a man at the wheel who gets the car to the next cross roads and turns to the right or left. There is somebody reading the map and choosing the road, but there is somebody else driving the car. I think these are two functions; you may say that they are both driving the car but they can be done by different people.

9992. It is surely not quite such an absolute division as that; there is still the budgetary process which sets the main course; the main course being chosen the other person twitches the thing to and fro as the economy goes along?——An analogy always fails at some point, because the two worlds are not the same; but I still think there is something in it. The Chancellor in his annual Budget is the person who is planning where to drive to and the stabilisation commission is the person who keeps the car on the road. Each Budget-time there are the big decisions like: do we want to give more to agriculture? do we want to alter the distribution of income?, and among these big things is the best guess as to whether there is going to be an inflationary or a deflationary pressure over the next twelve months. That is pure crystal-gazing, particularly for a country like this. However, the Chancellor makes the best guess he can, and then sets the best course; and between then and next April we want somebody there continually at the wheel. That is my idea.

9993. *Professor Sayers*: How frequently do you envisage changes of this kind?——I was content with once a quarter when I discussed P.A.Y.E. In the scheme of national insurance that was discussed in 1944 I always argued for once a month; but then I am a doctrinaire! I think once a quarter would be a great improvement.

9994. Do you think that the problem of diagnosis would be reasonably soluble once a quarter, in the way that would give the stabilisation commission sufficient assurance?——We have somehow got to get it across that, in this sort of policy and in the uncertain world in which we live, we have each time to make the best guess we can, and that there is nothing wrong in being found in three months' time to have done exactly the wrong thing provided we are prepared to turn back on it. That is why it must be prompt and frequent. I do not myself believe in economic crystal-gazing: I do not believe you can run the economy by foretelling for twelve months ahead what is going to happen. The main thing is to have a prompt and flexible reaction to a situation which will undoubtedly vary in ways one cannot foretell.

9995. *Mr. Jones*: How do you cover sections of the community who have substantial incomes but are neither in the insured population nor in the P.A.Y.E. group? It seems to me that your paper seeks to work out this proposal for dealing with demand on the basis of a substantial section of the community but not the whole of the community. It would not have universal application, in other words. I suppose that it could not?——I do not think that one can devise anything which would have universal application, but I should like to get the application as widespread as possible so that it is fairly small over a very large number of people. In so far as there are some people who are not affected, they would over the course of time sometimes gain and sometimes lose. I do not think that it is grossly unfair, because it is a thing that will sometimes be above normal and sometimes below normal.

9996. Would it not have a very serious effect on some sections of the industrial population; for instance the very lowest income groups? Would they not be sadly affected? Would it not be a very grievous hardship upon them to operate a system like this?——Not if it was done under P.A.Y.E., but if it was done with the present lump sum national insurance it might be; that is why I think you could not use the national insurance system beyond a rather limited amount.

9997. *Professor Sayers*: Are you looking for the effects solely in the impact on demand of people to spend money, or are you looking for further effects through the monetary consequences of these changes?——I am looking for further effects through the monetary consequences; that is to say, it would automatically pump liquidity in and out of the monetary system. But I think it should be possible to offset those if you want to. It seems to me that under this device an increase in the rate of contribution or tax would tend to reduce the supply of money, to take liquid

important that people should get used to any special stabilisation levy going up and down without regarding it as an abnormal crisis measure.

10027. You would not regard an autumn Budget or a supplementary Budget as a sufficient device for the purpose?——I come back partly to the political time lag. We have to get ourselves into a crisis mentality; the Chancellor has to be 200 per cent. certain that there is the sort of inflation going on that justifies a special Budget. That seems to me to be very different from putting something up and recognising that you may have been wrong and that you may have to put it down again in the next quarter.

10028. *Professor Sayers*: What is the argument against a regular autumn Budget? Might that not meet the case? The people who have to make this decision as to whether the pressure must be increased or diminished are surely not very likely to change their minds more than twice a year?——I think that that would make a very great deal of difference; it would be a very big move in what I consider to be a desirable direction. I still believe that there are two differences. One difference is that it is only twice a year instead of four; I do not know how important that is. But the other, I think, is psychologically very important; the atmosphere in which Budgets are made is not one in which a last minute snap decision is taken, for example, in view of what has happened in the previous three weeks to make the standard rate 6d. or 1s. higher or lower than had up to that time been in mind. It is a process which takes a good deal of time, and has a good deal of political situation behind it. It would be very much less flexible than a decision which might be taken not wholly but partly outside the ordinary political machine.

10029. *Professor Cairncross*: Is it possible for the size of the Budget surplus to be determined by one authority and for an interim Budget surplus, if you like, to be settled by what is to some extent a separate quasi-authority? What happens if the stabilisation commission takes a different view of what should be the current size of the Budget surplus from what the Chancellor does?——If one takes the extreme proposition, just to argue about the conflict, that the stabilisation commission is independent and is not going to be overridden, then, as I see it, the stabilisation commission would do what it thought right from the point of view of obtaining the objective, and the rest of the problem would be the Chancellor's. If he found that this levy was higher than anticipated, and producing a bigger surplus overall, he would have to decide whether he wished to do anything about it. I cannot see that it is unworkable.

10030. Let us take two possibilities. In one case it is possible for the stabilisation commission to say: "We will go to the limit in increasing the size of the stabilisation fund, and will maintain the maximum rate of turnover tax", whatever was being charged. If you take the opposite case, a different point comes in: is there not some limit to the financial resources at the disposal of the stabilisation commission to back their view that more liquidity should be pumped into the system?——I think the system would have to be one which gave them an unlimited access to funds. If they were fighting a great deflation, the legislative arrangement would have to be such that the monetary authorities did provide cash to do this.

10031. Is that easy to foresee? I can see a commission trusted with powers to raise money within limits, but is the Chancellor going to allow the size of the budget deficit to be altered by action on the part of other people?——Yes. It would actually happen when there was a serious slump on; he could stop it by other means: he could try to get interest rates down.

10032. *Sir Oliver Franks*: You are really saying that politicians, and Chancellors of the Exchequer in particular, are always likely to do too little too late; therefore, as far as you can, you should take the decision out of their hands in order to get it taken at the right time and achieve the right measure?——Yes.

10033. *Professor Sayers*: So far as a deficiency was concerned, would this be like the Unemployment Insurance Fund?——The principle is surely not different. If there is some fund which is running into deficit there has to be some way of finding cash for it. I am sure that this scheme will not work unless there is legislative provision for that, and I cannot see that there is any additional defect of principle whether it is due to the fact that the stabilisation commissioners put down the insurance contribution or to the fact that there will be more unemployed drawing benefit.

10034. *Chairman*: The fund is not going to need cash; it is simply going to increase the Budget deficit?——Yes, if it is a supplement to P.A.Y.E. When I said "find cash" I meant that the cash would simply be found by the fact that less would be coming in to the Inland Revenue.

10035. *Professor Cairncross*: Are you thinking also of a remission of taxation below the standard rate?——Unless taxes are reduced to zero, there is no problem for the stabilisation fund of finding cash. It is the Exchequer that has to find the cash. There may be an accounting system whereby this fund owes something to the Exchequer.

10036. *Mr. Woodcock*: With P.A.Y.E. would not the actual changes have to be very limited; they would only be able to print P.A.Y.E. tables to cover a limited number of movements?——They would have to be printed in advance for the standard rate, with one or two additions and one or two diminutions.

10037. They would have to be in multiples of 6d., and things of that sort?——Yes.

10038. *Sir Reginald Verdon Smith*: It seems to me that this is possibly a form of alchemy which all Governments would welcome, as they studied the matter. I am not quite clear what the fund does with its investment policy. This is not unemployment insurance, it is not health insurance, it is not covering against the contingencies of the individual; does it not become a highly desirable, highly convenient technique which politicians would find it very difficult to resist for financing, say, all below-the-line expenditure?——I do not see that particularly; there is always the temptation to run a budget deficit. I do not see that it increases that.

10039. *Professor Sayers*: It is another Road Fund?—*Mr. Woodcock*: Which was pinched by the Chancellor. ——This is not worth doing unless it is agreed by the main parties that it is desirable to do something to stabilise demand and that it is a good thing not to do it merely by altering the Bank Rate but to have some tax that can be put up and down like that, and some machinery for doing it. I do not think that it is like the Road Fund at all; it has to be regarded as a new monetary instrument and agreed as such.

10040. *Professor Cairncross*: What kind of people would you have on your stabilisation commission? Would it be tied with the Bank of England, or independent of the Bank of England?——I do not know; it could be the sort of people whom one could imagine running either a central bank or a Treasury.

10041. But not officials?——I have not given this question a great deal of thought.

10042 *Chairman*: How you would staff and control it would be a question of how far it would be acceptable?——Yes.

Chairman: Thank you very much, Professor Meade; you have stimulated us very much with your suggestions in your answers to our questions.

(*The witness withdrew.*)

W. MANNING DACEY, ESQ., Economic Adviser, Lloyds Bank Ltd', called and examined

10043. *Chairman*: Would you have your useful memorandum* in front of you, Mr. Manning Dacey? I think that we get to the centre of the theme of your paper in paragraph 13; what has gone before is leading up to your theme that the primary instrument for monetary control in this country should be a policy of active funding. That leads us to your paragraph 14: "In my submission, a systematic funding policy provides the most effective means of regulating bank deposits and should normally be regarded as the primary instrument of policy for that purpose." The emphasis there is on "systematic". Would you like to enlarge on what is involved in that concept? Does it mean funding year in and year out,

* Memoranda of Evidence Part XIII No. 6.

so that in a year when the Government finds that it cannot tempt the investor by normal funding it must then adopt a new instrument, such as the suggested index bond?——*Mr. Manning Dacey*: I do not really believe that there are conditions in which it is impossible to sell long-term Government paper of some kind or another. I think this ought to be a continuous process, not merely continuous in years, but from month to month, in order to keep down the liquid assets of the public.

10044. *Professor Sayers*: It is systematic in the sense of being continuous?——Yes.

10045. *Professor Cairncross*: Are you thinking of measures that would reduce the aggregate floating debt, or measures that would push back the maturity of the debt?——I am thinking chiefly from the monetary side, and I am therefore keeping primarily in mind that part of the debt in the banking system; but I am thinking also of the remainder of the floating debt outside the banking system—of all the liquid claims overbanging the economy—and that it is desirable to lengthen the life of the debt at any time when inflationary pressures are a danger. One might very well have the reverse conditions in which one wanted to defund as a matter of policy.

10046. Your emphasis is on the floating debt rather than on the debt which is being refunded annually?——Yes; but to lengthen the time structure of the national debt as a whole is part of the general funding policy.

10047. *Professor Sayers*: Would you limit that to circumstances in which the monetary system is in some sense out of control because the structure of the debt is too short, or would you under all circumstances be wanting to do that?——No; one would want to lengthen the debt when inflation was the danger. There is no harm in creating liquid claims on the economy if the economy itself is in a state of recession.

10048. *Chairman*: Giving that meaning to the systematic policy, you go on to recognise that you cannot make a systematic funding policy if confidence is lacking; no system can stand up against the lack of confidence?——No; although to what extent the lack of confidence is itself the result of the absence of a systematic funding policy would be another question.

10049. What would you say as a matter of comparatively recent history in regard to that point?——I think that there is a clear connection between the breakdown in confidence in gilt-edged last year and the fact that for many years previously bank deposits had either been expanded, or at any rate not reduced.

10050. *Professor Sayers*: Do you think that from 1951 to 1957 the pace of funding could have been raised by a different policy on the part of the authorities in pricing the debt?——Yes. The clearest case was the year 1954, when gilt-edged were booming. They reached a peak in November, 1954. It is clear that at that time the Treasury were not expanding the supply of long-term issues commensurately with the demand for them, much less trying to push their sales in order to reduce bank deposits.

10051. *Professor Cairncross*: That was a time when the Treasury was anxious to expand credit?——I think that in 1953 credit had been expanded as far as possible without danger; by 1954 the situation was already clearly inflationary, and I think that the policies in the second half of 1954 were rather misguided.

10052. *Professor Sayers*: The 1954 mistake having occurred, could the damage have been rectified to some extent in later years by a different funding policy, or had it gone too far?——Had the kind of measures that were taken last September been taken earlier, we might have had a short and sharp decline in gilt-edged which would then have found their floor; instead, they have been drifting downwards for several years.

10053. *Chairman*: Do you think that a long-term drift is the worst possible situation for the market?——It is very bad.

10054. *Professor Sayers*: Do you think the long-term drift itself had anything to do with the loss of confidence?——Yes, specifically in 1957. The level of prices at the beginning of the year was based on a fair measure of confidence that the general level of prices was going to be held. But I think that confidence was undermined, and that that accounts for the 16 per cent. further slide in gilt-edged prices during 1957.

10055. If, on this basis, the authorities adopted a more deliberate policy in altering the long-term rate, and instead of just selling when they could without damaging the market seriously, dropped the prices of long-term as deliberately as they change the Bank Rate, what would be the effect of that on the gilt-edged market?——We are thrown back on the concept of a norm of prices. If the market could take for granted that money in general was going to retain its value, then, by seriously depressing the market by funding sales, I think that the Government could put prices on a basis at which the market felt confidence that they were going to be maintained for some period ahead; but if doubts about the value of money begin to creep back again, the market's whole concept of the normal level of prices has to be revised to allow for a continuance of inflation.

10056. Would a step down in gilt-edged prices, that was known to have its origin in a decision on the part of the authorities that this was a step to be taken as part of an anti-inflation programme, of itself be damaging to confidence, or the reverse?——If it were part of a genuine anti-inflationary policy, which cannot be confined to the gilt-edged market, I think the effect on confidence would be good.

10057. *Chairman*: How much do you think the element of confidence you are speaking of depends upon a clear statement or statements by the authorities as to what they are doing in the market and why?——On the whole it is desirable that the market should feel that it knows what is in the authorities' minds, certainly; but the market has to make up its mind not only as to the policies being pursued but as to how much faith they can place in their success.

10058. *Professor Sayers*: On what sort of basis have you given this opinion as to the market's behaviour? Is this from your observation of market behaviour over a long period?——Yes; it is based on my general impression of what was happening last year, which I thought was confirmed by the Economic Survey's statement that it had proved impossible to prevent a large rise in bank deposits (which I take to be another way of saying that it was impossible to sell long-term securities).

10059. *Professor Cairncross*: In the last ten years the quantity of money has not risen as much as the national debt, but substantially less. You lay emphasis on the big increase in the quantity of money, but it has not all been in bank deposits?——No. Bank deposits have risen only about 8 per cent. over that period. As I say, I feel that in 1951, after the inflation which we had had, the quantity of money ought to have been reduced.

10060. Have you any idea when one could judge whether the quantity of money had been reduced sufficiently?——By the state of the economy.

10061. Do you think that a further compression of the supply of money would have put a stop to inflation?——Yes, I think that is bound to happen, unless confidence is so poor that one has a galloping inflation of the German type. Early compression of the money stock in 1951-52 would probably have restored the situation and prevented a great deal of the inflation that has since gone on.

10062. Do you mean restored the situation in the economy, or the monetary authority's control over the money supply?——It would have made it possible to maintain the stability of the value of money.

10063. There was a great deal of liquidity in the system in 1947-48, and that, to some extent, was outside the banking system altogether. Liquidity has not really diminished so enormously, even although interest rates have been pushed up and banks have come up against more pressure. Is there not still a great deal of slack and play in the system, so long as people are convinced prices are going to go on rising?——Yes.

10064. It might then be necessary to make quite a substantial reduction in quantity to overcome that?——Yes. It is really impossible to estimate; one just has to reduce the supply of money and see what happens. But for some years I was convinced that, if one could have drained off £500 million of money out of the banks, that would probably have brought us within sight of stable money.

10065. May I ask you about the power of the Government, the monetary authorities, to control the supply of money? From the figures you give it would seem that in most years the banks had liquid reserves in excess of 30 per cent.?——Yes.

10066. What would you say was the principal reason why the ratio did not fall to 30 per cent.?——Advances have been continuously controlled throughout that time, so that the only other assets the banks could have got would have been investments. No doubt they had good reasons for not buying investments on a scale that would have brought the liquidity ratio down to the minimum.

10067. But those reasons were fundamentally the same kind of reasons as may have made funding rather difficult. It is rather difficult for the Bank to sell long-term Government bonds when everybody thinks inflation is going to continue?——Yes; but I think there are differences as well as similarities between the approach of the banks and the public. The public is concerned with maintaining its capital in real terms; the banks have liabilities in money terms, and necessarily have a different approach.

10068. You mentioned that advances have been restricted by Government directives; would you say that that was an important factor limiting the growth of advances in the period up to 1955? I had the impression that a great many firms approached during the period 1953-55 were very reluctant to increase their overdrafts?——I find it difficult to answer that hypothetical question. I know that during that period the proportion of personal lending was falling. I do not think that it would have happened to the same extent in the absence of directives.

10069. *Professor Sayers*: This is before 1955?——Yes, and it is the tendency today; it is the personal borrower who has borne the brunt of the directives.

10070. *Professor Cairncross*: You would not think that business has been nearly so much affected by these directives?——I would not think so; but the ratio of bank advances to national income or to total bank deposits is abnormally low, if we take the norm to be the pre-war situation. One could take the fact that advances have fallen in relation to incomes, especially since 1951, as to some extent a measure of the effect of directives.

10071. When you speak of measures to fund enabling the monetary authorities to control the money supply more successfully, you are thinking primarily of Treasury Bills?——Yes.

10072. Would it be your view that, if the Government were successful in pursuing a funding policy that would reduce substantially the floating debt held by the banks, that would by itself dispose the banks not to increase their other assets?——If we are working to a conventional minimum that must be so.

10073. I was assuming for the moment that the convention was not too firmly established?——Banking views may differ, but in my mind 30 per cent. is very much of a minimum.

10074. Is this true even when the remaining assets that are held are increasingly under-five-year bonds?——I think it is a pure accounting convention, in fact.

10075. You do not feel that the banks themselves will have to make a change, in view of the fact that they now hold large amounts of Government bonds of very short maturity to give them adequate protection?——Yes; if the banks hold a large number of bonds maturing in a few months time, they are equivalent to bills, and I should have thought that that was the kind of situation the central bank might not leave to the banks themselves. I would have thought that that would be a proper subject for the central bank.

10076. *Professor Sayers*: To intervene in what sense?——In the sense of telling the banks that one does not treat bonds as liquid assets for this sort of purpose, and that, if one has a lot of very short bonds, nevertheless 30 per cent. would be a reasonable figure of actual liquid assets.

10077. In these circumstances you believe that the 30 per cent. minimum would have to depend upon the central bank's statements, and not be left to depend upon the banking instincts of the commercial banks?——I think so, having in mind that the mere figure of 30 per cent. does not give a measure of the true liquidity of the banks at all times. In 1955, for example, one or two banks went below, probably in the knowledge that some of their lending to nationalised industry was going to mature.

10078. *Professor Cairncross*: In that sense you make the 30 per cent. mandatory, and the Government would therefore be able to get away with rather less funding than it would otherwise require?——Yes; the object of the 30 per cent. being to fix bank deposits. That is the magnitude on which one really has one's eye.

10079. *Professor Sayers*: Correspondingly one could fix 35 per cent. in order to reduce the amount of funding at the present time?——In principle one could, yes. I would have thought that a change of that nature would rather indicate an intention to abuse the issue of Treasury Bills.

10080. Would you not use the same argument to support the central bank's intervention to insist on the 30 per cent.?——No; 30 per cent. has some kind of history behind it. That became established out of the action of the banks themselves, and is on a different footing.

10081. *Professor Cairncross*: When it became established most of the liquid assets of the banks were not Treasury Bills, but commercial bills, if it has an early nineteenth century background?——I doubt whether it has a nineteenth century background, because then we had many more than five banks. I think the only relevant period is the inter-war period, when the amalgamation movement had ceased and we had the same small number of institutions as now.

10082. It has its origin in the size of the floating debt that has existed in this country in the past, and in the distribution of the floating debt between banks and non-bank holders, quite as much as in banking?——Some bankers feel that it is merely the converse of the fact that they would not like their non-liquid assets to be much more than 70 per cent.

10083. *Mr. Jones*: What would have been the effect of the use of Treasury Deposit Receipts instead of Treasury Bills in this particular field during the period you are talking about? Treasury Deposit Receipts have no liquidity about them. How would that have helped the position you are arguing in this particular paper?——Treasury Deposit Receipts could be used to mop up a surplus of bank liquid assets to whatever was required to make them conform to the 30 per cent. convention; but I think the real problem has been to reduce deposits. I do not think that one could use the Treasury Deposit Receipt system so to compress the liquid assets of the bank that they would have to sell other assets. That would not be a very good means of achieving the object I think is necessary: namely, to reduce deposits.

10084. *Professor Cairncross*: Do you think it would be possible to create a bigger market for Treasury Bills outside the banking system?——Yes. That market has in fact increased in recent years. There have been periods when we have seen lots of firms going in for Treasury Bills on a large scale; and in the United States 85 per cent. of the total issues are held outside the banks, so clearly there is some scope.

10085. *Chairman*: But what institutional measure would you adopt in order to bring that about and keep it about?——I do not think I could suggest one. The securities would have to be attractive on their own merits.

10086. It must depend for the outsider on the yield on those as compared with some other use of his money?——Yes; to interest on deposit accounts.

10087. It seems to be a question of being competitive. Is there nothing one could set on foot that would maintain a permanently satisfactory relationship between the two?——I would think not. The relation between the deposit rate and the Bank Rate also has some history and tradition behind it. I do not think that one could vary that margin in order to vary the yield differential between Treasury Bills and the deposit accounts of banks.

10088. *Professor Cairncross*: Do you think it is possible that Treasury Bills might be more attractive if they were sold in smaller lots?——Possibly, although I would hope that not too many short-dated assets of this kind would be placed in the hands of the public. I would not consider that a desirable object of policy.

10089. *Professor Sayers*: What would be the objection to the public sale of these rather than bank deposits?——None. They are very much the same thing, and very

little is achieved by getting the public to switch from bank deposits into Treasury Bills; the switch should be into something longer.

10090. It compresses the liquid assets held by the banks?——Quite, if we are bound to have that amount of Treasury Bills in existence.

10091. *Professor Cairncross*: Is it not an alternative to funding?——Not to genuine funding.

10092. In its repercussions on the monetary supply?——Only if the liquid assets are switched from banks to the extent that they have to tip out other assets. In practice, that means investment.

10093. From the public's point of view there is very little difference; from the point of view of the banks, if they part with some of their Treasury Bills they are obliged to take action as long as they stick to the 30 per cent. convention?——If they were already at the minimum, yes; but the important thing then is the sale of bonds by banks to the public in exchange for bank deposits.

10094. *Professor Sayers*: The Americans have a system whereby a person who is not in close touch with the market from day to day can tender for a limited amount of Treasury Bills on the basis that he will get them allotted at the average rate established by the competitive bid. It means that a man is guaranteed his allotment for the limited amount, but takes either a high rate or a low rate according to how the market is tendering. Would that system, which is very popular in New York, have any sort of effect here?——It would result in the removal of a certain element of risk, no doubt.

10095. You propose that for dealing with circumstances in which there is a serious loss of confidence in the gilt-edged market the Government should have power to issue index bonds. Have you studied the experience of other countries with these? Which other countries have them?——Austria; Israel, I believe, is making good use of linked debentures; Finland; and France. I have not studied this, because I am much more interested in the general principle than in the details of such a measure.

10096. *Chairman*: If we started an issue of index bonds, would there have to be an option given to all existing holders of Government securities to change over to index bonds?——Yes; I think that if one did not want a convulsion in the gilt-edged market it would be necessary to give that option.

10097. That would be a very sweeping alteration in the standard of the Government's liabilities?——It would, yes.

10098. *Professor Sayers*: Why would there be a convulsion?——If this were done at a time when confidence was very low, one would expect very heavy selling of conventional securities to take advantage of it.

10099. If they were instituted in calm days, would there be any necessity then to give a general option?——Probably not, but then there would not be the same compelling reasons for issuing the index bonds.

10100. You are thinking in such circumstances simply of taking the powers?——Yes.

10101. Has the Government not the powers at present?——It may have; I was merely advocating that it should be considered as a course of action if confidence is low.

10102. *Chairman*: Do you think the existence of the power would itself have a stabilising effect and add to confidence?——No, rather the reverse.

10103. In other words, this kind of bond is quite frankly rather a desperate expedient, only to be done when one could not restore the market in any other way?——It is an expedient which would have been suitable in the circumstances of 1957, when the Economic Survey tells us that it was impossible to prevent an expansion of bank deposits.

10104. If this were an instrument to be resorted to only if it was unavoidable, I would have thought a measure, even in calm times, taking power to do this would have rather an unconfidence-making effect?——The taking of the power itself might be unsettling, but the actual issue would provide the authorities with resources that could be used to clean up the monetary situation.

10105. *Sir Reginald Verdon Smith*: What would the index relate to?——I had in mind the index of retail prices. I do not think that gold would probably be suitable here, as it is in France. The British public are not very conscious of the price of gold, but they are very conscious of the cost of living index.

10106. Would you not run the risk that you run in all cases where prices are pegged to an index, that it merely accelerates the rate of rise? As the index moved you would surely create not so much a condition of confidence but of further lack of confidence, and this would precipitate an inflationary movement? There might be some confidence in the index bonds; nevertheless would they not be a further pointer to an inflationary condition?——I am envisaging the initial issue as being taken up in sufficient volume to enable the Government to do the amount of funding that would be needed to eliminate the existing inflationary situation; one would hope that thereafter the Treasury would so conduct its finances that the stability of money would be reasonably assured.

10107. *Lord Harcourt*: It would be a once-for-all index bond issue?——Yes; one could not at frequent intervals give everybody the option to exchange out of existing securities into something entirely new.

10108. *Professor Sayers*: The attraction of this depends upon the assumption that the authorities could, by monetary measures, including this, stop the inflation?——Yes. I should say, subject to all the other reservations I made, that monetary measures are not the only thing; the Government's general policies have to be non-inflationary, and not merely their actions in the monetary field.

10109. If its general policy is non-inflationary, do you think it makes any difference whether or not its monetary policy is?——It makes some difference.

10110. *Professor Cairncross*: You mention the holders of conventional securities being given an option. Would you think that those who have deposits with the Post Office Savings Bank or Trustee Savings Banks, or National Savings Certificates, should equally be given similar options?——I see no reason why not. I think that it is purely habit on our part to assume that the saver has to bear the risk of inflation; I do not see why it should not also be applied to the savings securities.

10111. If we did this today, do you think the yield which would have to be offered on the market would be substantially less than the current yield?——I would not myself do it today, because the gilt-edged market has shown an incipient revival. I think that last year when things were at their worst they probably could have issued an index bond at a much lower nominal rate of interest than the rate on conventional bonds. The measure of that is this: Consols at the moment offer a gross yield of about 5 per cent., equivalent for a holder liable to the standard rate of tax to a net rate of 3 per cent. If inflation continues at a rate of 3 per cent. the real return would be nil. That is the extent to which the yield on the index bond could fall below that on a conventional security, if people are expecting a 3 per cent. inflation.

10112. You mean you could issue bonds at a nil return?——I think one probably could, because a lot of people merely wish to safeguard the real value of their capital, and have not been able to do so in Government securities for some time.

10113. *Mr. Woodcock*: Would the index provide for a fall as well as a rise?——It clearly should do; it would still serve the same purpose, which is to conserve the real value of one's capital.

10114. *Chairman*: In paragraph 16, having made your suggestion of index bonds, you say:

"Given an active funding policy, I believe that there should be no need for this expedient, nor for any of the other expedients adopted as crisis measures in recent years, and that other more normal instruments of monetary regulation need play no more than a supporting role. Stability would be preserved mainly by the maintenance of long-term rates of interest at an equilibrium level and not by manipulation of short-term rates."

What methods are to be used for that?——The systematic funding policy would maintain long-term rates.

10115. *Professor Sayers*: The Government would be selling at a price that kept the long-term rate stable?——We would get the long rate near to its equilibrium level.

10065. May I ask you about the power of the Government, the monetary authorities, to control the supply of money? From the figures you give it would seem that in most years the banks had liquid reserves in excess of 30 per cent.?——Yes.

10066. What would you say was the principal reason why the ratio did not fall to 30 per cent.?——Advances have been continuously controlled throughout that time, so that the only other assets the banks could have got would have been investments. No doubt they bad good reasons for not buying investments on a scale that would have brought the liquidity ratio down to the minimum.

10067. But those reasons were fundamentally the same kind of reasons as may have made funding rather difficult. It is rather difficult for the Bank to sell long-term Government bonds when everybody thinks inflation is going to continue?——Yes; but I think there are differences as well as similarities between the approach of the banks and the public. The public is concerned with maintaining its capital in real terms; the banks have liabilities in money terms, and necessarily have a different approach.

10068. You mentioned that advances have been restricted by Government directives; would you say that that was an important factor limiting the growth of advances in the period up to 1955? I had the impression that a great many firms approached during the period 1953-55 were very reluctant to increase their overdrafts?——I find it difficult to answer that hypothetical question. I know that during that period the proportion of personal lending was falling. I do not think that it would have happened to the same extent in the absence of directives.

10069. *Professor Sayers*: This is before 1955?——Yes, and it is the tendency today; it is the personal borrower who has borne the brunt of the directives.

10070. *Professor Cairncross*: You would not think that business has been nearly so much affected by these directives?——I would not think so; but the ratio of bank advances to national income or to total bank deposits is abnormally low, if we take the norm to be the pre-war situation. One could take the fact that advances have fallen in relation to incomes, especially since 1951, as to some extent a measure of the effect of directives.

10071. When you speak of measures to fund enabling the monetary authorities to control the money supply more successfully, you are thinking primarily of Treasury Bills?——Yes.

10072. Would it be your view that, if the Government were successful in pursuing a funding policy that would reduce substantially the floating debt held by the banks, that would by itself dispose the banks not to increase their other assets?——If we are working to a conventional minimum that must be so.

10073. I was assuming for the moment that the convention was not too firmly established?——Banking views may differ, but in my mind 30 per cent. is very much of a minimum.

10074. Is this true even when the remaining assets that are held are increasingly under-five-year bonds?——I think it is a pure accounting convention, in fact.

10075. You do not feel that the banks themselves will have to make a change, in view of the fact that they now hold large amounts of Government bonds of very short maturity to give them adequate protection?——Yes; if the banks hold a large number of bonds maturing in a few months time, they are equivalent to bills, and I should have thought that that was the kind of situation the central bank might not leave to the banks themselves. I would have thought that that would be a proper subject for the central bank.

10076. *Professor Sayers*: To intervene in what sense?——In the sense of telling the banks that one does not treat bonds as liquid assets for this sort of purpose, and that, if one has a lot of very short bonds, nevertheless 30 per cent. would be a reasonable figure of actual liquid assets.

10077. In these circumstances you believe that the 30 per cent. minimum would have to depend upon the central bank's statements, and not be left to depend upon the banking instincts of the commercial banks?——I think so, baving in mind that the mere figure of 30 per cent. does not give a measure of the true liquidity of the banks at all times. In 1955, for example, one or two banks went below, probably in the knowledge that some of their lending to nationalised industry was going to mature.

10078. *Professor Cairncross*: In that sense you make the 30 per cent. mandatory, and the Government would therefore be able to get away with rather less funding than it would otherwise require?——Yes; the object of the 30 per cent. being to fix bank deposits. That is the magnitude on which one really has one's eye.

10079. *Professor Sayers*: Correspondingly one could fix 35 per cent. in order to reduce the amount of funding at the present time?——In principle one could, yes. I would have thought that a change of that nature would rather indicate an intention to abuse the issue of Treasury Bills.

10080. Would you not use the same argument to support the central bank's intervention to insist on the 30 per cent.?——No; 30 per cent. has some kind of history behind it. That became established out of the action of the banks themselves, and is on a different footing.

10081. *Professor Cairncross*: When it became established most of the liquid assets of the banks were not Treasury Bills, but commercial bills, if it has an early nineteenth century background?——I doubt whether it has a nineteenth century background, because then we had many more than five banks. I think the only relevant period is the inter-war period, when the amalgamation movement had ceased and we had the same small number of institutions as now.

10082. It has its origin in the size of the floating debt that has existed in this country in the past, and in the distribution of the floating debt between banks and non-bank holders, quite as much as in banking?——Some bankers feel that it is merely the converse of the fact that they would not like their non-liquid assets to be much more than 70 per cent.

10083. *Mr. Jones*: What would have been the effect of the use of Treasury Deposit Receipts instead of Treasury Bills in this particular field during the period you are talking about? Treasury Deposit Receipts have no liquidity about them. How would that have helped the position you are arguing in this particular paper?——Treasury Deposit Receipts could be used to mop up a surplus of bank liquid assets to whatever was required to make them conform to the 30 per cent. convention; but I think the real problem has been to reduce deposits. I do not think that one could use the Treasury Deposit Receipt system so to compress the liquid assets of the bank that they would have to sell other assets. That would not be a very good means of achieving the object I think is necessary: namely, to reduce deposits.

10084. *Professor Cairncross*: Do you think it would be possible to create a bigger market for Treasury Bills outside the banking system?——Yes. That market has in fact increased in recent years. There have been periods when we have seen lots of firms going in for Treasury Bills on a large scale; and in the United States 85 per cent. of the total issues are held outside the banks, so clearly there is some scope.

10085. *Chairman*: But what institutional measure would you adopt in order to bring that about and keep it about?——I do not think I could suggest one. The securities would have to be attractive on their own merits.

10086. It must depend for the outsider on the yield on those as compared with some other use of his money?——Yes; to interest on deposit accounts.

10087. It seems to be a question of being competitive. Is there nothing one could set on foot that would maintain a permanently satisfactory relationship between the two?——I would think not. The relation between the deposit rate and the Bank Rate also has some history and tradition behind it. I do not think that one could vary that margin in order to vary the yield differential between Treasury Bills and the deposit accounts of banks.

10088. *Professor Cairncross*: Do you think it is possible that Treasury Bills might be more attractive if they were sold in smaller lots?——Possibly, although I would hope that not too many short-dated assets of this kind would be placed in the hands of the public. I would not consider that a desirable object of policy.

10089. *Professor Sayers*: What would be the objection to the public sale of these rather than bank deposits?——None. They are very much the same thing, and very

little is achieved by getting the public to switch from bank deposits into Treasury Bills; the switch should be into something longer.

10090. It compresses the liquid assets held by the banks?——Quite, if we are bound to have that amount of Treasury Bills in existence.

10091. *Professor Cairncross*: Is it not an alternative to funding?——Not to genuine funding.

10092. In its repercussions on the monetary supply?——Only if the liquid assets are switched from banks to the extent that they have to tip out other assets. In practice, that means investment.

10093. From the public's point of view there is very little difference; from the point of view of the banks, if they part with some of their Treasury Bills they are obliged to take action as long as they stick to the 30 per cent. convention?——If they were already at the minimum, yes; but the important thing then is the sale of bonds by banks to the public in exchange for bank deposits.

10094. *Professor Sayers*: The Americans have a system whereby a person who is not in close touch with the market from day to day can tender for a limited amount of Treasury Bills on the basis that he will get them allotted at the average rate established by the competitive bid. It means that a man is guaranteed his allotment for the limited amount, but takes either a high rate or a low rate according to how the market is tendering. Would that system, which is very popular in New York, have any sort of effect here?——It would result in the removal of a certain element of risk, no doubt.

10095. You propose that for dealing with circumstances in which there is a serious loss of confidence in the gilt-edged market the Government should have power to issue index bonds. Have you studied the experience of other countries with these? Which other countries have them?——Austria; Israel, I believe, is making good use of linked debentures; Finland; and France. I have not studied this, because I am much more interested in the general principle than in the details of such a measure.

10096. *Chairman*: If we started an issue of index bonds, would there have to be an option given to all existing holders of Government securities to change over to index bonds?——Yes; I think that if one did not want a convulsion in the gilt-edged market it would be necessary to give that option.

10097. That would be a very sweeping alteration in the standard of the Government's liabilities?——It would, yes.

10098. *Professor Sayers*: Why would there be a convulsion?——If this were done at a time when confidence was very low, one would expect very heavy selling of conventional securities to take advantage of it.

10099. If they were instituted in calm days, would there be any necessity then to give a general option?——Probably not, but then there would not be the same compelling reasons for issuing the index bonds.

10100. You are thinking in such circumstances simply of taking the powers?——Yes.

10101. Has the Government not the powers at present?——It may have; I was merely advocating that it should be considered as a course of action if confidence is low.

10102. *Chairman*: Do you think the existence of the power would itself have a stabilising effect and add to confidence?——No, rather the reverse.

10103. In other words, this kind of bond is quite frankly rather a desperate expedient, only to be done when one could not restore the market in any other way?——It is an expedient which would have been suitable in the circumstances of 1957, when the Economic Survey tells us that it was impossible to prevent an expansion of bank deposits.

10104. If this were an instrument to be resorted to only if it was unavoidable, I would have thought a measure, even in calm times, taking power to do this would have rather an unconfidence-making effect?——The taking of the power itself might be unsettling, but the actual issue would provide the authorities with resources that could be used to clean up the monetary situation.

10105. *Sir Reginald Verdon Smith*: What would the index relate to?——I had in mind the index of retail prices. I do not think that gold would probably be suitable here, as it is in France. The British public are not very conscious of the price of gold, but they are very conscious of the cost of living index.

10106. Would you not run the risk that you run in all cases where prices are pegged to an index, that it merely accelerates the rate of rise? As the index moved you would surely create not so much a condition of confidence but of further lack of confidence, and this would precipitate an inflationary movement? There might be some confidence in the index bonds; nevertheless would they not be a further pointer to an inflationary condition?——I am envisaging the initial issue as being taken up in sufficient volume to enable the Government to do the amount of funding that would be needed to eliminate the existing inflationary situation; one would hope that thereafter the Treasury would so conduct its finances that the stability of money would be reasonably assured.

10107. *Lord Harcourt*: It would be a once-for-all index bond issue?——Yes; one could not at frequent intervals give everybody the option to exchange out of existing securities into something entirely new.

10108. *Professor Sayers*: The attraction of this depends upon the assumption that the authorities could, by monetary measures, including this, stop the inflation?——Yes. I should say, subject to all the other reservations I made, that monetary measures are not the only thing; the Government's general policies have to be non-inflationary, and not merely their actions in the monetary field.

10109. If its general policy is non-inflationary, do you think it makes any difference whether or not its monetary policy is?——It makes some difference.

10110. *Professor Cairncross*: You mention the holders of conventional securities being given an option. Would you think that those who have deposits with the Post Office Savings Bank or Trustee Savings Banks, or National Savings Certificates, should equally be given similar options?——I see no reason why not. I think that it is purely habit on our part to assume that the saver has to bear the risk of inflation; I do not see why it should not also be applied to the savings securities.

10111. If we did this today, do you think the yield which would have to be offered on the market would be substantially less than the current yield?——I would not myself do it today, because the gilt-edged market has shown an incipient revival. I think that last year when things were at their worst they probably could have issued an index bond at a much lower nominal rate of interest than the rate on conventional bonds. The measure of that is this: Consols at the moment offer a gross yield of about 5 per cent., equivalent for a holder liable to the standard rate of tax to a net rate of 3 per cent. If inflation continues at a rate of 3 per cent. the real return would be nil. That is the extent to which the yield on the index bond could fall below that on a conventional security, if people are expecting a 3 per cent. inflation.

10112. You mean you could issue bonds at a nil return?——I think one probably could, because a lot of people merely wish to safeguard the real value of their capital, and have not been able to do so in Government securities for some time.

10113. *Mr. Woodcock*: Would the index provide for a fall as well as a rise?——It clearly should do; it would still serve the same purpose, which is to conserve the real value of one's capital.

10114. *Chairman*: In paragraph 16, having made your suggestion of index bonds, you say:

> "Given an active funding policy, I believe that there should be no need for this expedient, nor for any of the other expedients adopted as crisis measures in recent years, and that other more normal instruments of monetary regulation need play no more than a supporting role. Stability would be preserved mainly by the maintenance of long-term rates of interest at an equilibrium level and not by manipulation of short-term rates."

What methods are to be used for that?——The systematic funding policy would maintain long-term rates.

10115. *Professor Sayers*: The Government would be selling at a price that kept the long-term rate stable?——We would get the long rate near to its equilibrium level.

10116. *Professor Cairncross*: That level might change at some time; how would you allow it to change in the conditions in which long-term rates were being maintained?——If it became evident that inflationary pressures were welling up, as in the second half of 1954, the Government broker would then have to sell heavily; he would have to throw securities on the market.

10117. *Chairman*: In your experience of watching the market, are you satisfied that that is feasible? He would be prepared to sacrifice the current rate because he has a duty to keep on offering; but do you think he could find takers in gilt-edged bonds?——Yes; I think that, unless confidence in the value of money is seriously disturbed there is always a market for long-term securities.

10118. That means as much volume as is involved in current operations?——Yes; I think that the Government broker could place securities on a sufficient scale to bring about the kind of changes in the volume of bank deposits which are needed to have a steadying influence as a continuous process.

10119. *Professor Cairncross*: Are you envisaging continuous selling down or a break in the long-term rate?——In practice it cannot be literally week by week. When it is decided that the long-term rate is too low, then I think that heavy funding sales should be made in a short period, allowing the market to ground at some lower level and consolidate.

10120. It has been put to us that it is almost impossible to fund on a falling market; you do not accept that?——Yes, I do on the whole. I think it is difficult to fund on a falling market; that is why one's initial sales probably have to be so vigorous that the market is fairly certain that in the short run prices will not decline further.

10121. *Chairman*: It is difficult to conceive of that assurance arising in the market when an unknown but large volume of sales of Government securities is taking place, given your view that they have got to feel that they will have firm ground under their feet at a certain higher yield?——Yes, but if the alternative is distrust as to the value of money itself being maintained, then they cannot have that confidence at all.

10122. *Professor Sayers*: I notice all the time you are assuming that funding on a large scale is necessary because you want to keep the volume of money down, although you envisage the equilibrium as shifting. If, under pressure of the Government broker's sales, the market rate of interest rose to the level that you thought proper, would you worry about what happened to the volume of sales at that price, and therefore to the volume of bank deposits?——I should certainly worry about what happened to the volume of bank deposits.

10123. Would you worry about them in the very short run, as well as in the longer run?——Yes, I think so. I watch my own bank's index of net deposits month by month, and I do not like to see it go up.

10124. You would attach importance to the Government broker being able to continue these sales on an appropriate scale as he pushed the market down?——After he pushed the market down.

10125. So that you really do envisage a step down?——Yes; as a matter of technique it probably has to come to that. One has in mind that personal incomes are constantly accumulating and ought to be drained off.

10126. *Chairman*: In paragraph 20 you say that in the first six months of 1955 the banks succeeded in selling about £250 million gilt-edged over a period when the Government, according to figures we have, was a net seller of about £50 million. So they were both in the market on the same side. Have you any idea who were the takers of that volume of gilt-edged, on a falling market?——No, I am afraid I am not in touch with these actual operations.

10127. *Professor Sayers*: Do you remember whether you were surprised about the absorptive capacity of the market at that time?——Yes; but I think other people perhaps were more surprised than I was, because I always thought that at a price it was possible to sell securities. The volume of those sales was impressive from that point of view.

10128. *Chairman*: You would not think that that volume of absorption was caused by any peculiar circumstances in that part of 1955? Given reasonable confidence, do you think you could repeat such an operation year in and year out?——I would not expect there to be an extremely elastic market for the very short-term bonds which were the kind the banks were selling. What impressed me about the sale of £250 million was that the sales must all have been of pretty short-term bonds, and therefore, I would have thought, likely to appeal less to other holders than to the banks; and yet they were absorbed.

10129. *Professor Cairncross*: If, in the second half of 1955, the banks had been free to make advances as they chose on the basis on which they were making advances in earlier years, would it be your judgment that there would have been a substantial further increase in advances and a further sale of Government bonds by the banking system?——I do not think that advances would have fallen by 9 per cent.

10130. You are one of a rather limited group of people in the banks who are interested in general economic policy as well as in what is happening to the banks themselves. How do you seek to inform yourself about the intentions of the monetary authorities: by reading newspapers and talking to people, or are you able to go along to the Bank of England and see somebody there?——Until recently I have had no contact with the Bank of England.

10131. So that you rely largely on what you read in the newspapers?——On reading, together with contacts of various kinds in the academic and other worlds.

10132. Would you think it would be an advantage if economists serving with commercial banks had more contact with the Bank of England?——Yes, I would. In a good many other countries there is more contact than has existed here.

10133. Do you find it possible to have contact with the Treasury on an easier footing?——The Treasury gives public press conferences, many of which I attend.

10134. *Chairman*: You refer in paragraph 23 to gaps in the statistical field; you say that there are a few gaps you would like to see closed, as far as your own purposes as an observer of the monetary scene are concerned. Should we give full force to the word "few"? Do you find that, with the exceptions that you mention, the available data are satisfactory for your purposes?——Yes. The gaps I mentioned are those which I found to be rather important and frustrating. I do not believe a great deal is to be gained by prolific detail.

10135. *Professor Cairncross*: Some of the gaps which you find are quite far-reaching, especially in relation to Government debt?——Certainly; and I think that there I am in agreement with the National Institute of Economic and Social Research, who have, I understand, submitted a memorandum. The knowledge of what is the effective as distinct from the nominal debt is a really basic piece of information that we lack in trying to make intelligent interpretations.

10136. Do you find it possible to reach conclusions about the international position and the movements of overseas funds here?——For the purpose of my particular position I have the information there that I need.

10137. *Sir Oliver Franks*: In paragraph 21 you refer to selective controls: "an advances squeeze or hire purchase restrictions"; and you say that the water will find its way round, and that nothing except reducing the actual volume of the stream (in other words reducing bank deposits) in your view will have any real effect. By coincidence the Chairman showed me an article in today's "Financial Times" reporting some remarks by the President of the New York Federal Reserve Bank; he is reported as saying that "the supplementary use of some selective controls may prove useful at times in helping to achieve our goal of steady economic growth". It is difficult to know how far generalised controls in monetary policy and practice require to be backed up by selective measures; I suppose that the view that one takes on this question is very largely determined by the view one takes about the rigidities of the system, which prevent a market force set in action from penetrating. Taking our system as it is, and without thinking of any particular modifications that policy might bring about, do you think that we ought to be able to deal with moderate inflation or moderate deflation by general measures alone, or do you think that some selective controls may also be needed, and if so, which?——My personal view would be that overall quantitative controls would be sufficient. I know that

central banks have made use of selective controls; that is perfectly respectable, but I think myself the overall liquidity of the system is what really matters.

10138. I suppose the building society rate has a relative rigidity in relation to the movement of the Bank Rate and the other rates which always move with the Bank Rate, so that the market forces do not work through in that sector. No doubt the reason why the market forces do not completely work through is in the end a social decision that the building of homes should not be regulated in this way. Do you still feel that the existence of rigidities like that, affecting something which the price of money usually influences in an important way, does not prevent one attaining the desirable result by purely general measures of control?——No, I do not. To take the particular example of the building societies, I think the forces affecting the rest of the market do work through, with perhaps some time lag. Last year, for example, although the building societies were not raising their mortgage rates, they were rationing borrowers; that has much the same effect operationally in that sector as if their mortgage rates had moved in line with other long-term rates.

10139. *Chairman*: What limit would you give to the time lag? Do you think that these measures do work through and make their effect in the end? Will it not take too long for your purpose?——I can only say that my personal feeling about it is that these time lags are not very great; if, for example, Bank Rate had been maintained at 7 per cent. instead of being reduced recently, probably the building societies would have had to adjust their rates soon, and meanwhile they were in any case restricting their lending because they were not getting the resources.

10140. *Sir Oliver Franks*: Does that mean that you disagree with another view, which has been advanced both by the Bank of England and by the Treasury, that when monetary measures are called for by the state of the economy they should never be employed alone, but always as part of a package containing other measures? Are you saying that in your view it is not the case that a package is inevitably necessary to deal with inflation or deflation, and these generalised monetary measures are capable of dealing by themselves? Or are you not disagreeing with the Treasury and the Bank?——I am not disagreeing with them; I think monetary policy is only part of a general anti-inflationary policy. But the package cannot be limited to purely technical measures; there must be wider policies which are known to be opposed to inflation. It hinges on things like wages policy and that sort of thing.

10141. *Professor Sayers*: Do you think that it is possible to have a wage policy that slows down inflation, and that the base of the inflation is regulated therefore by other factors than the monetary conditions?——I do not think there would be any point in having a wages policy if one were injecting a large supply of money into the economy, with the result that wages would be bid up. Everything has to march together: wages policy, fiscal policy and monetary policy.

Chairman: Thank you very much, Mr. Manning Dacey, for your paper and for your help this afternoon.

(*Adjourned until Thursday, 17th July*, 1958, *at* 10.45 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-FIRST DAY

Thursday, 17th July, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The following witnesses, representing the Trades Union Congress, called and examined:

J. A. BIRCH, ESQ., Chairman, Economic Committee, T.U.C., General Secretary, Union of Shop Distributive and Allied Workers,

H. COLLISON, ESQ., Member, Economic Committee, T.U.C., General Secretary, National Union of Agricultural Workers,

L. MURRAY, ESQ., Secretary, Economic Committee, T.U.C,

F. JONES, ESQ., Assistant, Research Department, T.U.C.

10142. *Chairman*: I think we broke off at paragraph 24 of your memorandum last time*; perhaps we could look at it from paragraph 25. You concluded paragraph 26 by saying:

"We do not therefore see any objection to local authorities borrowing from the P.W.L.B. at rates of interest which reflect government policy rather than market rates."

That is preceded by the sentence:

"A curb on local authorities' capital expenditure could be exercised more fairly and effectively by direct Government control . . ."

What have you in mind there?——*Mr. Birch*: Our concern there is that the present system puts up the local authorities' costs so much. We see no reason in principle why the local authorities should pay a higher rate of interest than the central Government; the expenditure is determined by Government policy.

10143. Would that be based on a general view that the main activities which local authorities are engaged in carrying out are an expression of the central social policy of the Government of the day?——Yes; welfare services, housing, education and so on.

10144. Then we come on to nationalised industries in paragraph 27. You say:

"The advantages of [the current] arrangement appear to be considerable and we see no reason why it should not be made permanent. In our opinion it would be neither desirable nor practicable to force the nationalised industries to raise money in the capital market without the Treasury guarantee. The priority of the investment concerned would not be affected since this would continue to be at the discretion of the Government."

—*Sir Oliver Franks*: It could be argued that the need of the Government to borrow not only for its own purposes but for those of the local authorities and for the nationalised industries makes a total of borrowing demand wearing the Government stamp which is often greater than the market, in the way it ordinarily functions, can absorb; that this has meant, from time to time, that the Government has been driven to increasing the amount of Treasury Bills beyond what it would otherwise have done; and that, in proportion as that is true, it blunts all the instruments of credit policy, and therefore tends to make it necessary to extend the area of administrative direction and control beyond the extent to which it would otherwise have been required. That seems to me to raise a series of questions, which have importance and require argument; they are implied, I think, in what is said here, and I wondered what you thought about the argument when it was deployed at rather greater length?——*Mr. F. Jones*: First of all, we think that an important reason for taking over industry is to enlarge the sphere in which direct Government control is possible. We also recognise that the need to raise finance for the nationalised industries' investment programme enlarges the Government's own programme of borrowing and that this can be very hampering and can affect the amount of short term borrowing that the Government has to do. The point we have stressed in our evidence is that this may well mean that the Government should try to get an overall surplus, and so reduce the amount of borrowing that it has to undertake.

10145. You would look for a fiscal remedy?——Yes.

10146. *Chairman*: Somewhere in your paper do you not also envisage as another partial solution a pricing policy on the part of the industry that would put it in possession of a much larger proportion of its own funds needed for capital?——Yes, we do. We feel that this must depend upon circumstances; we have not said that there is one single principle which should determine the way the nationalised industries' programmes should be covered. It might be by increased prices, i.e. a levy on the consumer; or by an overall Budget surplus, i.e. a levy on the taxpayer; or it might be possible to raise money on the capital market on the guarantee of the Government.

10147. One then comes up against the question of what you think are the signposts which would lead you to choose one method rather than another? Could you give us any of your thinking on that?——*Mr. Birch*: It depends on the circumstances of the time. I do not think that one can generalise about this. The dominant fact is that the nationalised industries, in the main, cannot be self-financing; they must go to the market for their development. That is largely because of the control of prices which the Government exercises, apart from the market effect on prices. The extent to which private industry has financed its development from revenue has been much greater since the war than ever it was in the past. We have considered the implications of this for the question of general control, in the sense that obviously a much greater control can be exercised by the Government in relation to the public industries than to the private, particularly if the private industries' large area of monopoly can more or less determine pricing policy, in relation to what it thinks should be its future development programme. It may be a good thing in many cases; but it does obviously have an impact on our views about planning, in the sense that it would take out of the sphere of planning, to a large extent, very large areas of industry, if a decision on pricing were left to industry itself.

* See 34th Day, Qns. 8993 to 9139.

10148. *Professor Cairncross*: You have envisaged that the investment programme of non-nationalised industry should respond to a change in credit conditions. If credit is getting tighter, and rates of interest go up, that may of itself induce a nationalised industry to put forward a smaller programme of investment. You appear, however, to be thinking in terms in which the industry is told to limit or expand its investment. Are you thinking of autonomy, or are you thinking of control of the total volume of investment inside each industry?——We have that, to a large extent, within the nationalised industries. The railway programme is being determined very largely by Government policy, as to the extent to which it is developing. There is a direct control in relation to nationalised industries, but a very indirect one in the sense of general monetary policy, so far as the private industries are concerned.

10149. You could conceivably operate on a basis upon which each nationalised industry was free to decide for itself what its prices should be, and how much it should invest. That does not seem to be what you are arguing for here?——No. We want a long term plan of investment. We want balanced investment in the country, and we do not think that is likely to be arrived at if it is left to each industry, whether privately or publicly owned. We think, as we say later on, that we should have a much longer view of what are the intentions of industry, to see how they conform to the Government's views on policy, and to measure the probable impact on our resources.

10150. Would you have also to operate through prices to secure this result? It would be possible, for example, by allowing the railways to increase their fares and rates, to make them more receptive to the idea of an expanded programme?——If the railways are permitted to increase their charges for this purpose, there must be an assessment of the effect on public policy in other directions, on the costs of other industries, and so on. There is also the question of competition: the position of road transport, and so on, which may actually lead to a decrease in the total revenue of the railway industry. All those factors have got to be taken into consideration. I do not think, in any case, that publicly owned companies can be called a monopoly, in the sense that they can just go on increasing their prices without any limit at all and without having any effect on the general financial position of industry.

10151. You have an option between using financial weapons of control and administrative weapons of control. You can, if you like, allow each of your nationalised industries to respond to changes in credit conditions by changes in the prices they are going to charge which will allow them complete discretion on the shape and size of their programme; or you can intervene in ways that determine the total scale of the programme, and leave them to work out the composition. Finance here is inseparable from the system of control which you are thinking of. When you say at the end of your document that there are three different ways in which this can be provided, each of those has different implications?——*Mr. Murray*: This brings us back to the question of the signposts, which the Chairman raised earlier on. Our view is that the Government is in a much better position to read the signposts than any individual industry. It has a responsibility to bring about a balance, not only between the private sector and the public sector, but also between the nationalised industries themselves. As to signposts, there are so many. Mr. Birch has mentioned the prices side; there is the state of the market, and the general level of the economy. All these have to be taken into account. We think that the Government is in a better position to take a broad overall view of these indicators, and to act correspondingly by administrative direction to the particular nationalised industries.—*Mr. Collison*: I should have thought that it is fundamentally a question of top policy as to what the nationalised industries are required to do. They are providing a public service, which is a question of policy. If the policy envisages expansion to any degree, then the expansion has to be financed somehow. How it is financed will depend, I would imagine, upon the circumstances of the time. There are the three ways of doing it. If it is done through the market, by putting up prices, there is the question of increasing costs. In an inflationary situation one would have thought the fiscal approach was a much better one than the process of just increasing costs. But these things cannot be determined permanently. They can only be determined in accord with the situation at the time, and in accord with Government policy.

10152. There is a general question here, as to how to treat the relative claims of the public and private sectors in conditions in which there is pressure on real resources. It is very easy for the Government to get into a position where it meets the requirements of the public sector absolutely, and tries to meet them in full, so creating in the private sector a degree of congestion which results in inflation. In those circumstances something has to be worked out to limit the scale of the programme of the nationalised industries. Must they then to be put in a position in which each is constantly required by the Government to invest less than it would, of its own volition, wish to invest?——*Mr. F. Jones*: That may well happen. It depends, again, on the circumstances. I think you are suggesting that, if it were left to the nationalised industries concerned to decide their own investment programmes, they might take into account only what the market would bear, the strictly economic need and so on, and in that way put less pressure on resources than follows from the Government's own decision. It might work the other way. The Government might restrict public investment, because it is in the public sector that it has direct control. It might restrict public investment more, indeed, than private investment, because on the whole it has not got control over private investment. All the time we want to stress the public interest; we think that having these industries nationalised enables their investment programmes to be determined in relation to the public interest. Certainly the T.U.C. would not want to see the nationalised industries conducting their investment programmes without reference to the public need as laid down by the Government of the day.

10153. *Chairman*: The harmonising centre, which you envisage for this, is the National Investment Board?——*Mr. Birch*: We think that that should be an advisory body only. Obviously the responsibility must be the Government's and no one else's. What we envisage in the National Investment Board is a continuous supply of information on the recognised standards, which the National Investment Board itself would indicate as the basis of its calculations, forecasts and so on. But the decision either to accept a recommendation of the National Investment Board or to vary it would be entirely for the Government.

10154. This overall plan, to cover everything private and public, would be very difficult even for a Government to make?——Yes. It could not be done on the present basis of information. We have not got the long term forecasts of industrial investment. At the most industries give the Treasury their next twelve months' forecast of investment, which is hardly enough to do this kind of planning.

10155. *Sir John Woods*: Even on that basis, is there not some real administrative difficulty? Let us suppose that you had your National Investment Board, getting a great deal more information about investment plans from the private sector than the Government does now. I would have thought, from experience on both sides of the fence, so to speak, that although a great many firms have their formal investment plans running three, four or five years ahead, in fact when it comes to the point they change an enormous amount, and quite rapidly. Going through all these administrative procedures and getting advice from the National Investment Board, to come to the right decision, is there not a difficulty that they would be operating on what they thought was factual information, which by that time would be well out of date?——There must always be some flexibility in any plans; but one of the purposes of the exercise is to avoid the circumstances under which industry makes sudden changes in its investment programme. The very fact that there are these changes may be an indication of the lack of foresight which we are trying to avoid.

10156. They may, on the other hand, be due to circumstances entirely outside anybody's control, to a change in market conditions overseas, and so on?——That may be; that is why any plan has to have some flexibility about it. But merely to pose against the idea the fact that experience has shown that there are changes in the plans of industry with regard to investment may not be

conclusive, because you may be saying in effect that industry has fluctuated like this because of the lack of the very kind of thing that we are suggesting, and because there has not been an attempt to relate one industry's plans against another's, and get some general, overall perspective of what the economy is going to do in the next five or ten years.

10157. *Professor Cairncross*: You are not putting it to us that investment in the public sector has followed an even trend, and never had its own reverses?——I do not think that anyone would suggest that for one minute; but it is pretty generally known in the public sector what is needed for quite a way ahead. Most of the fluctuations which have taken place have been because of sudden changes in Government policy, as much as anything else.

10158. *Sir Oliver Franks*: Is not that in a way a criticism of the view you are putting forward?——*Mr. Murray*: I do not think so. We recognise that the investment programmes of the nationalised industries are more or less under the direct control of the Government, and we envisage that the sort of situation Sir John has referred to may be taken up by variations in the investment programmes of those industries. We do not imagine that this would produce a precise, smooth-running instrument, and settle investment programmes for all time. I do not think that it is a criticism, bearing in mind that one allows for these possible variations even within a balanced programme.

10159. *Mr. Woodcock*: One of your points is that the general level of investment would be affected by general factors?——*Mr. Murray*: Yes, indeed.—*Mr. Birch*: We go on from there to deduce that, if the general level of investment has to be changed, one cannot solve the problem by simply cutting the same amount off everybody. One has to decide where the impact of it should be registered to the greatest extent. That is one of the weaknesses of the monetary technique.

10160. *Professor Cairncross*: Is there not a difference between a system in which cuts are enforced from outside, and a system where assessments are made from day to day from inside? From the point of view of any one industry there is surely a very great difference between private ownership and public ownership?——*Mr. Murray*: We recognise that there is a difference, but we do not recognise that one way of settling it is better than the other.—*Mr. Birch*: One advantage of the monetary weapon for the politician is to be able to say that it is an act of God, as it were: "It is something that we have not initiated. Do not blame me for this. It is all following the natural law". It is a very convenient escape from responsibility in that sense. Perhaps that is putting it too high; but there is no doubt that, if there is to be Government planning, it has to be done in such a way as to get the reasonably willing co-operation of the people who are affected by it. If it cannot be done like that, then the alternative is to do it by act of God, as it were.

10161. *Chairman*: In paragraph 29 you open by saying:

"In our opinion the rates of interest on government borrowing are too high at the present time and should be brought down at the earliest opportunity."

What standards are you applying when you say that they are too high?——*Mr. F. Jones*: One of the things which worries us is the burden of interest upon the sterling balances held by foreigners. We wondered whether it was necessary to raise the Bank Rate to 7 per cent. last September, in order to achieve the effect the Government was after. Our argument in this paper is that on the whole it was not necessary and that the rate of interest which the Government is paying on sterling balances is higher than is necessary.—*Mr. Birch*: "At the present time", of course, refers to the date when this memorandum was submitted. I am not suggesting that everything is all right now, by any means; but that was at the peak of the 7 per cent.

10162. *Sir John Woods*: Are you saying, in respect of last September, that the necessary effect could have been obtained without the use of the Bank Rate, or that there is some other figure less than 7 per cent. which would have done the trick?——*Mr. Murray*: It is anybody's guess. We were talking about whether the necessary effect could have been achieved by 6 per cent., but we do not know. Perhaps for immediate effect on foreign holders it would have had to be 7 per cent., but we think that it was operating too long, for the reasons given by Mr. Jones.

10163. But it is anybody's guess, and 7 per cent. may be as good as 6 or 5?——*Mr. F. Jones*: We are reviewing a rather longer experience. We are reviewing the whole experience since 1951, when the monetary weapon was taken out of cold storage. There has been this general upward movement of interest rates, which we feel could have been avoided if more emphasis had been placed on fiscal policy rather than on monetary policy as such.

10164. *Professor Cairncross*: What standards do you apply to the long rate?——The upward movement of the short rates has had an effect upon the medium and long-term rates. Therefore, in wanting the short-term rates of interest to be brought down, we are also in favour of the medium and longer term rates going down. But we recognise that there may be circumstances in which that would not necessarily be a good thing, and in that case we feel that the Government would certainly not try to force down the medium and long-term rate.

10165. *Professor Sayers*: When you say that interest rates are too high, what is your standard? You seem in your last answers to have been saying that the rise in interest rates was wrong. That rise has been going on since 1947; at what point did the long-term interest rates become too high?——*Mr. F. Jones*: We would not look at it in that way. We would look at the overall pressure on resources, which had effects upon the internal price level, and of course upon external confidence, and we would say that the Government should have put more emphasis on fiscal policy, to avoid the need for pushing the Bank Rate up. When we say that the rates of interest on Government borrowing are too high, that follows from our view that fiscal policy should have been used to a greater extent.—*Mr. Birch*: We are not saying that the rate is too high at the present time, or that that necessitates anyone defining that interest rates should never be above a certain figure, or that 2½ or 3 per cent., or whatever it is, should be standard. Everything is relative to the other circumstances, and it was not our intention, in putting this in this way, to do it on the basis of some uniform standard which would always operate. There must be some movement, some flexibility; but one can only judge whether the rate is correct at any time by having regard to the circumstances of that time, and the other courses of action that might be open.

10166. Could I put your point this way: as the rate of interest rises certain disadvantages become greater, and at any given time there is a moment when the disadvantages become greater than the advantages?——Yes.

10167. And when you say: "too high at the present time" you mean?——That at that time the disadvantages were outweighing the advantages.

10168. *Professor Cairncross*: You lay stress at the end of paragraph 30 upon more direct contact between the Bank of England and the commercial banks. How do you think that this would facilitate Government control over banking credit?——*Mr. Birch*: We started off the document, if you remember, by questioning the relationship with the Bank of England and asking for more information. I think that this follows from that approach.—*Mr. F. Jones*: In order to reduce bank liquidity the Government operates through the discount market. We believe that, if the Government operated directly on the banks, it might be easier to secure Government control. The method of affecting bank liquidity recently announced by the Chancellor is the sort of direct approach to this problem that we envisage when we say that we believe that "more direct contact between the Bank of England and the banks would facilitate Government control over banking credit".

10169. *Sir Oliver Franks*: On a mere question of fact it does not seem to me to follow that, if the Government was borrowing direct from the commercial banks as opposed to borrowing *via* the discount market, that would carry with it any consequence about frequency and intimacy of personal contact. It might do, but the movement of money would, I think, be purely automatic between Treasurers' departments in the banks and the Chief Cashier of the Bank of England, whereas I think

what you had in mind when you spoke of contacts in the earlier part of the paper were contacts which were significant in relation to the interchange of views on policy. As a matter simply of fact the two do not necessarily march together.——*Mr. Birch*: We would accept that.

10170. *Chairman*: Do you attach much importance to the question of whether the discount market is there, carrying out all the services it does and taking the middle-man's turn? Is it a thing which appears to you to be of any major significance in the faults or oddities of our monetary system?——No, we do not want to make too much of it. The term "middle-man" in any sphere of activity has now almost become a term of abuse. We should not take that extreme view at all. There are obviously services which can be much better performed by someone who collects and distributes between the two sides; on the other hand, that does not mean that in every case the middle-man is performing the function that he originally did or was intended to do. There is a tendency to become a vested interest. That has to be recognised, and one has always to re-examine the situation as it develops. In the City, as in many other spheres, there are well-established classes, and so on; they may have been very well chosen at the time they were instituted, and they may be necessary today, but it is not right to assume that, because at one time they were correct, they are necessary for present day conditions.

10171. This is not a major element in your paper?——We would not elevate it to that.

10172. In paragraph 33 you say: "Apart from the banks, the main lending institutions are insurance companies, investment trusts, building societies and hire purchase finance houses." One of the suggestions you have in mind in the paragraph is that there should be vested in the monetary authorities a greater ability to influence the actions of these institutions by giving them legal power to require information from them and to issue directions to them. How far do you envisage a system like that as going? If you are dealing with pension funds and insurance companies, to take two examples, the use of their funds is directed by their needs to meet obligations over a long period of years to those to whom they incur liabilities; and insurance companies need to make a competitive profit for their stockholders out of the use of their funds. If you give a central authority power to issue directions to them as to the use of their funds, are you envisaging that it should extend to directing the type and volume of investment that they make?——We do not want to get down to the level of the investors themselves, whether they are investors in superannuation funds or insurance investments; but the actual institutions in which these investments are made are at the moment apparently more or less outside any control or even advice. I think that it is obvious that, if the Government is making a request to the banks in certain directions, these institutions should not depart from that policy in their own sphere merely because no request has been made to them direct. We should like to see some measure of conformity between their policy and the one that is being followed by the more traditional institutions, which are subject to Government advice and, to some extent, control.

10173. Let me put one or two concrete questions, to see how far it may go. A Government might take the view that an investment trust had been investing too much of its funds outside the country and not supporting internal investment to the extent that it thought appropriate; or it might take the view that one insurance company had been investing in equity shares rather than long-term gilt-edged, and that Government credit and long-term borrowing were needlessly being starved by that fact. Would you envisage that there should be power to pull the situation round by issuing directions in that field?——*Mr. F. Jones*: In so far as the Government should be determining the national interest, we think it should have an over-riding power. It can give directions to the banks. Certainly in an emergency we would think the Government should be able to influence directly the lending operations of financial institutions. We do not think that this power of the Government would be exercised frequently; indeed, it would be regarded as intolerable by the investment institutions themselves if they were instructed what proportion of their funds they should invest in equities and how far they should invest in gilt-edged. But we have in mind that in extreme circumstances the Government ought to have the power. It ought not to be in a position of not being able to influence financial operations of institutions which could gravely affect the country.

10174. I am assuming, of course, in all my questions that a Government believes that the actions it takes are in the public interest; but it happens very often in a democracy that there is great public debate as to whether any particular action is in the public interest or not. Would you envisage that if this power were given, and if the Government thought the situation was serious enough, there would in effect be no limit as to the direction or instruction they could give about these institutions' funds?——*Mr. F. Jones*: That is what we think. We also think that in practice it would not be necessary to direct; there is already an informal contact between the Bank of England and these institutions.——*Mr. Birch*: We qualify that suggestion when we say that the Government's powers to require information from them should be "similar to those which it already possesses with the banks". That is as far as we go.

10175. *Professor Cairncross*: In the case of the banks, it is negative: a ceiling is imposed on the use of funds in a particular direction. Is there not a distinction between saying to an insurance company: "You must not put more than so much into this", and saying: "You shall put such and such a proportion into gilt-edged"?——*Mr. F. Jones*: There is a difference, but we have not gone so far as that. Underlying our view here is the idea that the Government may want to say to the investment institutions that there is an important conversion operation or that there is to be a new issue, and it is very important that it should be supported, because of the effect on confidence abroad. In those circumstances the fact that the Government could give directions in the last resort would strengthen its hand. We agree that these powers could be very dangerous.

10176. *Chairman*: I will put it to you in a dangerous form. You are saying that the Government must have the legal power to marshal the available funds of the country in support of a Government issue, because otherwise these institutions might not be ready to use their funds in support of it. Is not that what it comes to?——*Mr. F. Jones*: We are saying that there might be circumstances in which the national interest would require that sort of Government influence.—*Mr. Birch*: I think it would be exceptional, because if the Government makes an issue on those terms obviously it has been guilty of some wrong calculations or mistiming in the first place.

10177. I do not mean that all these things are possible; but I want to see what the implications are. It is a forced loan in the form in which it is put?——*Mr. Birch*: The fact of the matter is that, although we do not see this being done at the moment, these institutions are in a position to frustrate the Government's policy in other directions. Even a negative control would prevent that. It might be more important if the Government was doing what we suggest, and taking a more active interest in control in other directions. Then the independence of these institutions might become more important than it is today.—*Mr. Collison*: We do not envisage that these directions would be used except in the case of extreme emergency, in which case the Government might have to do something anyway; but the proposition, as we look at it, is a simple one: if people know that powers of direction are there, then it can be brought to their consciousness that they have to pay some attention to the public interest as well as to their purely private sectional interest.

10178. Is not this rather like saying that, as long as you have a whip in your hands, you may not have to use it?——*Mr. Birch*: None of this is intended to imply that we think the first responsibility of the Government should not be to ensure that its policy is acceptable to the people who have to work it. I know there is a great danger, if it has powers, for that to become less important in its mind; but that is not our approach to it at all. There are issues on which there is a difference of opinion, as you have said, on what is the public interest. One would hope that those differences would be settled in a democratic way; as we have seen so often in our history right up to the present time, even people who do not agree altogether with the Government's definition of

public interest do not carry their opposition to the point of revolt, and that applies on all sides. But, in the final analysis, it must be the Government's will which prevails. The extent to which it has to be exercised by direct means is to some extent a measure of its failure in doing it in the proper way, by convincing people that this is right and has to be done. We are dealing with one particular aspect of Government policy here, and therefore we have not put this general background all the time, but it must be understood that it is in our minds.

10179. *Lord Harcourt*: You are talking about directions to insurance companies and pension funds, which have long-term contracts with a large number of people, and you envisage taking powers to direct their investments to the extent, as you have just said, of having in effect a forced Government loan. If that was repeated to the their long-term contracts, would you envisage it as the responsibility of the Government to take over those contracts?——That would only arise if the extent to which the Government used this materially affected the use by investment trusts and finance houses of pension funds and other securities invested with them. Over the long term a pension fund, when deciding to put a proportion of its funds into equities, either through an investment trust or, by some other means, will do it on the record of the investment trust or companies concerned and on its estimate for the future. We are not suggesting that the Government should get down to that level, and say: "You should not put money into that particular trust"; but they will judge what they will do with the funds in the light of the effect of these powers the Government has over the investment trust itself. It seems to me that you are going a stage further than we are. We are thinking of some advice and direction to the institution itself, not to the people who put their money into the institution. They would be affected only at the second remove, if Government advice or direction to the institution affected its activities in the future.

10180. That is not quite my point. An insurance company sells a contract on an assumed rate of interest; if your proposal got to the stage where the Government direction affected the rate of interest there, that would then make the insurance company unable to meet its obligation; it would have assumed on the obligation on the basis of a rate of interest which it would not be capable of earning owing to the direction. Is not that quite possible?——*Mr. Birch*: We admit that, if this was carried to that extent, there would be a legitimate ground for complaint on the part of the company. But nothing is envisaged here, in my view, knowing the cautious way in which insurance companies work and the number of times over that they cover their liabilities, that seems to us likely to cause that to arise.—*Mr. Collison*: There is the further point that a responsible Government would have to think before issuing such an instruction, even though they had power to do so.

10181. One consequence of taking powers of direction is that you must assume responsibilities for the results?——*Mr. Murray*: That is a fair point.—*Mr. Birch*: Yes.

10182. *Chairman*: Then we come to the National Investment Board, which we have mentioned already. In paragraph 36 you say:

"There is a danger of governments becoming so preoccupied with short-term changes in the economic situation that they fail to take the long-term view that is necessary if the nation's investment needs are to be met. Unless provision is specifically made for reviewing and co-ordinating all forms of capital expenditure there can be no guarantee that a balanced distribution of investment will be achieved."

—*Professor Cairncross*: How is this different from the kind of arrangement which used at least to exist inside the Government for reviewing investment in the ensuing years, where the programmes of the public sector were gone into one by one, and the probable level of investment in the private sector was also examined?——I think your use of the word "probable" there is the key to it. From what we can see at the present moment, in this field where it is most important that we should know where we are going, there is only a very rough and ready appreciation of what is likely to happen in the private sector. The less clear the Government is about what is happening in the private sector, the greater is the tendency for them to put the whole weight on the public sector. We want to try and get a balance on this, and at least try to get the two sides on to the same level of information and feasibility. We do not want to be dogmatic about this National Investment Board. There are grounds for suggesting that this ought to be a job for the Government itself. We have mentioned some of the points in paragraph 36 as to why it may be desirable to have an independent body looking at this in an advisory capacity. I think that it could have a greater possibility of continuity of information and standards; but, as I said earlier on, in the final result the standards adopted by the National Investment Board would presumably be part of its report. They would relate their forecasts and their information to certain standards which they had adopted in collecting and assessing it, and the Government would judge on the basis of both; it would not necessarily accept the standards. But even that would be an advance on the present position, because if the Government departed from the advice of the National Investment Board they would have to explain why, and to that extent there would be much greater public discussion of the circumstances and the policy questions involved.

10183. *Chairman*: You attach importance to making this a body outside the Government?——From the point of view of continuity I think it is important; but if it ever got to the stage when it was regarded as a supra-governmental body, then obviously it would be quite foreign to our ideas. Our experience of the working of independent bodies and commissions, including the one you are now presiding over, Mr. Chairman, has been that they have never assumed in this country those powers over governments which some people are afraid they might. They have been put into their proper place, and have performed an extremely useful purpose, very often doing something which the Government itself could not have done, that would have been much more suspect coming from a Government than from an independently constituted committee or commission.

10184. *Mr. Woodcock*: Does that include the Cohen Council?——I think that that is a perfect example, because the fears which people may have had of the Cohen Council being a supra-governmental organisation have been pretty effectively demolished, without detracting from the honesty of the people on it and the report that they wrote. It is still subject to public appraisal. The same would be true of the National Investment Board. One could expect in this particular field, where after all there are not the grounds for acute differences of opinion or for opinionated committees, because facts count for very much, that a National Investment Board could do a good job.

10185. *Professor Sayers*: You said that you thought that these bodies, when they are set up, tend to keep in their proper place. I accept that in general, but there are two examples which seem to me to be particularly apt here, where I wonder if their proper place did not rather quickly tend to become something less than Mr. Birch would have thought right. I am thinking about the Economic Advisory Council and the Economic Planning Board. Both of those, if I am right in my assessment of what happened, were pretty quickly submerged into the general governmental machine. How do you envisage a National Investment Board that would not suffer that fate and yet would be kept in its proper place? Is not this a very real constitutional problem?——*Mr. Birch*: Yes indeed. The Economic Planning Board is so much a part of the governmental machinery now that the public in general knows nothing about it. All its papers are strictly confidential and secret and all its discussions are private, whereas a National Investment Board would issue reports which would be available to the general public. It is very difficult to make comparisons. It is an extremely interesting piece of study, this whole question of commissions and committees. One of the difficulties about this National Investment Board is whether it would be able to have the power to collect information as an independent body. It might be thought that industry would be less anxious or willing to give the information to an independent body, even if it was created by the Government, than it would be to give it to the Treasury staff or to a Government department. That is one of the reasons why I said we were not dogmatic about it. But one thing we are completely seized of: the importance of getting this information somehow and presenting it in a factual way, so that we can get judgments of public policy in this field.—*Chairman*: There is the point

that, when this long-term work is done by commissions or committees and the report is made public, there is a value in it having been done and made public, even though it is not adopted, or if what is adopted is one dissenting opinion out of fourteen.

10186. *Professor Cairncross*: We ought to be absolutely clear about the functions of the National Investment Board. One assumes that it would have to decide on the total scale of investment, and how that was related to the capacity of the economy to stand it; and that is very much tied up again with monetary control and therefore with the Treasury and the Bank of England. You seem to imply in paragraph 36 that its function is more than merely studying the pattern of investment and the ways in which it should be financed; you use the word "co-ordinate" as well as "review". Co-ordination is an executive function, surely?——*Mr. Birch*: Yes. We were doing a comparison of the pattern of investment in Western Germany and the United Kingdom, and the figures are worth just mentioning. The excess of German investment over British was in such fields as iron and steel, engineering and metal goods, building materials, chemicals, non-ferrous metals. On the other hand, in the United Kingdom we did more on atomic energy and aircraft (which they are not allowed to do), motor vehicles, shipbuilding, and, very significantly, in consumer goods industries. There is obviously a lesson for the future in the greater attention paid to basic industries by the Germans and our greater attention to consumer goods industries. That may be some explanation of the trend of export markets and the competition we are meeting from Western Germany. That is the kind of thing which is finally for the Government to decide, but we would have thought that a National Investment Board, in discussing the pattern of investment, would certainly look more at what our competitors were doing and relate both the scale of investment and its pattern to the developments in other countries.—*Mr. Murray*: The Board's co-ordinating activities would consist in bringing to the Government its proposals for co-ordinating needs and resources; the Government itself would take the decision and do the co-ordinating in that sense, but the Board would produce a balanced and coherent set of proposals for the Government of the day to reject or modify.

10187. It would prepare a critical review, in other words; it would not take action, but would bring to the notice of the Government and the people any trends to which it attached importance?——*Mr. Murray*: Yes. —*Mr. F. Jones*: Mr. Birch was referring to a paper based on work done by Dr. Barna of the National Institute of Economic and Social Research, comparing investment in Western Germany and this country. He drew the conclusion that the investment pattern of Western Germany was better adapted to the changing trends of world trade than that in this country. This is the sort of thing which the National Investment Board could take up. They might say: "Is this really true?" and prepare a more detailed analysis. The National Investment Board could take a long-term view of investment.

10188. *Professor Sayers*: This is all critical review? ——Critical review, as well as collecting information.

10189. *Chairman*: On industrial finance you say in paragraph 40 that there may be a number of small firms which still find difficulty in obtaining equity capital. Have you any hard material on that?——*Mr. Birch*: That is really a general impression based on discussions with business people. We have no concrete evidence.

Chairman: Are there any more questions? Mr. Birch, thank you very much for coming back today. We are much obliged to you and your colleagues.——*Mr. Birch*: We are obliged to you, Sir, and we shall await your report with the greatest interest.

(Adjourned until Thursday, 24th July, 1958, at 10.45 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-SECOND DAY

Thursday, 24th July, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.

THE VISCOUNT HARCOURT, K.C.M.G., O.B.B.

W. E. JONES, ESQ., O.B.E.

GEORGE WOODCOCK, ESQ., C.B.E.

SIR JOHN WOODS, G.C.B., M.V.O.

MR. R. T. ARMSTRONG, *Secretary*

MR. G. PENRICE, *Statistical Adviser*

PROFESSOR L. C. ROBBINS, C.B., F.B.A., Professor of Economics, University of London, called and examined.

10190. *Chairman*: Good morning, Professor Robbins. We have all read your memorandum*, for which we are very much obliged; there are a number of points on which we should like you to enlarge upon those ideas you have expressed, and questions will come from any of us who want to come into action. Would you first underline one thing that you say in paragraph 14? Two contrasting arguments lead up to that point: one is on the benefits of gradual inflation, if it can he treated as gradual, as at any rate stimulating the accumulation of funds in the hands of industry and husiness; on the other hand you notice the arguments hearing upon its disruptive effects upon money contracts. You say that these arguments in favour of slow inflation assume that the inflation is not expected and that there is something of a lag hefore people become aware of what is happening; otherwise everything goes wrong. In your view is it possible to escape from this dilemma, that, once inflation becomes recognised and it is acknowledged that there will be a gradual reduction over the years in the purchasing power of money, the long term contract fixed in terms of money becomes unattractive?——*Professor Robbins*: I can think of various devices which would mitigate the effect for certain classes of the community. But I cannot help thinking that the more it was realised the more the results which it was intended to achieve would be frustrated. I was very impressed a few years ago when I spent the summer in Brazil, which is a country which has enjoyed something like secular inflation. The rate of discount on first class paper was in the neighhourhood of 12 per cent.; on second-class paper or anything inferior to that it could easily go up to 25 per cent. The whole life of the community had gradually adjusted itself to the expectation of a depreciated standard. I had an interview with the manager of one of the state undertakings who always found himself in the red and I said to him: "Why is this? Surely you are all powerful. Surely you can adjust your rates to take account of the prospective increase in costs?" He informed me that he had to spend a great deal of time in Rio (he was resident elsewhere) lohbying Memhers of Parliament in order to make it possihle for Ministers to acquiesce about six months too late in the upward adjustment of his schedules. That is very typical of something that was going on there all along the line. The whole public utility apparatus was waterlogged with inflation. One felt there was really no end to it. That was a comparatively moderate example. If people expect that the inflation will accelerate to keep pace with difficulties of this sort, then it turns into what we sometimes call hyper-inflation when the bottom drops out altogether.

10191. *Professor Cairncross*: In Brazil is it not the case that the national income has increased very rapidly in spite of progressive inflation?——Yes, but I suspect that it would have increased as rapidly, and that future progress would have been more solidly based, if the behaviour of the price level had approximated more, say, to the Canadian model.

10192. At the hack of my mind was the question whether investment would hold up if the inflation ceased?——I have very little doubt that, if one put the hrake on to an inflationary movement of that sort, for the time heing one would get a pretty bad jam. I should not expect that for two or three years while things sorted themselves out production would go on increasing, any more than if a man had a serious surgical operation in order eventually to facilitate his movement I should expect him to be ahle to walk as soon as he came out of the operating room.

10193. You would expect this to be an interruption, at the end of which investment would regain the previous level?——That puts it very precisely. I would not expect the rate of investment over the years to be seriously damaged hy the abandonment of habits of this sort, and I should expect that in other ways the economy would be strengthend. If I go back to the Brazilian case again, it was very plain that there was a great deal of misdirection of investment. The people who had hecome aware of what was going on were speculating on a stupendous scale in real estate development, and it was not at all clear to me that the good health of the Brazilian economy was best forwarded by the ceaseless erection of skyscraper apartment dwellings by the Copacabana Beaches.

10194. What would you pick on in the progressive inflation that we have had over the last twenty years as having heen most damaging to the economy?——First and foremost halance of payments difficulties.

10195. That would arise because of more rapid inflation here than abroad; have we had more rapid inflation here than abroad?——More rapid inflation here than in some places abroad; at any rate more rapid inflation here at particular times than was conducive to balance of payments equilibrium. It is a long time since the war and there have been different rates of change at different times. Speaking generally, I am clear that, if the brakes had been on ever so slightly more, our position would have been better.

10196. None the less the balance of payments position is a great deal more favourahle than before the war, so that these difficulties have been recurrent but have not been continuous?——The balance of payments depends upon the changing pattern of needs; for various reasons it had to be more favourable than it was before the war. The difficulty is that there has heen a shortfall of, let us say, 10 per cent. No one would deny that the improvement in exports has been quite spectacular. When you and I used to make computations of the future halance of payments during the war years, if anybody had come to us and suggested that exports would be as favourahle as they have been, we should have suggested that he should be transferred to another office. The trouhle is that up till recently it has not been favourable enough.

10197. *Chairman*: The point you are dwelling upon in this passage is that, when continuing inflation hecomes

* Memoranda of Evidence Part XIII No. 33.

accepted as a desirable policy, there is a climatic change in the approach towards anything like long term lending of money. What is the status of long term lending in Brazil in the climate you are speaking of? Is it protected by an index?——Not that I know of; but I am a very unreliable witness on these details.

10198. *Professor Cairncross*: Your emphasis is on the progressive upward movement of interest rates as people catch on to the progress of inflation, rather than on the failure of savings to come forward? It would be difficult to argue that savings have fallen off during the last inflationary period?——Very difficult; but all these things are relative. If interest rates move upward, that means that that movement has been necessary to equate supply and demand; so savings have not been as great as they need to have been to keep interest rates from rising. Surely this is based on an extremely simple principle of rational action: if prices are rising at 5 per cent. per annum and the rate of return on long term bonds is 5 per cent., I am lending to the Government at a zero rate of interest.

10199. *Chairman*: Would you say that there is a considerable time lag in the appreciation of that simple truth?——Certainly; one can take advantage of popular ignorance, particularly in a community as smug as ours, for years and years; but eventually the Church of England and the learned societies tumble to it, and then there is a landslide. That is, roughly speaking, what was happening two years ago and last year.

10200. *Professor Cairncross*: Could I take you from that to a more general question about the nature of the world we are living in? I get the impression, particularly from paragraph 63, that you are assuming that we have to face for the next few decades at least, an inflationary bias in the world at large. Is it your view that we have to face continuing pressure on savings and on capital resources, or are you looking to a world in which there may be periodic interruptions of substantial dimensions to the process of capital accumulation?——This paragraph was intended to convey a spot of comfort after the rather severe prescriptions of preceding paragraphs. I was simply asking myself the question whether the task of maintaining reasonable international equilibrium was going to be particularly difficult for the authorities in this country. In that context I suggested that it was reasonable to assume that there would be a general upward tendency in prices throughout the world. If you press for my reasons why, I must fall back on a variety of reasons. I am still inclined to think that in the world at large there is very considerable capital scarcity, using the word in a very loose sense. I also think, whatever happens in this country, so far as the United States is concerned there is probably for some years to come at any rate the prospect of cost inflation; my diagnosis of the U.S. position is rather different from my diagnosis of U.K. position and I would expect the tendency of things to be upward in the United States for that reason. But from the point of view of the objective of paragraph 63 it does not very much matter; if there is a general inflationary tendency in the world at large, then it is easier for us to do these things by a very slight application of the brakes here.

10201. If you make this assumption does it not also affect domestic monetary policy as well? If we are in a world where other countries are inflating, and monetary policy has to be attuned to general inflation, it may have effects that are different from what one could expect of it in a deflationary world?——Surely.

10202. Your expectation is that we have to adjust ourselves at home as well as on the external side to continuing inflation elsewhere?——I would not put it in quite that way. I would say that the prospects of the next two decades may present us with the sort of opportunity which we have had but have frequently neglected since 1948-49; a state of affairs where there is a general upward tendency in which it is much easier for us to keep in equilibrium, provided that we exercise a very moderate degree of financial virtue.

10203. In other words marginal adjustments may be sufficient?——Yes.

10204. But in a different kind of world there might be abrupt and sudden changes in the desire to invest, that would be difficult to control by monetary techniques?——In a world in which the tendency was the reverse, I should expect that in our institutional circumstances we might have to resort to some extremely unorthodox measures.

10205. Your paper centres very exclusively on monetary techniques; you do not even raise, I think, the possibility of use of the Budget, or of direct controls, which one would assume to be to some extent alternative and to some extent complementary?——With great respect you have got me wrong. In paragraph 68 I thought I had taken emphatic care to safeguard that flank. It seemed to me that this paper was too long already, and that the main business of this Committee was monetary policy as such.

10206. But there may be issues as to how effective monetary policy is by itself. Did you not leave it a little open how far you would wish to see monetary techniques used when these alternatives existed?——It was not spun out, but in the third sentence I say:

"It is well known that, at certain stages of economic depression, a very substantial increase of money supply may be inadequate to promote an immediate increase of spending. Similarly, in circumstances of acute capital shortage, it may well be felt that to attempt to control the situation solely by limitation of the credit base may result in a level of interest rates which, for reasons of public finance, may be undesirable."

I hold this view very strongly. My conception of stabilization measures is essentially eclectic. If in any publications in recent years I have emphasised the desirability of monetary policy, that is simply, so to speak, leaning to the side of the boat which seemed to me to be most out of balance. I think that, when during the war in the context of the discussions of employment policy we started to consider the means of stabilisation, most of us tended to overlook monetary policy; if you recollect the White Paper on Full Employment, the part on monetary policy, although in fact it was drafted chiefly by Lord Keynes, was feeble in the extreme. On the whole, monetary policy has had a much less enthusiastic press than other instruments. But if you were asking for a rounded view of the totality of expedients, one would need a long chapter devoted to the Budget and quite a long chapter devoted to other forms of control—although the results would not always be recommendations in favour.

10207. Let us confine ourselves for the moment to monetary policy. You lay a great deal of emphasis in the latter part of your memorandum on the impact of credit restriction on the cash base, and on the operation of monetary policy through variation of the cash base rather than through interest rates. Did you mean to make an opposition between the two?——The order was quite deliberate. The credit base seems to me to be absolutely fundamental; I therefore emphasised that by putting it first. Then I went on to explain that I had deliberately not introduced the rate of interest at an earlier stage, because I felt that to approach these questions by discussing *the* rate of interest as though there were only one led to an over-simplified position. Then I went on, in a rather perfunctory way I admit, to make various observations about interest rates and policy.

10208. *Chairman*: What effects would you expect to see, and how, by either an enlargement or a reduction of the credit base, which are not dependent upon an alteration upwards or downwards of one rate of interest or another? What is the separate effect on demand of the alteration of the credit base?——It must surely directly affect the policy of the clearing banks as regards lending.

10209. *Sir John Woods*: You think first of a contraction of the credit base leading to less availability of money?——Yes.

10210. *Professor Cairncross*: When you refer to a change in the policy of the clearing banks, do you mean in relation to advances alone or in relation to investments also?——I would not wish to be exclusive in that respect. It would depend how they found themselves situated at the moment.

10211. A change in investments would have no direct effect on demand?——It would certainly affect the capital market and the long term rate of interest.

10212. Is not that the point the Chairman is making?——I should not in the least want to deny that possible effect, but I would wish to emphasise that it is not the only effect. After all it is notorious that banks do not give effect to their lending policy only by altering the rates that they charge. There is always a great amount of discretion and an element of rationing in carrying out banking policy in general, and that would be directly affected by changes in the size of the credit base.

10213. *Chairman*: Suppose that they can protect themselves by turning to their investments without having to modify their policy in regard to advances; how then is demand affected?——In that case I should expect there to be an effect on the long term rate of interest, and this in turn would be transmitted to the field of investment.

10214. It expresses itself there in the long term rate of interest?——Yes.

10215. *Sir John Woods*: But would you not also say that it is very desirable to squeeze the liquidity of the banks by funding?——Yes.

10216. You are envisaging a situation in which with contraction of the cash base the banks have to react more fully than they do in present circumstances?——Yes. It is one of my main contentions that in present circumstances this traditional mechanism is thrown out of gear by the presence of the abnormal volume of short-term Government debt.

10217. *Professor Cairncross*: If anyone is refused an advance from the banks, do they not have other possibilities open to them, possibly at higher rates of interest? The exclusion of such customers from the queue at the banks may mean that they obtain credit at a higher rate. Or do you feel that the people who are trying to obtain bank accommodation represent a separate market with a single source of supply of capital?——No; but, if one source of supply becomes more difficult, I should not expect there to be complete compensation elsewhere, unless there were something very wrong with the control mechanism generally.

10218. You feel that there is an imperfection which would mean that some people would be excluded merely because of rationing of bank advances?——All these things, as you would agree, are matters of greater or less importance. If there were a tiny contraction of bank advances, I am not prepared to say that, in an advancing society, there would not be adequate substitutes available elsewhere; but, if the contraction were bigger, then I should begin to feel that the squeeze would make itself generally felt.

10219. You would, I think, agree, if I understand the drift of the reasoning rightly, that the major impact of credit restriction is on the complex of interest rates rather than availability as such. You lay a good deal of emphasis on the long term rate, for instance.—*Sir Oliver Franks*: I think that there may be two questions and not one; one question would be whether the availability of credit and the operations to restrict or to expand it were what mattered and the rate of interest could be left right out of account; the other would be whether the availability of credit and operations to affect it were primary, but the consequences of those operations would express themselves in all sorts of variations in rates of interest. If I have understood it, what Professor Robbins was saying was that the availability of credit, in terms of the credit base, was primary, in the sense that the changes in the rates of interest, which undoubtedly occur in fact, are consequences of that rather than primary?——That puts the main point very well. I should want to add one more sentence, to say that in the institutional complications of our particular capital market I would expect some things to happen *via* changes in interest rates or in consequence of changes in interest rates which would not necessarily happen in a market differently situated. If I might enlarge on the fundamental attitude leading to this argument, although it leads me into some slight degree of professional economist gossip, I fancy that Professor Cairncross and I were both brought up on, or at any rate brought in contact with, the general Wicksellian theory concerning the rate of interest and the rate of overall expenditure. There you have a model where there is only one rate of interest and a homogeneous credit supply. In those circumstances it seems to me to be comparatively a matter of indifference where you start. You can either start with prices and look at consequential variations of amount, or you can start with amount and look at consequential variations of prices. But the real world is much more complicated than that. There is not just one rate of interest but many; and although there are, of course, heterogeneous elements within the system of credit, yet, if you start at that end, it seems easier to trace the consequential influences, than if you begin with changes in any one interest rate and try to follow that through. That is the reason for this, rather than any pre-supposition regarding policy.

10220. *Professor Cairncross*: I think that there are policy consequences in what you say. You are looking to the power of the monetary authorities over the quantity of money to work through various ways to demand. But one can work by direct operation on various rates of interest and thus on various elements of demand; it is a question as to how far one should rely on the short circuit. There are various rates of interest that are settled by the Government itself; the Government has a certain power of manoeuvre between maturities of different lengths in the management of debt. Do you regard that as outwith the field of monetary policy, or are you taking these as supporting operations directed to the same purpose?——I do not think that they are outside the field of monetary policy. But I do hold that, if reliance is placed upon devices and strategems of that sort and it is assumed that the credit base can look after itself, then we are likely to get into difficulties. That is an unequivocal conclusion of my mode of approach, but I hope it is reasonably non-contentious.

10221. May we pursue the question the Chairman put initially about the impact on demand of changes in the size of the credit base? If I understand your line of thought, you are laying a good deal of stress on the normal reaction, through higher rates of interest on investment. Are you thinking of anything else?——It depends in what sense you use the term "investment", to start with. Even if you use it in the most comprehensive sense, I can believe that there are effects on consumption as well.

10222. On saving, in other words?——Yes, and directly on consumption *via* consumers' credit, which is surely rather important: look at the United States of America.

10223. Do you think that the response to a rise in the long term rates of interest or to the whole complex of interest rates is sharp and immediate, or do you think it is very gradual and limited in the kind of economy we are living in today?——I do not think that a simple answer is possible to that question; it depends on so many other elements in the total business conjuncture. It depends on business expectations, on the trend of events elsewhere, on the Budget, and so on and so forth. I can conceive of situations in which the response would be very quick; I can conceive of situations in which the response might easily take months or even years to get through to consumption.

10224. One wants to know whether a given change in the quantity of money or the size of the credit base has any calculable effect on demand, or whether what really matters is the circumstances in which it takes place and the measures by which it is accompanied?——If you mean by "calculable" do I think that, if I were clever enough, I would be able to give you a single coefficient of reaction, of course the answer is no.

10225. Do you think that the effect of a change in the size of the credit base alone, together with the consequences on interest rates, would be an important ingredient in the total impact on investment and on demand? Do you think that it would be of a strength in the circumstances in which it was normally used to give rise to an abatement in demand such as the monetary authorities might want?——I do not want to be perverse, but "normally" presents me with a question to which I do not want to answer yes or no. The situation is very seldom normal. In some circumstances I can conceive that an increase of 1 per cent. in the long term rate of interest would be quite insufficient to restrain undue expansion; in other circumstances I should expect that it would pull it up sharp. I do not know which circumstances you wish to call normal.

accepted as a desirable policy, there is a climatic change in the approach towards anything like long term lending of money. What is the status of long term lending in Brazil in the climate you are speaking of? Is it protected by an index?——Not that I know of; but I am a very unreliable witness on these details.

10198. *Professor Cairncross*: Your emphasis is on the progressive upward movement of interest rates as people catch on to the progress of inflation, rather than on the failure of savings to come forward? It would be difficult to argue that savings have fallen off during the last inflationary period?——Very difficult; but all these things are relative. If interest rates move upward, that means that that movement has been necessary to equate supply and demand; so savings have not been as great as they need to have been to keep interest rates from rising. Surely this is based on an extremely simple principle of rational action: if prices are rising at 5 per cent. per annum and the rate of return on long term bonds is 5 per cent., I am lending to the Government at a zero rate of interest.

10199. *Chairman*: Would you say that there is a considerable time lag in the appreciation of that simple truth?——Certainly; one can take advantage of popular ignorance, particularly in a community as smug as ours, for years and years; but eventually the Church of England and the learned societies tumble to it, and then there is a landslide. That is, roughly speaking, what was happening two years ago and last year.

10200. *Professor Cairncross*: Could I take you from that to a more general question about the nature of the world we are living in? I get the impression, particularly from paragraph 63, that you are assuming that we have to face for the next few decades at least, an inflationary bias in the world at large. Is it your view that we have to face continuing pressure on savings and on capital resources, or are you looking to a world in which there may be periodic interruptions of substantial dimensions to the process of capital accumulation?——This paragraph was intended to convey a spot of comfort after the rather severe prescriptions of preceding paragraphs. I was simply asking myself the question whether the task of maintaining reasonable international equilibrium was going to be particularly difficult for the authorities in this country. In that context I suggested that it was reasonable to assume that there would be a general upward tendency in prices throughout the world. If you press for my reasons why, I must fall back on a variety of reasons. I am still inclined to think that in the world at large there is very considerable capital scarcity, using the word in a very loose sense. I also think, whatever happens in this country, so far as the United States is concerned there is probably for some years to come at any rate the prospect of cost inflation; my diagnosis of the U.S. position is rather different from my diagnosis of U.K. position and I would expect the tendency of things to be upward in the United States for that reason. But from the point of view of the objective of paragraph 63 it does not very much matter; if there is a general inflationary tendency in the world at large, then it is easier for us to do these things by a very slight application of the brakes here.

10201. If you make this assumption does it not also affect domestic monetary policy as well? If we are in a world where other countries are inflating, and monetary policy has to be attuned to general inflation, it may have effects that are different from what one could expect of it in a deflationary world?——Surely.

10202. Your expectation is that we have to adjust ourselves at home as well as on the external side to continuing inflation elsewhere?——I would not put it in quite that way. I would say that the prospects of the next two decades may present us with the sort of opportunity which we have had but have frequently neglected since 1948-49; a state of affairs where there is a general upward tendency in which it is much easier for us to keep in equilibrium, provided that we exercise a very moderate degree of financial virtue.

10203. In other words marginal adjustments may be sufficient?——Yes.

10204. But in a different kind of world there might be abrupt and sudden changes in the desire to invest, that would be difficult to control by monetary techniques?——In a world in which the tendency was the reverse, I should expect that in our institutional circumstances we might have to resort to some extremely unorthodox measures.

10205. Your paper centres very exclusively on monetary techniques; you do not even raise, I think, the possibility of use of the Budget, or of direct controls, which one would assume to be to some extent alternative and to some extent complementary?——With great respect you have got me wrong. In paragraph 68 I thought I had taken emphatic care to safeguard that flank. It seemed to me that this paper was too long already, and that the main business of this Committee was monetary policy as such.

10206. But there may be issues as to how effective monetary policy is by itself. Did you not leave it a little open how far you would wish to see monetary techniques used when these alternatives existed?——It was not spun out, but in the third sentence I say:

> "It is well known that, at certain stages of economic depression, a very substantial increase of money supply may be inadequate to promote an immediate increase of spending. Similarly, in circumstances of acute capital shortage, it may well be felt that to attempt to control the situation solely by limitation of the credit base may result in a level of interest rates which, for reasons of public finance, may be undesirable."

I hold this view very strongly. My conception of stabilization measures is essentially eclectic. If in any publications in recent years I have emphasised the desirability of monetary policy, that is simply, so to speak, leaning to the side of the boat which seemed to me to be most out of balance. I think that, when during the war in the context of the discussions of employment policy we started to consider the means of stabilisation, most of us tended to overlook monetary policy; if you recollect the White Paper on Full Employment, the part on monetary policy, although in fact it was drafted chiefly by Lord Keynes, was feeble in the extreme. On the whole, monetary policy has had a much less enthusiastic press than other instruments. But if you were asking for a rounded view of the totality of expedients, one would need a long chapter devoted to the Budget and quite a long chapter devoted to other forms of control—although the results would not always be recommendations in favour.

10207. Let us confine ourselves for the moment to monetary policy. You lay a great deal of emphasis in the latter part of your memorandum on the impact of credit restriction on the cash base, and on the operation of monetary policy through variation of the cash base rather than through interest rates. Did you mean to make an opposition between the two?——The order was quite deliberate. The credit base seems to me to be absolutely fundamental; I therefore emphasised that by putting it first. Then I went on to explain that I had deliberately not introduced the rate of interest at an earlier stage, because I felt that to approach these questions by discussing *the* rate of interest as though there were only one led to an over-simplified position. Then I went on, in a rather perfunctory way I admit, to make various observations about interest rates and policy.

10208. *Chairman*: What effects would you expect to see, and how, by either an enlargement or a reduction of the credit base, which are not dependent upon an alteration upwards or downwards of one rate of interest or another? What is the separate effect on demand of the alteration of the credit base?——It must surely directly affect the policy of the clearing banks as regards lending.

10209. *Sir John Woods*: You think first of a contraction of the credit base leading to less availability of money?——Yes.

10210. *Professor Cairncross*: When you refer to a change in the policy of the clearing banks, do you mean in relation to advances alone or in relation to investments also?——I would not wish to be exclusive in that respect. It would depend how they found themselves situated at the moment.

10211. A change in investments would have no direct effect on demand?——It would certainly affect the capital market and the long term rate of interest.

10212. Is not that the point the Chairman is making?——I should not in the least want to deny that possible effect, but I would wish to emphasise that it is not the only effect. After all it is notorious that banks do not give effect to their lending policy only by altering the rates that they charge. There is always a great amount of discretion and an element of rationing in carrying out banking policy in general, and that would be directly affected by changes in the size of the credit base.

10213. *Chairman*: Suppose that they can protect themselves by turning to their investments without having to modify their policy in regard to advances; how then is demand affected?——In that case I should expect there to be an effect on the long term rate of interest, and this in turn would be transmitted to the field of investment.

10214. It expresses itself there in the long term rate of interest?——Yes.

10215. *Sir John Woods*: But would you not also say that it is very desirable to squeeze the liquidity of the banks by funding?——Yes.

10216. You are envisaging a situation in which with contraction of the cash base the banks have to react more fully than they do in present circumstances?——Yes. It it one of my main contentions that in present circumstances this traditional mechanism is thrown out of gear by the presence of the abnormal volume of short-term Government debt.

10217. *Professor Cairncross*: If anyone is refused an advance from the banks, do they not have other possibilities open to them, possibly at higher rates of interest? The exclusion of such customers from the queue at the banks may mean that they obtain credit at a higher rate. Or do you feel that the people who are trying to obtain bank accommodation represent a separate market with a single source of supply of capital?——No; but, if one source of supply becomes more difficult, I should not expect there to be complete compensation elsewhere, unless there were something very wrong with the control mechanism generally.

10218. You feel that there is an imperfection which would mean that some people would be excluded merely because of rationing of bank advances?——All these things, as you would agree, are matters of greater or less importance. If there were a tiny contraction of bank advances, I am not prepared to say that, in an advancing society, there would not be adequate substitutes available elsewhere; but, if the contraction were bigger, then I should begin to feel that the squeeze would make itself generally felt.

10219. You would, I think, agree, if I understand the drift of the reasoning rightly, that the major impact of credit restriction is on the complex of interest rates rather than availability as such. You lay a good deal of emphasis on the long term rate, for instance.—*Sir Oliver Franks*: I think that there may be two questions and not one; one question would be whether the availability of credit and the operations to restrict or to expand it were what mattered and the rate of interest could be left right out of account; the other would be whether the availability of credit and operations to affect it were primary, but the consequences of those operations would express themselves in all sorts of variations in rates of interest. If I have understood it, what Professor Robbins was saying was that the availability of credit, in terms of the credit base, was primary, in the sense that the changes in the rates of interest, which undoubtedly occur in fact, are consequences of that rather than primary?——That puts the main point very well. I should want to add one more sentence, to say that in the institutional complications of our particular capital market I would expect some things to happen *via* changes in interest rates or in consequence of changes in interest rates which would not necessarily happen in a market differently situated. If I might enlarge on the fundamental attitude leading to this argument, although it leads me into some slight degree of professional economist gossip, I fancy that Professor Cairncross and I were both brought up on, or at any rate brought in contact with, the general Wicksellian theory concerning the rate of interest and the rate of overall expenditure. There you have a model where there is only one rate of interest and a homogeneous credit supply. In those circumstances it seems to me to be comparatively a matter of indifference where you start. You can either start with prices and look at consequential variations of amount, or you can start with amount and look at consequential variations of prices. But the real world is much more complicated than that. There is not just one rate of interest but many; and although there are, of course, heterogeneous elements within the system of credit, yet, if you start at that end, it seems easier to trace the consequential influences, than if you begin with changes in any one interest rate and try to follow that through. That is the reason for this, rather than any pre-supposition regarding policy.

10220. *Professor Cairncross*: I think that there are policy consequences in what you say. You are looking to the power of the monetary authorities over the quantity of money to work through various ways to demand. But one can work by direct operation on various rates of interest and thus on various elements of demand; it is a question as to how far one should rely on the short circuit. There are various rates of interest that are settled by the Government itself; the Government has a certain power of manoeuvre between maturities of different lengths in the management of debt. Do you regard that as outwith the field of monetary policy, or are you taking these as supporting operations directed to the same purpose?——I do not think that they are outside the field of monetary policy. But I do hold that, if reliance is placed upon devices and strategems of that sort and it is assumed that the credit base can look after itself, then we are likely to get into difficulties. That is an unequivocal conclusion of my mode of approach, but I hope it is reasonably non-contentious.

10221. May we pursue the question the Chairman put initially about the impact on demand of changes in the size of the credit base? If I understand your line of thought, you are laying a good deal of stress on the normal reaction, through higher rates of interest on investment. Are you thinking of anything else?——It depends in what sense you use the term "investment", to start with. Even if you use it in the most comprehensive sense, I can believe that there are effects on consumption as well.

10222. On saving, in other words?——Yes, and directly on consumption *via* consumers' credit, which is surely rather important: look at the United States of America.

10223. Do you think that the response to a rise in the long term rates of interest or to the whole complex of interest rates is sharp and immediate, or do you think it is very gradual and limited in the kind of economy we are living in today?——I do not think that a simple answer is possible to that question; it depends on so many other elements in the total business conjuncture. It depends on business expectations, on the trend of events elsewhere, on the Budget, and so on and so forth. I can conceive of situations in which the response would be very quick; I can conceive of situations in which the response might easily take months or even years to get through to consumption.

10224. One wants to know whether a given change in the quantity of money or the size of the credit base has any calculable effect on demand, or whether what really matters is the circumstances in which it takes place and the measures by which it is accompanied?——If you mean by "calculable" do I think that, if I were clever enough, I would be able to give you a single coefficient of reaction, of course the answer is no.

10225. Do you think that the effect of a change in the size of the credit base alone, together with the consequences on interest rates, would be an important ingredient in the total impact on investment and on demand? Do you think that it would be of a strength in the circumstances in which it was normally used to give rise to an abatement in demand such as the monetary authorities might want?——I do not want to be perverse, but "normally" presents me with a question to which I do not want to answer yes or no. The situation is very seldom normal. In some circumstances I can conceive that an increase of 1 per cent. in the long term rate of interest would be quite insufficient to restrain undue expansion; in other circumstances I should expect that it would pull it up sharp. I do not know which circumstances you wish to call normal.

monetary management, and were given the authority to do its best for the final objectives in that field? Would that lead to a healthier working, or is it impossible in our set-up?——It is easy to indulge in pipe dreams about hard and fast limitations of functions; but I suspect that these hard and fast limitations would always break down with changes of the situation. On balance I would rather trust to good sense and a more flexible relationship.

10248. The significance of that, according to your experience, is that the Bank is somewhat inhibited in the work which is in practice left to it to do, because it has not a delimited sphere of its own responsibility?——What I mean can be put this way. Suppose that we reverted to a position like that under the old Bank Act of 1844, in which the Bank of England had complete autonomy with regard to a great many operations; and then suppose some fundamental change in the general position, a bad slump for instance; if it was felt that the ideas of the Bank with regard to the treatment of the slump were flagrantly aggravating the situation, I cannot believe that in modern circumstances there would not be a pretty immediate change in the law.

10249. Do other countries not succeed in running a system in which the central bank has to bear the possible burden of that kind of thing and gets way with it?——I do not know enough of what goes on in all the leading capitals of the world, but I think that that sort of structure is often subject to severe strain; and where, as in the United States, there is statutory delimitation, there is very often a continuous conspiracy on the part of men of good will to get round the statutory regulations. In a sense, a great deal of modern American history can be looked upon as the result of that sort of conspiracy; it is notorious in respect of relations between the Federal Reserve System and the Treasury. There have been extremely difficult situations, only circumnavigated by an immense amount of coming and going.

10250. Do you think that, in itself, is a bad thing?——It is not a bad thing in the American context, because it harmonises with their constitutional way of life, and doubtless they have become acclimatised. I cannot think of a desirable reproduction of similar institutions over here, though I confess I should like to be able to think of one, because I prefer that policies should proceed according to rule rather than arbitrary decision. But the fact is that we do not know a lot about these things; we are floundering very much in the dark. I think that it would be unwise to crystallise out prematurely, even though we may find laid up in heaven a better constitution. But a freer interchange of ideas, and less reserve about the problem is bound to do good.

10251. Would you add to that that the Treasury must be able almost to duplicate the expertise which you place in the Bank?——It must be able to stand up to it.

10252. Does not that almost mean that it must have the same equipment in expertise?——No: duplication is a very strong word. To duplicate the Bank of England at the Whitehall end would be to create a monstrosity.

10253. I was wondering whether that was not something towards which one was led by the knowledge that you put all the executive skill in this field on one side and yet leave the other side to control it?——There is a large expanse of territory intermediate between duplication and a situation in which one over-worked administrative officer who has one junior may have to deal with the massed resources of the Bank. But you must realise that I have not been in this for ten years; it may all have changed for the better since I was there.

10254. *Professor Cairncross*: Would you regard the interchange of staff as practical or useful?——A very good thing indeed, in itself. How practical it is I do not know. I think that some of the trouble, if there be trouble, at the Whitehall end is a by-product of the very special circumstances of the expert labour market since the war. I remember that, when I was still head of the Economic Section, ambitious plans were formed for the secondment from universities and elsewhere, for periods of five years at a time, of expert economists and statisticians and so forth, who would reinforce the organisation from that end. It has not been from any lack of willingness to carry out that programme on the part of high officials from the Treasury that those plans have not been realised; it was simply that the bodies were not there. In time to come that may change.

Chairman: Thank you very much, Professor Robbins; we are very grateful to you.

(*The witness withdrew.*)

R. F. HARROD, ESQ., F.B.A., Nuffield Reader in International Economics, University of Oxford, called and examined.

10255. *Chairman*: Thank you very much for your memorandum*, Mr. Harrod, and for the copies of your article *The Role of Gold Today* from the *South African Journal of Economics* and of an article on the same subject for *Optima*.† We should like you to enlarge on some aspects of the matters which you have dealt with, which seem to us to need following up for our own purposes. The questions we shall ask are not primarily critical; they are primarily exploratory. I think that it is best to go through the questions in the order in which you deal with them yourself. That brings us to the part which deals with statistics first.—*Professor Cairncross*: You lay emphasis in this section on statistics that you do not feel are available sufficiently promptly, or not available at all. It would be useful to us if you could enlarge on this. First of all there are two sets of figures upon which you lay stress, factory starts and orders for machine tools. Do you think these are more important than figures of what is happening currently to aggregate investment?——*Mr. Harrod*: I think the orders figures are more important than the achieved investment. It is the orders that reflect what is destined to happen. In 1954 the aggregate of achieved investment went up hardly at all; orders, however, went up in a spectacular manner. It seems to me that to know that the orders were going up at that rate would have been very important in 1954. Shortly afterwards I had cause to address a conference of purchasers. Purchasers are people who know exactly all about delivery delays, and from all parts of the conference I was assured that the situation had deteriorated, right back to the situation as it had been in 1950-51, unlike the intervening years of 1952 and 1953, where deliveries had been fairly prompt. This was a wide experience from a wide range of people, and that made me think that something had been seriously wrong in 1954. So I think that it would be a good thing for us to have up-to-date figures of orders, such as they profess to have in Germany, and that the achieved investment figures should come along much more slowly.

10256. You mention machine tools specifically as one example?——I mention those because they provide us with these figures; they exist. But there are no proper global figures that I know of.

10257. Do you not think that figures such as are now being collected on investment plans and intentions would be more useful than the figures of factory starts and figures of orders received?——No, I think they would be of less value. I always look at these figures when the Board of Trade produces them; but I think that the intention is of less value than the fact, just as the factory starts figures are much better at giving an indication of what is going on and what is about to happen than the factory approval figures. People may have ideas of doing things, but when one starts a thing it does really reflect the fact that one has in mind that one is going to proceed with it and that the time is ripe and good to make this investment. And a lot more investment will follow from the start: that is only a beginning, which means that we may expect in the following two years or so a good deal of investment of money. Plans are interesting up to a point, but they can be, and are, revised.

10258. *Chairman*: Have you had any opportunity in past years of comparing plans, as reflected in the Board of Trade figures, with the actual achievements?——The Board of Trade figures have only been coming out for a relatively short time.

* Memoranda of Evidence Part XIII No. 12.

† The two articles, having been published elsewhere, are not included in the Committee's record of evidence.

10259. Has anybody had a chance, in any detailed way, of comparing over a number of years the plans of particular industries or concerns with their actual performance?——I do not think so.

10260. *Professor Cairncross*: Would you agree that the figures of plans may give you an earlier indication of a certain trend?——I am all in favour of having as many figures of plans as you can get, subject to the bother of putting people to the trouble of filling up forms. But an order is something more definite than a plan, just as a start is something more definite than an approval.

10261. You seem to attach less importance to information about factory building, where there is more information about the value of the work done and the number of people employed on factory building, than to the data on starts?——The information is more up-to-date about the value of the work done, but that value reflects the decision taken when the factory was started, so that although the reporting of the value of the work on a factory is more up-to-date, it may not reflect so up-to-date a fact. There was a curious mistake in the Economic Survey in 1957; it said, in surveying investment, that in 1956 there had been a shift of emphasis away from plant and equipment on to construction, and the authors of the Survey seemed to imply that the business world had decided to devote more to construction than to plant. In fact what had happened in 1956 was simply that the recession began and fresh orders for plant were not being put, while the increase in the work of factory construction was as a result of orders placed in 1954 and 1955. The mere fact of a swelling up of construction in 1956 did not represent any increase of activity from a current point of view; one can see that by looking at the starts. The swelling up in 1956 was consequential on the high level of starts in 1955. The plant and equipment which was ordered in 1955 had, to a large extent, been delivered; that is why there seemed to he less delivery of plant and equipment in 1956, because the orders placed had heen met to a great extent, while the factories which had begun to be huilt could not be built so quickly.

It seems to me that monetary policy is designed to influence decisions; an act of monetary policy taken today is designed to influence decisions by boards of directors in the next three months. Monetary policy is not designed, except in very abnormal circumstances, to alter decisions previously taken: for instance, to hring about the cessation of a factory huilding half-way through. That sort of thing did happen after 1929, hut we hope that monetary policy will not be so misunderstood now that anyone will actually want to stop building their factories half way through.

10262. The two cases you have taken relate to the private sector. Is this deliberate, or do you feel that there is information in the puhlic sector which would be of equal importance?——I would have supposed that the public sector was not quite so much amenable to the influence of monetary policy, though we hope it is amenable to the influence of economic policy; if the Treasury takes a certain view about the tempo of investment in the public sector, we hope that the public sector responds to that view in due course.

10263. From the point of view of changes in economic policy it is just as important to know what is to happen with regard to school buildings and power stations and other items of equipment of that type?——Definitely; and looking at the figures for the public sector I was rather surprised to find that the public sector had behaved rather better over a period of five years, than I had feared at the time. The public sector stepped up its investment in 1952-53 when the private sector was slack, and in 1954-55 it has stepped down the tempo a little generally.

10264. What about consumers? In 1956 it was the consumer whose behaviour was a little difficult to predict? The change in savings appears to have been greater than any change in investment in the private sector. Do you feel that better information could be obtained about what the buyer is doing, or intends to do?——We do now have information about consumer expenditure; it could be more up-to-date. The Americans generally seem to get these things out a month or two quicker than we do. In the case of the consumer one does not perhaps notice so much the division between the decision to spend and the actual expenditure, apart from some items such as housing starts; the consumers' decision to spend and the expenditure itself are closer together than in the case of building a factory, in which the expenditure goes on for two or three years afterwards.

10265. Some people have suggested that we should collect figures of details of consumers' intentions to spend. Would you regard that as important or not?——I would have put it as rather less important. I do not know how far those consumer intentions in America have been verified in fact.

10266. What about savings? If in fact consumers give signs in a given year of stepping up savings pretty sharply and if factory building has also gone up, do you think that there is any inflationary effect?—Yes, I would have thought so. Again it is a question of the order of importance of these things. I do not think that, whatever consumers had thought they might do with regard to savings, it could possibly have prevented inflationary pressure in consequence of stepping up investment plans hy the order of 40/50 per cent Even if one got enough people to respond to questionnaires about saving, they could not alter their saving habits as drastically as that.

10267. There are certain sectors which do not quite meet the ideas you have put forward: shipbuilding, for example, where activity is not affected at all. There have been cases where a start has been made on a new ship and the ship has been left without any further work done to it. I should imagine that very much the same thing might happen with factories?——I would have thought it rather exceptional to start a factory and then leave it. I dare say it may happen sometimes; but in shipbuilding there is something else, which I seem to remember from wartime days; a sort of bottleneck. It is just not possible to expand the pace of shipbuilding very rapidly. We certainly could not do it in the war, when it was most important to do so. All one gets is a pile-up of orders, such as one also gets in industrial equipment but to a lesser degree.

10268. *Chairman*: Does anybody know exactly what a start is?—*Sir Oliver Franks*: Would it not be accepting a tender?—*Mr. Woodcock*: It means an actual start on physical activity: getting the materials on to the site, or site clearance.—*Chairman*: I raised that, because in paragraph 9 your theme is that the restrictive measures begun in the second half of 1955 appear to have had a quick effect, quicker than people realised; you suggest that the fact that factory huilding starts turned down in the last quarter of the year was a result of the restrictive measures taken currently in the second half of the year. I find it difficult to think that they could reflect so quickly on starts. What measures are you thinking of here: the request for the limitation of bank advances?——The limitation of bank advances in the form of the directions to managers, and the actual reduction by the banks in the quantity of money available. This was attended by a certain amount of publicity, and prominence was given to it later on by the Chancellor's letter and so on; people knew that some sort of credit squeeze was on, and they would certainly have thought twice if they had a plan for starting on a new factory extension in 1955. If they thought that it might lead to stagnation in their own market at some time, they would decide that it might be well to postpone building for the time being. Also they may have found difficulties in their own liquidity; they may have had to think about some means of improving it.

10269. I was questioning the quickness of the reaction. If we regard starts as the beginning of some physical activity, must they not be the result of some considerable planning beforehand?——Yes. I cannot be sure about this, of course. There may be a school of thought which says that by the last quarter of 1955 the boom had already played itself out to some extent, that the various plans put into the last part of 1954 and the first part of 1955 were dying naturally. I cannot answer that, but I have a feeling that the monetary policy contributed to that effect.

10270. *Professor Cairncross*: When building controls were removed a great many people were free to build factories who were not free to build them before, or not free to build them in the areas in which they wanted to build them. It is therefore likely that a great many

people came forward with plans which were translated into actual construction in the early 1950s, but that this was a once and for all effect that might well have exhausted itself towards the end of 1955. Was not construction actually higher in 1956 than in 1955, and even in 1957 not noticeably lower?——I cannot deny that. It may be, of course, that the third quarter of 1955 saw the natural termination of the spurt, for the reason which you have given. On the other hand I suspect that it is too much of a coincidence that it should happen in that particular quarter. Furthermore we have a supporting figure for machine tool orders, which had not been affected by the same restrictions. The fact that they were turning down so soon after the start of the credit squeeze suggests to me that it was being effective, though not perhaps as effective as it might have been, because the initial downward movement was only moderate.

10271. Was it not inevitable that starts should come down at some stage, because they were so much in excess of the current rate of completions?——I remember that at the time I was very strongly in favour of a sharper credit squeeze; but when I discussed this with expansionist economists, if I may so call them, they said: "No; this is the sort of pace of investment that Britain should have, by comparison with the United States and with Germany, and there is no excess at present." I did not take that view; I believed that there had been an excess. But it was strongly argued at the time that the economy bad been cramped by post-war difficulties for a number of years, so that it had been too low, and it might be that investment in 1954-55 was resuming what was a reasonable and desirable level.

10272. Are there any other specific sets of figures that you believe should be collected regularly? You refer to productivity inside factories, for instance, in paragraph 14?——Yes. That is no doubt a difficult one to get, but it would be very valuable, if it could be got. I tried to explain here that there was uncertainty when one looked at the scene in 1956 and saw that the global average index of productivity was going down, as it had gone down in 1952 when there was a recession. It was said that much of this was due to slack working in motor car factories, because it was known that there was a deliberate recession in motor cars due to the releasing of steel for other purposes. The question was how far this fall in productivity could be accounted for by a reduction in productivity in a restricted sector, or whether it was much more widespread. I do not see how we can get at that without more information.

10273. *Mr. Woodcock*: Does not that contradict all that you say in paragraph 12, where you discount the value of employment and unemployment figures?——Perhaps I over-stated it; I did not mean to discount that sort of figure completely. I meant that, when there is this disposition of employers to be more conservative as regards standing off employees and also as regards taking on labour, the "in and out" of employment will not give the same prompt guidance as it did before the war.

10274. I agree; but it is not always a question of taking on or of dispensing with labour. It may be a question of short-time labour?——Exactly.

10275. On a point of productivity, would you think that we might have statistics on the doing away with overtime and on putting people off? There are people who may not in all cases be able to sign on at the local labour exchanges, because there are certain conditions?——Yes. We do have statistics of short-time labour, and that is very valuable. Although the actual amount of short-time is not important in itself, there may be factories on disguised short-time, in the sense of work being spread a little, in times of relative slackness. I have been told of cases where a certain amount of overtime pay has been, so to speak, built in to the weekly pay packet, and employers are very reluctant to take it away again; they may allow the work to be so spread that it goes further than it normally would.

10276. But that was not true to the same extent in 1956 as it is today?——That is the year I stressed because since then unemployment has become a little more prominent; but in 1956, although the actual employment was hardly down at all, there was disguised unemployment or under-employment in the factories. The precise extent of that we cannot judge without the assistance of statistics.

10277. I think there is more of it today. There is a strong feeling, from the reports that we get, that there is very heavy unemployment, in the sense of short-time working, in some districts and in some industries. Should not those figures be available?——Certainly; one would hope to get as full figures as possible on all forms of short-time work.

10278. In this respect, would you think that some industries are more important than others?——I think that one would get it by taking broad types of industries: consumer goods, capital goods, machine tools, etc.

10279. Steel, because there is some concentration of employment in steel in all industries?——Yes.

10280. *Professor Cairncross*: How do you think the situation you have described here would be affected by a change in credit policy? Is it your contention that a relaxation of credit policy would increase output?——We have just had a relaxation of credit policy. I hope it may: I do not feel optimistic about it, but it might do.

10281. Supposing that in 1957 credit policy had been relaxed, would you have expected to see, as a result of that and not as contingent on any other action, an increase in output?——Yes. The further an economy gets into the recession probably the less efficient credit policy is in giving a quick result. There was probably more elasticity in 1957 than there is now, because the recession has receded further and we have on top of it the world recession; so I think these relaxations are absolutely right now. It is rather a background measure, and more positive measures are required to do what is needed.

10282. How do you see a relaxation in credit policy reacting on industrial output in a position in which the capital goods industries are already pretty fully occupied?——I do not know that they are fully occupied now. The mechanics of it are that, if any firm's plans are being held back for lack of liquidity or lack of finance, such firms may, in the new environment, no longer be held back. The only problem is how many such firms there are at this particular phase; obviously it has a particular force in one direction. I think there are people who have been held back in improvements and sundry work that they can do in their factory and that, if there is a chance of getting finance, they will hold back no longer. That seems a natural consequence.

10283. Even though the capital and building industries were busier in 1957 than ever before?——I do not know that they were busier than ever before. They produced more, but that does not mean that they were busier. Their own productive capacity was considerably expanded in 1957. That is why I should like to have these statistics about productivity in the capital goods and machine tools industries. It would have done no harm for some new orders to have come in then, because though they were busy they were busy on past years' orders. In connection with monetary policy, in the sphere of capital goods as opposed to consumer goods, one has all the time to be thinking a year or two ahead and asking: "Are the orders currently being placed sufficient to keep the economy active in the next two years?" just as in 1954 we should have been wondering whether the orders currently being placed were likely to cause inflationary pressure in the next two years, as in fact they did.

10284. *Chairman*: May we go on to the next section of your memorandum, on the effective working of credit policy? You speak in paragraph 33 about the drift to equities, and you imply that this is not merely the product of inflation, but is due to "deeper causes". Would you enlarge on that?——I have not got any figures, but it is well known that the insurance companies had altered their portfolios quite considerably well before 1939. Those are the big investors, but coming down to humbler bodies, like colleges and pension funds, that drift was already quite marked in the 1930s. The "deeper causes" I had in mind were that the status of equities had been changing over the previous half century, and there were far more great firms whose position was so well assured that it would be extremely sceptical not to regard an investment in them as being as safe as in gilt-edged. Then also, on the side of the investors, the typical case used to be that of the widow who was told by her lawyer to put money into Consols and similar investments. Now much private

saving is channelled into the insurance companies or occurs through the building up of pension funds and so on, and has therefore become institutional; it is handled by institutions which can spread the risk for the small people. Instead of the small man having to invest in gilt-edged he can invest in an insurance company which can distribute the risk. I am not absolutely denying the "hedge against inflation" aspect of this; but inflation started up strongly with the war, and I think that the main movement anteceded the war.

10285. *Professor Cairncross*: Would you not recognise forces operating in the other direction? The redistribution of income must have put money into the hands of people whose natural inclination is to save money in institutions which have a natural bias towards the gilt-edged, although it may be weakening?——As regards the holdings of insurance companies, I think I am right in saying that they have a larger portfolio of equities than of gilt-edged.

10286. There has been a change, but the change in favour of institutions must be a change of investors who normally put a much bigger proportion of their savings into gilt-edged?——You mean that, given a more equal distribution of income, if these people had not been doing their investing mainly through institutional channels, then it might have helped gilt-edged?

10287. *Chairman*: These very large investors, the insurance companies and the pension funds and so on, have to consider their obligations in terms of money; I should have thought, therefore, that it would be natural for them to distribute their assets in terms of securities with fixed interest and fixed redemption rates, because that would be a natural way of meeting the monetary obligations which they exist to fulfil. I should have thought that a great increase in that type of investor meant a great increase in the appetite for gilt-edged, compared with what it has been in the past?——I accept the argument, but my own doubt was on the facts.

10288. I was not disputing that; but does that not introduce the question of the effect of inflation?——The question so far as inflation is concerned is one of date. My understanding of it, to begin with the insurance companies as the biggest of all, is that they went into equities and had a fairly even balance between equities and gilt-edged prior to the war, that during the war, for patriotic reasons, they loaded themselves very heavily with Government stock, so that the distribution of assets in their portfolios went back to something more like an earlier date, and that since the war they have been gradually working back towards their pre-war distribution. That puts the change of distribution definitely pre-war rather than post-war, and therefore it seems to me that it cannot be regarded as primarily a hedge against inflation.

10289. *Sir John Woods*: It is no doubt true that equities became more popular before the war with all sorts of investors; nevertheless that was not being done at that time by anything approaching a flight from gilt-edged, whereas in recent years it seems to me that there has been something like a flight from gilt-edged. Must one not attribute the flight to some inflationary force? Or would you not agree that there has been a flight from gilt-edged?——I should not have put it quite as strongly as that. The quantity of gilt-edged has gone up considerably since the war and it is all being held by someone, and although there are a few shares which yield less than gilt-edged, on the whole the yield on gilt-edged is lower than on industrial shares. I am not talking about particular months when some unfortunate incident has occurred and there has been a bit of a flight, but on the broad front over the last ten years I think the word "flight" is too strong.

10290. In a general way I should have thought that there had been a marked increase in distrust of gilt-edged?——I do not want to challenge the view that the fear of inflation has played a part in the process; I would only say it is not the sole cause of this change. There were other causes operating before the war, and this has come along to increase the desire to move out of gilt-edged.

10291. *Professor Cairncross*: In order to deal with the situation that has been created in the gilt-edged market, you would like action to be taken in two directions: (1) to improve the bargaining position of the Government and reduce its need to be in a borrowing position, and (2) to change the status of the obligations of the nationalised industries. If it were not for the considerations of monetary policy that we are discussing, would there be anything improper in the Government raising money in the gilt-edged market in order to finance the nationalised industries?——My argument is on monetary policy, but I have a feeling that it is undesirable in a more general way, from the point of view of prestige, for the British Government, at the centre of the sterling area, to be a borrower all the time. It is not only a question of the difficulty that this borrowing raises for the pursuance of a credit policy; I dislike the British Government being a borrower. I think that it is bad for the general financial repute of the country in the financial world as a whole.

10292. In spite of the fact that the Government is financing nearly half the total investment of the country?——I am not saying that it is not making good use of the money which it borrows; I am merely saying that it would strengthen prestige if people did not see the British Government borrowing.

10293. Suppose that this was carried to the point that the Government was responsible for three-quarters of the total investment in this country; would you still say that the whole of that should depend on current financing?——As one departed further and further from a free enterprise system one would have to think in quite different terms of the whole banking and monetary system. Taking it to the other extreme, one would have to think in terms of what is done in Russia. I am not an expert on that, but I have no doubt that the considerations would be quite different where almost the whole of investment was publicly provided. I am assuming a banking and monetary system within the framework of a still predominantly free enterprise. The nationalised industries are not half of industry, but they seem to account for almost half of the capital requirements of industry.

10294. It was that point I had in mind. If the Government still further increased its responsibilities for investment, would you still hold to the view that it reflected ill on the Government if it had to borrow for these capital requirements?——Yes. I think it gives to others a sense of weakness in the Government all the time, and a feeling that something terrible would happen if the Government did not succeed in finding all this money each year.

10295. *Chairman*: I see the point about the Government looking needy in these circumstances, but the alternative is either that the taxpayer provides all the funds for this large-scale investment, or that the consumer of the products of the nationalised industry, out of his current pocket, provides the funds. Are not those two very heavy assumptions?——*Mr. Woodcock*: And is there not the further possibility that in some cases the service would just wither?——I hope that would not happen. If we had a very stern Chancellor of the Exchequer finding the money, because he had to find it we might get less spent on a nationalised industry than what ought to be spent; there is that side as well as the other side.

10296. That is a very important point. I was thinking of a third consideration: that in some cases, thinking of the Chancellor as being neutral, there would be the question whether to retain, say, the railways as a service or as an economic unit?——That opens wider questions; but it would not be so very special for the consumer to pay for capital requirements. After all in a great deal of private enterprise the capital requirements of the companies have been found by auto-finance, which means that the consumers of the product have paid for it in the selling price, a sufficient profit being included to allow for something to be ploughed back into the business and used for its own expansion. A great deal of British industry has been financed in that way. One would only be putting nationalised industries on the same footing, but of course they would have to be allowed to charge more remunerative prices.

10297. *Mr. Jones*: Would it not be difficult to secure the capitalisation required, for instance in coalmining, at the stage where we are now, with 30 million tons of coal in stock, particularly having regard to the competition of other primary means of fuel, and to the fact that during the last ten years coal sold at a premium and substantial capital could have been found for the coal-mining industry? Would it not be more difficult to carry

out your policy now than it would have been, say, in 1947?——I think in that case it is true. I was always in favour of more expensive coal in the last ten years. I think the case for cheap coal is greatly exaggerated as regards our overseas competitiveness. If we had a better price for coal we would have the best possible incentive for people to adopt fuel economy more instead of squandering their coal; but I agree that that not having happened makes the situation more difficult now.

10298. And you have to take into account what other governments are doing in these fields. For instance, we were selling coal abroad at £2 a ton more than it was selling at home, and Germany and Belgium were substantially finding means to run the industry in their countries. Have you not got to take that into account in formulating your investment?——No; if the coal industry is a monopoly, so far as the home market is concerned, they can get what price they ask. If they said: "We must charge enough to cover the cost of mechanisation", they could get it.

10299. But hardly a monopoly in the present setting, where the Minister has the last word on price?——I agree. The Minister would have to agree with the principle, and to agree a price also which allowed that to happen.

10300. You would have to have a commercial basis to work out the level of price that they were capable of finding?——I think so.

10301. Do you think that in the present situation, if coalmining wanted £500 millions of new capital, we should be likely to get it without Government guarantee?——No; what I meant by a commercial basis was that they should be left to make a price policy which gave them the funds they require in order to plough back and mechanise. I do not think that the nationalised industries can raise the capital they require by capitalistic methods, by offering stock in the market, unless it has a Treasury guarantee.

10302. Must not the question of adequate capitalisation with regard to efficiency be one of the bases for nationalising an industry?——Yes.

10303. For that reason does it not become a definite responsibility upon the part of the central government to ensure that that capital is made available?——There will always be exceptional cases, where some particular work may be regarded as basically a social service rather than an economic need, or as I have said, in this note, where it is a case of asking a nationalised industry to speed up its capitalisation; but otherwise I do not see why any Board should not be told that under a long-range planning policy it would normally be expected to show a sufficient surplus to finance its own capital development.

10304. You say "normally", and in some paragraphs here you refer to "the main part". Are you meaning that the rest should be financed from capital, or are you looking to additional sources?——I was thinking that, if the Government asked a nationalised industry to expedite its plans and the industry said: "We cannot do so because we have not collected enough money", then the Government could make a loan in those circumstances.

10305. Might they not go to the market for some of their capital?——They might go to the market for a little capital, provided it was not on Treasury guarantee; but that might be regarded as de-nationalising. I can see that politically it might be said, though I do not think that it is quite fair to say, that, if you issue equity shares in the nationalised industries you are handing them back to the capitalist owners, even though the owners were in fact merely a well-distributed class of shareholders and no power would be attached to the shares.

10306. It is your view that some stock could be raised without Treasury guarantee?——I think so; a reasonable amount could be raised.

10307. In the present situation, with the present amount of stocks and the tremendous amount of competition, and having regard to declining demand, would you be prepared to advocate for that purpose an increase in the price of coal?——I think so. I would not like to say that this could happen in the next six or twelve months. I do not know how deep the recession is going to be. It may be that, as you say, this is not the moment at which to do it. I take it that the broad trend of the coal-mining industry will be to shrink somewhat.

10308. Yes, but the industry's responsibilities in Germany and in Belgium have been met by the Government, and in the face of that Britain has been in a position to send coal cheaper to those countries than they have been able to produce it there, and at a premium on the internal prices. Now we have come to the end of that situation; indeed we were never able to operate it. What would be the effect if we increased prices now? Would it not result in an increase in the cost of living, in this country at any rate? Would you be prepared to risk that?——I would be prepared to risk it, and I think the time to risk it is sometime during this recession, having regard to the falling prices of materials all round. A certain increase in the price of coal would be offset by that; we could carry an increase in the price of coal at the present time without doing any great harm. Of course, I am not an expert on this.

(Adjourned until 2.15 p.m.)

MR. R. F. HARROD, F.B.A., further examined.

10309. *Chairman*: I should like you to enlarge a little on a phrase you have used: "the diffused difficulty of hornwing", which is what you regard as the inherent result of a credit squeeze in the old sense. Is it that there is a shrinkage of the credit base, which results in a certain displacement of the facilities of borrowing?——*Mr. Harrod*: Yes. There is actually less money available.

10310. Is it your view that that in itself has a certain economic effect in the sense that it restricts demand, or that it expresses itself in interest rates, and in the effect of interest rates upon intending borrowers?——I think it has a direct effect in restricting demand both for stocks and even for fixed capital. On the question of displacement of credit, people tend to insist on prompter payment; they will not allow accounts to stand. One firm has to make a prompter payment and insists on its customer making a prompter payment, or tells him in advance that it cannot give him the credit which it might otherwise do, so that everybody will be less inclined to spend unnecessary money on stocks, and may even be in a position in which they cannot spend money on fixed capital. They will also sell portfolio securities, in order to maintain their liquidity under pressure. This will be a net extra sale on the Stock Exchange.

10311. If they can make good their needs for liquidity by selling, the liquidity lost by the shrinking of the credit base is replaced, but the rate of interest may be affected if the volume of sales is exceptional, so that it expresses itself in the rate of interest?——I think it does express itself in the rate of interest; but if there is an absolute shrinkage in the amount of bank balances in the system and somebody replenishes his liquid position, somebody else must go short. It must be diffused throughout the system.

10312 Does it follow that the man who goes short is a likely spender, compared with the man who wants to maintain his liquidity?——Not all individuals would be affected by the squeeze, but I suggest that there would be a lot of people who would be less comfortable than usual. When they do the finance side of their budget they will say: "Where is the cash coming from? We are no longer getting credit on the one hand, and we find that payments are in arrear on the other hand". A finance committee looking at it for the purpose of liquidity says: "We do not see where the money is coming from; shall we try an issue, or go to the bank?" The bank will say: "No"; then they say: "We had better defer doing this".

10313. *Professor Cairncross*: You have agreed that, if there is an expectation of rising prices, this may not take much effect?——If there is inflationary pressure,

the credit squeeze will not necessarily completely overcome it; if people have rising prices, long order books and expectation of good profit, they will no doubt find the means of carrying on with their project. It will only be the marginal people; we do not expect the credit squeeze to affect everybody, but to affect a sufficient number of people to restrict the number of orders placed.

10314. *Chairman*: The squeeze of the credit base is directed at the banks; the banks are the subject of the operation?——In the first instance, yes.

10315. That means that you are trying to reduce the volume of bank advances, so far as they are not protected by sales of investments?——In the first instance. In the old days the banks reduced their holding of bills or called in money lent to the discount market for the holding of bills, and the reduction of lending was rather a reduction at the expense of the foreign borrower. As the rate of interest went up in London, the flow of bills for discount in London was reduced. That was when the main medium of the discount market was financing international trade. Now the market is transformed and the major medium is undoubtedly the Treasury Bill; the international bills play quite a secondary part. When the deposit banks are squeezed, instead of their reconstituting their position by lending less on account of foreign trade, they have to try and reconstitute by lending less to the Government on short term.

10316. And if you take Government expenditure and its necessity of borrowing as fixed?——If the Government has got to borrow a certain definite amount on short term, the discount market puts up the rate; this may attract some outside bidders, but not enough outside bidders, and they still get a certain quantity of bills assigned to them. If the amount assigned to them exceeds the cash provided for them, the Bank of England has to help them out; if the Bank refused to help them out for weeks or even months on end, then the discount market might say: "We cannot take the whole offer of bills because we are being put in an impossible position". So the Bank will be driven to help them out at a lower rate of interest than the Bank Rate. Then the Bank of England will naturally say: "The whole operation seems rather futile; if we are going to conduct open market operations, squeeze the deposit banks, and then the discount market comes back to us and makes an unshakable case for having accommodation granted, we have undone what we did in the first instance". So the open market operations seem to be hamstrung. The banks might draw in their horns in other directions. That is what they did in the earlier part of 1955; the banks sold such of their investments as had a reasonably short date so that they did not make too big a capital loss. When they have disposed of as many of their investments as it seems reasonable to do, at a minimal capital loss, they say: "We cannot go on with that any more; now we must begin restricting advances"; because they cannot restrict in the most natural way, namely through the short-term market, they are driven to restrict advances. In 1955 the banks were in a position in which they realised that in order to reconstitute their position they would have to restrict advances, and before the Chancellor's letter in July they published a letter in *The Times* warning people that they were going to restrict advances. All the same they were endeavouring to restrict loans to the money market, and the Bank of England was all the time helping the market; prior to the Chancellor's letter the Bank of England could not actually make them reduce advances by a sufficient amount. The Bank of England, perceiving that its first impact was on the discount market, felt itself unable to carry through open market operations on the scale desired, because it found that, as soon as it tried to do that, the discount market came back to the back door, and they had to re-lend the same amount by a different channel. They were so impeded in their open market operations that, though it appeared that the banks were finally going to reduce advances, the Chancellor thought that this must be speeded up, and sent his letter to the Governor of the Bank of England to ask for a speedier restriction of advances as the only method of reducing the quantity of money circulating in the economy.

10317. There was a shrinkage of bank liquidity in those early months of 1955; in your view what brought that about? The operations of the Bank of England in the old sense?——It is difficult to measure, because there is always a seasonal reduction in the early part of the year; but it does seem that the Bank of England in the early part of 1955 was operating in that sense and the banks reacted by selling their shorter-dated gilt-edged; so there was quite a reduction in the total amount of accommodation given by the banks.

10318. Does anybody know who were the people who took over the securities which the banks had sold?——I suppose that they were taken up into the general market. Prices went down, and yields increased; people who were interested in short-dated stock no doubt took them up.

10319. *Professor Cairncross*: How do you view the degree of perfection of the market here? If the money supply is not affected but the banks are constrained to reduce their advances, would you expect industrial borrowers to be seriously embarrassed, or would you think they could normally hope to obtain funds elsewhere?——Different firms have different ways of financing themselves. Quite a large number of firms regularly finance themselves by their overdraft; others do not. People who would normally expect to finance certain things by overdraft will be unable to do so. Being deprived of their overdraft facilities, they may sell some securities, which makes the market a little stickier, and makes it difficult for other people to make new issues.

10320. Stickier than it would be if the money supply were contracted?——The money supply will have been contracted by the reduction of advances. The reduction of advances is one way by which the money supply is contracted. The old traditional method of contracting the money supply was by a reduction of loans by the deposit banks to the discount market. If that is partly blocked, the Bank of England cannot compel the deposit banks to make the discount market short of funds. The deposit banks may reduce other lines of assets; they may reduce investments or advances, and reducing advances does curtail the money supply and does have an overall effect on the economy. There will be an overall reduction in the quantity of money. My main contention is that doing it in the first instance or chiefly by contracting bank advances is less satisfactory than doing it in the first instance and chiefly through the short loan market. Both will cause a reduction in the quantity of money. If you look up the statistics of the total quantity of deposits held by people in the country you will find that they have gone down, whether the reduction has been through a reduction of advances or through a reduction of call money.

10321. When one brings in funding, the issue may be whether the monetary authorities through the central bank sell long-dated securities or whether the commercial banks sell?——There is no doubt that the credit squeeze itself makes funding by the authorities more difficult. The operation of the credit squeeze tends towards a general liquidation of holdings of gilt-edged stock and weakens the gilt-edged market, so that the Government authorities who are trying to dispose of stock held in the departments, say with a view to reducing the volume of Treasury Bills, find that funding is much more difficult.

10322. Your view of the old-fashioned credit squeeze was that it reduced the amount of money available for the accommodation of people who wanted short-term loans in the discount market, and that, because the main assets there were bills for financing trade, it reduced the volume of trade that was being carried? Nowadays, where the main asset is the Treasury Bill, it does not reduce the volume of Government expenditure, because that has to be maintained?——Yes. The authorities cannot make the contraction that they desire to make in the quantity of money that way. Suppose that the amount of money available for the banks and the discount houses to use in the market is curtailed. In the old days they put up the rate of interest. The bulk of the medium was international trade hills, and its supply was elastic, so that when the price was put up the bills went elsewhere for discount and the flow of bills through London was reduced. The banks and the discount houses between them were able to reduce the amount of money they put into circulation, because as the rate of interest went up the demand for this money fell off. In the modern situation, where the main medium is the Treasury Bill, the same

thing happens; they put up the rate of interest a little. But these Treasury Bills have got to be carried. In certain circumstances the higher rate may attract foreign holders into Treasury Bills, but there has to be no fear of devaluation, and convertibility. All these things play their part, so there may not be a strong effect in attracting foreign holdings of Treasury Bills. So the mere fact that the rate of interest has gone up may not reduce by a large amount the amount of accommodation the discount market has to make to the Government, and if it cannot find the money, then the Bank of England supplies it by the back door, and the original open market operation is frustrated.

10323. In paragraphs 43 and 44 you direct attention to the possibility of separate operation on "the diffused difficulty of borrowing" and on short-term rates, and you visualise three distinct possibilities. Do not these three distinct possibilities presume considerable imperfections in the markets for short- and long-dated securities? You presume that people do not move very freely between the short and the long end of the market?——That is partly implied, but it is not my main point. My main point is that, if you take the totality of borrowing and lending, including trade credit and everything else, a large part of the total market is imperfect. There is an enormous quantity of borrowing and lending going on, of which a part flows through perfect markets. The Treasury Bill market may be called a perfect market: so may the gilt-edged section of the Stock Exchange, though even that is not quite perfect, because the banks find that, when they want to unload a substantial quantity of gilt-edged securities, they just cannot unload all that amount at a given price. Still, we may regard those two markets as entirely perfect. But they only represent a part of the totality of borrowing, and much of the other borrowing is conducted in imperfect markets, such as trade credit, private lending and so on; even bank advances themselves, to some extent, are imperfect. The bank advance depends on a discussion; it is not just a question of being willing to pay the rate of interest created by supply and demand. There is a great deal of borrowing and lending in imperfect markets. I would say that the reduction in the quantity of money makes borrowing difficult throughout the whole system. When that happens one would expect, as one symptom of this difficulty of borrowing, that the long term rate of interest and the short term rate of interest would rise. But I contend that the short term rate of interest, which is so much governed by the supply and demand of Treasury Bills, will be strongly influenced simply by the supply of Treasury Bills in relation to demand, and may not move upwards or downwards by the same amount as the general difficulty of borrowing. It might even move in the opposite direction from the general difficulty of borrowing in certain circumstances, because one is dealing with a particular specialised perfect market which has its own price quotation determined by the supply and demand of one specific security.

10324. I see the theory well enough; I wondered how far you had pushed any statistical verification of this. In paragraph 44 you say: "Recent experience has suggested that the Treasury Bill rate has been sensitive to small changes in the ratio between the quantity of cash and the amount of tender Treasury Bills. Have you investigated this to see whether it is borne out by the figures in recent years?——I have been watching it closely for the last four or five years, and it has seemed to me that there has been a rather strong movement in the rate in relation to fairly small changes in the quantity of discounts and call money at the banks on the one side and Treasury Bills on the other. I have not done it in the form of a chart or a mathematical correlation, but merely observation. But I would say that the general difficulty of borrowing does not move in exact proportion to the Treasury Bill rate; and I think that the general difficulty of borrowing is much more accurately reflected in the long term rate.

10325. I am not clear precisely what you are meaning by the quantity of cash. You used a phrase just now which was not what I expected; you spoke of discounts and call money; is this what you are thinking of as quantity of cash? In paragraph 44 you talk about the ratio between quantity of cash and the amount of Treasury Bills?——I think I should have added in paragraph 44: "between the quantity of cash available directly or indirectly to the discount market."

10326. Including cash provided from abroad?——No.

10327. I am not sure of the relationship you are trying to make?——The relationship between the cash made available through the banking system and the supply of Treasury Bills. A relatively small change on either side will produce a change in the Treasury Bill rate. This implies that the supply of cash from abroad is fairly inelastic. If the supply of cash from abroad was elastic to the Treasury Bill rate, then a very small change in the rate would bring in a lot of foreign cash, and the effect of a small change in the supply of cash by our banks would be negligible; but if the foreign supply of cash is not very elastic, then a relatively small change in the supply of cash by our banks, given that the amount of Treasury Bills is unchanged, would produce a strong effect on the rate of interest.

10328. You are excluding autonomous changes in the supply of cash from abroad to the discount market, and are only therefore considering what the effect would be of an increase by the banking system in the release of cash to the discount market, independent of anything happening from other sources. If I may then take you back to paragraph 43, your first possibility is one in which you speak of a domestic credit squeeze without there being any need to attract international short term capital. In those circumstances you are thinking how to reduce the quantity of money and reduce the flow of tender Treasury Bills by the same amount. Would this not postulate that it was possible to find another market for those tender Treasury Bills?——It assumes a possibility of funding.

10329. But is it not just the difficulty of funding that you have been drawing attention to in other parts of your memorandum as making monetary policy awkward nowadays?——Yes, and my argument is that, if one wanted to execute a delicate policy of the kind I am here suggesting, where one could either emphasise the change in the rate of interest, while not wanting to have too much change in the domestic difficulty of borrowing, or have a strong squeeze internally but without the rate of interest going up, then one must first have overcome the obstacles that have made funding so difficult in the last two or three years. If we go on with a system in which the Government is always finding it extremely difficult to fund, then it will not be easy to work a system of this kind. That is why I want to put the Government into a position in which it does not have to borrow so much all the time. I cannot believe that funding alone would present an insuperable problem if the Government was not going to be a large borrower. When the Government broker has to get the new money into long or medium-dated stock, and on top of that to fund a nice big block of Treasury Bills, he finds his task impossible; but if the Government was not a big borrower, then, although the Government broker might have his technical difficulties in certain periods of the year, on the whole I should say that it would not be difficult to fund such quantity of Treasury Bills as is required for a credit squeeze, since he would not also have on his plate the problem of funding a lot of new money to finance new Government expenditure.

10330. You seem to me to be implying three things: (1) that for this policy to work there should be a substantial outside market for Treasury Bills, (2) that there should be a substantial outside market for gilt-edged, and (3) that the arbitrage between the short and the long ends of the market is little. Are not those the three suppositions of the policy outlined in paragraph 43?——You have put the third too strongly. There will always be some arbitrage between the long and the short markets, but it is never complete; the long rate never moves by nearly as much as the short rate.

10331. That is always true, and therefore any change in the short rate is not likely to be reflected in a similar change in the long rate?——But the authorities can direct their policy deliberately so as to have a strong effect on the short rate, or a strong effect on both rates, or a strong effect on the long rate and not on the short rate. I do not say that there can be substantial rise in the short rates without some rise in the long rates, or conversely; but if the difficulty of funding is not too great, the

authorities can stress either side of the policy according to the requirements of the situation.

10332. Is there not a fourth assumption there, about the effects of changes in the short rates on the international situation? Are you not postulating that there is in fact some elasticity in the supply of credit either to foreigners or from foreigners in response to changes in the short rates of interest?——I regret that there is not more elasticity. There used to be a very high elasticity in the old days, but in order to get such elasticity there has to be absolute confidence that there will not be a devaluation, otherwise changes in the forward rates always exceed small differences in the rate of interest.

10333. But unless you see some connection between the two, does this make sense? You are dealing here with the ancient difficulty of trying to distinguish between impacts externally and impacts at home of a given change in monetary policy, and trying to have it both ways. You speak in this paragraph, and I should have thought you were obliged to speak, of a high Treasury Bill rate attracting international capital. If it did not attract international capital, would there be in fact any possibility of having it both ways?——No. If the height of short-term money rates in London has no effect on international capital movements, then that side of the story goes out; we need not bother with it any more. But my hope is that in the future, when fears of devaluation are sufficiently overcome (and I think they have largely been overcome in the last nine months), we shall be able to get back to a greater elasticity in the response of foreign funds to the rate of interest. I have said that when there is a fear of devaluation there is no elasticity, but that may be an overstatement. There may have been some elasticity in recent years, if only in the sense that the high rate has been a factor preventing people withdrawing funds from London. Sterling has been in a parlous position, and there have been anxieties about devaluation; many people have been tempted to withdraw their funds from London because of fears of devaluation. If they entertained those fears very seriously, they would not think about anything else; they would withdraw. But there are marginal people who may wonder whether sterling is the best currency to hold their money in, and it is possible that those people have been attracted to hold on to their sterling because of the good rate of interest prevailing in the last year or two. So it may be that, though the short term rate does not operate in the highly effective way that it would if there was no fear of devaluation, it may yet have had some influence. I would not like to say that the whole history of the high Bank Rate in the last two years or so has had no effect on the foreign situation at all; I am sure that would be an overstatement.

10334. Could we go on to Section V? You say that the normal long term interest rate in Britain should be 3 per cent. I am not clear from the argument here why you say 3 per cent. Why not 4 per cent., or 2 per cent., or some other percentage?——It is purely traditional; I was thinking of the nineteenth century.

10335. We do not lend abroad now half our savings annually?——Perhaps I ought to have said: "should not be higher than 3 per cent." I chose 3 per cent. as the traditional figure. I believe that we should get back to being a low interest rate country, and I thought 3 per cent. was commonly accepted as the British rate of interest in the nineteenth century, though I have no doubt that it diverged from time to time.

10336. You do not foresee that there might be a shortage of capital at home over a very long period, that might make it appropriate to have higher rates of interest than in the past?——I do not think so. I think that there will be every reason to encourage investment in the next ten or twenty years. I do not think that we shall revert to the sort of situation we had after the war, in which there were far more claims on investment than we could meet, and we had to curb them, by controls in the early period and by a higher interest rate later. With a stationary population here it is most unlikely that the claims on investment arising in the ordinary way will be very great; on the contrary I should say that it should be our policy to encourage investment. As I pointed out, we are encouraging investment by accelerating depreciation allowances. I do not know whether they are a strong stimulus, but they may have some force. I am in favour of them, and I think that it is absurd to have accelerated depreciation allowances and yet have a high rate of interest, in so far as that is meant to discourage investment; and if a high rate of interest does not discourage investment, I do not see what it is doing, except adding to the burdens of the taxpayer.

10337. May we then go on to your discussion on the price of gold? You draw an interesting comparison between what would happen if the United States' quota in the International Monetary Fund were increased, and what would happen if the price of gold were increased, and you indicate that there is a disproportion between these two lines of action. The extent to which one wants to add to international liquidity depends a little on the pattern of settlements one foresees; if the pattern of settlements is one in which there is no particular difficulty one way or the other in reaching balance with the United States, the international liquidity required would have to be such as to allow other countries to adjust their differences with each other. That being so, is it quite fair to make a comparison in which an increase in the I.M.F. quota is equated entirely with a change in gold or dollar liquidity? Is it only a change in gold or dollar liquidity that is useful, or may it not be necessary to provide some form of liquidity that allows countries to settle their differences with one another in other currencies or through international drawing?——The trouble about the I.M.F. is that a country may draw other currencies but it has to repay in dollars. So the availability of other currencies in the International Monetary Fund is not really much increase of international liquidity.

10338. If drawing rights within the European Payments Union were substantially increased?——I am all in favour of that. I would not like it to be thought that I want the price of gold raised at the expense of other contributions to international liquidity. I am all in favour of an increase in liquidity in the International Monetary Fund, and I regret that the European Payments Union seems to be moving in the opposite direction, towards 100 per cent. gold settlement. I thought that the holding of E.P.U. units was in its way a contribution to the total volume of international liquidity. But all feasible plans involve such small sums compared with what we should get by a change in the price of gold. On re-reading paragraph 69 before coming here this morning, I think I have stated the matter too weakly, because I have only referred to the increase in the dollar value of gold holdings outside the United States. I failed to say here, though I have said in the articles, copies of which were sent to you yesterday, that it is of the greatest possible importance that the gold holding of the United States itself should be increased in value. The whole world would benefit by that. In the last eight years the United States, by its military expenditures, by its aid and by all sorts of methods has allowed itself to have an adverse overall balance of payments, the result of which is that the dollar holdings of the rest of the world have risen from about \$5,000mn. in 1950 to about \$13,000mn. today. That has been a very substantial increase in international liquidity. But the United States have now got to a position in which that simply will not be allowed by their own people to go on happening. The U.S. has by this time given away the whole of its surplus gold; it is now right down to the bone. It has \$22,000mn. of gold, against which \$13,000mn. should be earmarked against its external liabilities, just as we now have £1,100mn. of gold, of which £500mn. should be earmarked against our external liabilities. The remaining amount of gold is just enough to cover the 25 per cent. that it is a legal requirement for the Federal Reserve to hold. It used to be said in the old days that, if only the United States would give all their spare gold to the rest of the world, what a good thing it would be. Well, they have done it; if they give any more gold away, they will be eating down into the reserve that is legally required to be held. They might do that, but they will not go on doing it indefinitely. If they raise the price of gold, that enhances the value of their own gold holdings; their external liabilities, instead of being half of their holdings, will at once shrink to only a quarter of their holdings, and the 25 per cent. cover required will only be half as much gold as it was before. That would release at least \$20,000mn. of gold. You may say that

the United States so far has shown no inhibition in lending and making these grants, and so on, but I am sure that cannot go on. So I would not put these two things as alternatives: *either* the United States can provide more liquidity *or* it can raise the dollar price of gold. It has *got* to raise the dollar price of gold as a necessary preliminary to increasing its advances on a really generous scale to the rest of the world. So this increase in the value of the United States' own stock of gold has to be added to the $16,000mn. that I put down here, because that increase will benefit the rest of the world.

10339. If you look at the effect on this country of increasing the price of gold, does it not also mean that we would have to start paying twice as much for our imports of gold, if the price of gold is, say, doubled?——Our gold holding is not very great in relation to the total holdings of gold or in relation to what we need; but the value of our gold holding will at once be doubled; its power for international settlement will at once go up. We would benefit from the fact that the values of other countries' gold holdings would go up, so that we should be much less vulnerable as regards sterling; if people are not so short of reserves then their requirement to convert sterling into dollars will be that much less. We suffer because, if other people run short of gold or dollars, they will convert their sterling into dollars; or we suffer because they impose import restrictions on our exports because they are short of reserves. I am sure that we should gain in innumerable ways if the rest of the world could be restored to the reserve position that it had before the war. That cannot be done by increasing the liquidity of international institutions, because the feasible increases of liquidity of the International Monetary Fund and so on can be measured, I would say, in terms of billions of dollars, whereas in the price of gold we are dealing in tens of billions of dollars.

10340. In one sense that is true, in another sense not. If you are excluding the United States, Germany and Switzerland, the total gold reserves of the world are of the order of $10,000mn; the assets of the International Monetary Fund are of the order of $9,000mn. They are not very different?——No, but I would not admit those bagsful of inconvertible currencies. They are just not available; they are no use to people because when they borrow those amounts they incur gold liabilities. I am not saying that it is not useful for countries to have currencies of all other countries, but they do not want that at the price of incurring a new gold liability. My argument is that, if the United States' own reserve was increased in value, we should all benefit because the United States could at once adopt easier aid policies than they are likely to do if they are running short of gold. We would benefit indirectly; I do not say that we would benefit much in the first year, but I am sure we would benefit over a ten year period.

10341. Your view is that in the next ten years U.S. imports will not be affected by inadequate gold holdings?——That is right.

10342. In the last section of your paper, on reserves, you have implied that currencies will continue to be on an inconvertible basis, and that countries will therefore continue to look on their reserves of gold as different from reserves in inconvertible currencies. You set out in Table II some rather striking figures about the British net reserve; you exclude from the liabilities our liabilities to other sterling area countries, which can of course be cashed in dollars if other members of the sterling area run a deficit of dollars. Is it reasonable to exclude those liabilities from a consideration of our reserve position?——I think it is, provided always that one adds the corollary that we hold our reserve against a deficit of the whole sterling area. In any year we may be called upon to finance part of the deficit; our liabilities to the sterling area countries boil down, as I understand it, to an obligation to finance in dollars, if required, any deficit they may have. I do not precisely know what may happen in regard to such countries as Ghana, though I should hope that the position would be safeguarded. I regard the sterling balances outside the sterling area as different in kind. If a bank or a trader outside the sterling area does not like the look of sterling, he can and will cash it for dollars, not because he has any immediate need for dollars but because he prefers to hold dollars rather than sterling in the circumstances. I put it that the sterling area countries do not do that; they regard their sterling reserve as something which can be converted into dollars if they have a dollar commitment to meet, but, so far as I understand, none of the sterling area countries would convert sterling into dollars merely because they liked the smell of dollars better. That would not be playing the sterling area game. If any country started doing that in a big way, then we should have reservations, though some sterling area members may sometimes build up little nest-eggs of gold out of their own earnings; but I think that is rather different.

10343. If you look at the history of our reserves over the past few years, has not one of the major factors producing fluctuations in them been fluctuations in sterling balances held by sterling area countries?——But the sterling area balances held by sterling area countries may be influenced by their own external deficits, to meet which they draw down their sterling balances; or alternatively they have a deficit with us and use up the balances in buying our goods.

10344. The leads and lags which affect our trade are surely the leads and lags which affect the sterling area's trade, and can do so only so long as these sterling balances are held?——Take trade between ourselves and Australia: if the leads and lags go against us, even if Australia had no sterling reserves it would produce deficits in the U.K. balance of payments.

10345. In Australia's trade with third countries financed through London is there not an opportunity for larger leads and lags than would arise if their reserves were not held in London?——I am not saying for a moment that I think our reserve is satisfactory; I wish it were larger. One of the important needs for a reserve is in order to finance possible leads and lags of trade. My argument is that, as unfortunately it is not large, we must be really cautious in a policy of deliberately increasing it, especially in a time of world recession. I would not mind trying to increase it in a time of world inflation, but to increase it in a time of world recession, to have a deliberate policy of stepping up our reserve by more than a reasonable share of the newly-mined gold each year, or of any additional dollars that may be available, may make the world recession worse and will hit back at us through restrictions on imports from the United Kingdom.

10346. Would you hold this also if the increase in our gold reserves were accompanied by a parallel increase in sterling liabilities?——I argue that we should pay the minimum amount of attention to that. I think the right policy was that of the pre-war days, when we paid no attention to inflows of gold due to inflow of hot money. The two things should be regarded as cancelling out, and we should not regard our position as any better as we get more gross gold reserve if the additional reserve is offset by gold liabilities in the form of more sterling balances.

10347. Would we not be in a much better position if we had larger gold reserves, even if in the process of adding to our gold reserves we added simultaneously to our liabilities, which would increase the reserves of other countries and to that extent take from the force of the argument you are putting?——I do not see that it would increase the reserves of other countries, because they part with gold in exchange for sterling; supposing that they part with £100 million gold in exchange for £100 million sterling, their reserve is the same as before, and it takes the form of sterling instead of gold. You say that we are better off because we have got £100 million gold, and we can forget the £100 million liabilities. I do not see the point of that. I would take our net position, and say that we were no better off with an increase of £100 million gold and £100 million liabilities. I am talking about sight liabilities, not about some liability that may be due in twenty years' time.

10348. On your own figures, if these new sterling liabilities were owed to sterling countries, our net reserves would improve, and the position of the sterling area as a

whole would improve, but countries outside the sterling area would be in a weaker position?——I do not understand this. This is going on all the time. We buy newly-mined gold from the sterling area countries, which raises their sterling balances and raises our gold reserves. How can we buy gold from the other sterling area countries, except the newly-mined gold?

10349. The suggestion was not that we bought gold from the other sterling area countries, but that we added to our gold reserve. That does not in any way specify where the gold is obtained, any more than it does in your own document when you are speaking of an additional £100 million of gold per annum.——I am not against adding to our gold reserve; all I am saying is that we should not make it an aim of policy to add to it at too great a rate. I do not quite understand how the sterling area sterling balances come into it. It is the gold reserve for the sterling area. If gold comes in from outside the sterling area, that is excellent, if it happens in a natural sort of way; but I am against a deliberate policy of adding to our gold reserve by restricting our imports, especially in a time of recession. We must not be greedy about reserves. There is very little reserve for all the countries to share between them, and we should not seek to increase our reserve by more than a due proportion of the newly-mined gold and the newly available dollars in the world.

10350. Germany has increased her reserve by $700 million since February; what is your comment on that?——Some people say that I take too kind a view, but I would say the Germans are trying their best not to do that. They know that it causes some embarrassment, and they are trying to minimise that by paying off certain debts, by lowering their Bank Rate, and by liberalising their imports. They have an argument, which I am not quite able to follow; I was reading the report of the Deutsche Bundesbank the other day, and they claim that the rest of the world has not lost reserve by the full amount of the German gain in reserve, owing to the fact that they count in their foreign exchange holding International Bank exchange notes and the E.P.U units. However, I think that the Germans deplore this influx, which arises from an unduly favourable balance of trade combined with speculative capital movements, and particularly with the leads and lags of trade which went to an exorbitant amount last year, and I think that they are honestly trying to correct that situation. Though we may criticise them for not doing all they can, they have done certain things. To that I would add that they are convinced that the present situation will not last long; in fact it would not have already lasted so long had they not had the same benefit we have had from the improved terms of trade. The German external terms of trade have improved by 10 per cent. in the last twelve months, so that has made their balance *pro tanto* that much more favourable than it would otherwise have been.

Chairman: I think that concludes our questions, Mr. Harrod; we are very grateful to you.

(*The witness withdrew.*)

J. R. SARGENT, ESQ., Fellow of Worcester College, Oxford, called and examined.

10351. *Chairman*: Good afternoon, Mr. Sargent. Would you please have your memorandum* in front of you? We should like to ask you one or two questions about what seem to be the essential points in it.—*Professor Cairncross*: In the early part of your paper you draw attention to what you describe as a drift towards convertibility, and you then go on to give us some figures, from which you deduce that the swings in gold and dollar payments to other countries have been aggravated by this drift, in relation to the deficits incurred with other countries. I do not want to spend a lot of time on the statistical basis for this conclusion, but would you agree that, if you took rather different periods, or took the individual years involved, the results might look different?——*Mr. Sargent*: Yes. I was measuring the swings in payments with the non-dollar world, not the dollar world. If I were to take different periods, it is possible that it might come out differently. I did as a matter of fact work out what difference it would make if I excluded the second half of 1951, which is a period of enormous fluctuation; it reduces the contrast by about one-half, compared with what I have stated here, but it does not by any means eliminate it. I think that one must take periods somewhat like the ones that I have taken, for the purpose of contrasting what happened in a period when there was restricted convertibility with what happened in a period when there was *de facto* full convertibility.

10352. I meant really that the results which you obtained are subject to a considerable margin of error, on the grounds that if you took it year by year you might find that the fluctuations in the movements of gold and dollars were not accompanied by the fluctuations in payments that you predict, on the basis of the ratios that you have worked out?——Yes, that is possible. Ideally one would want to do it for as short a period as possible, because presumably in a six-monthly period the fluctuations are to some extent ironed out; but that is on the figures available to me.

10353. You did not in your paper provide the link between the statistics and the theory that you set out earlier on. Would I be right in saying that in your view the principal factor at work producing this relationship has been the change in the gold content of E.P.U. settlements from 50 per cent. to 75 per cent., or is there some other major factor which you think has been responsible?——I should have said that the major factor responsible was the decision to support the transferable rate. This is why I chose the beginning of 1955 as the second period. The tendency to harden E.P.U. had been going on before the beginning of 1955, and any change due to that would be reflected in the first period. In the second period the two major factors are the increased hardening of E.P.U., and the decision to support the transferable rate.

10354. How would the decision to support the transferable rate affect this? I can see that it might lead to an increased movement of funds out of this country through time, but would it give rise to a greater volatility of gold and dollars for a given change in the balance of payments? Would this not be more likely to be related to speculative pressure such as we had last autumn?——I think it would tend to increase the volatility, because by supporting the transferable rate one makes it easier and less risky to sell any accumulations of sterling which might arise in the hands of non-dollar countries for dollars in the New York market or elsewhere. I should think that it would have both effects. I have outlined one of the effects in the table in paragraph 5, in which it is shown that there is an increase in the sterling area's deficit, taken as an average, which no doubt reflects this factor. But I think that it is also bound to increase the volatility, because if it is made more easy for people to exchange their sterling for dollars, then a greater proportion of any temporary surplus of sterling which arises is likely to be converted into dollars.

10355. There are two quite distinct factors here. You show that the deficit of the sterling area with the non-dollar world has increased. There have been a large number of factors at work there; there has been the increased deficit of India over the period of time you are considering; there may have been a switch in our sources of supply from non-dollar to dollar sources, or *vice versa*; there may have been differences in the treatment of dollar purchases in the accounts which are published. I do not myself know how the White Paper treats a purchase of cotton in the United States for dollars, and its subsequent sale for sterling, say, to France or Germany; but is it not clear that any change in the accounting might give rise to rather curious effects in the statistics?——That is quite possible.

10356. If we take the practical outcome of this, one view you come to is that there should be a softening of E.P.U. That can be differently interpreted. Would it not meet your point if the settlements were made against the transactions not in the past month, but in the past three, six or twelve months? This, I think, is one of the suggestions you make in one of your paragraphs?——Yes.

* Memoranda of Evidence Part XIII No. 36.

10357. Is that the only form of softening that you are thinking of?——Yes.

10358. In that event, the percentage settled in gold and dollars would not necessarily change. There would be merely a larger tranche of transactions which would be squared from time to time?——That is what is primarily in my mind. I do not think that we can validly complain about settling in the ultimately acceptable form of currency any prolonged deficit that we may incur. By a softening of E.P.U. I would like to achieve that we only had to settle what appeared to be persistent deficits in the form of gold and dollars, and leave the temporary ones to even themselves out through swings of credit.

10359. *Chairman*: What, in your view, would be the underlying reasons which have led to the hardening of E.P.U. settlements?——There has been considerable pressure from some of the other E.P.U. countries: the Germans, I suppose, and the Dutch and the Belgians, I believe, particularly. There is also the fact that, once we returned to the support of the transferable rate, it was in our interest to harden E.P.U., so that we could get back as much as possible of the sterling that they freely sell in New York.

10360. Do you know enough to say what has in fact been the motive that has led to the hardening, or has it been by argument and agreement?——At the level of inter-governmental discussions I know nothing.

10361. You take it as a fact that it has happened?——Yes.

10362. *Professor Cairncross*: When you are speaking of the swings in gold and dollar payments, you have partly in mind seasonal pressure; but the fluctuations that you are discussing in the table in paragraph 5 are presumably not just these seasonal swings?——No. I think it would be inadequate if we were only safeguarded from seasonal swings. I should hope for some greater insulation of the internal economy than that.

10363. One would have thought that, if it were purely a seasonal pressure, it would not necessarily expose us to the need for violent correctives, but that commercial credit could take care of it; but you later lay stress on the fact that at the same season each year we seem to get into difficulties?——I do not wish to attach any particular significance to the seasonal factor, but merely bring it in to illustrate the fact that nowadays we have to get worried even about this obviously self-reversing movement, which in former days would not have worried us at all.

10364. Was not the seasonal factor operating before the war?——I believe that it has always operated, but my memory does not go back to reading a financial commentary at the time. But I have the impression that it was not noticed nearly as much as today.

10365. At the end of paragraph 6 you speak about the degree of restriction on internal demand which convertibility has forced upon us. Taken literally this implies that the changes in monetary policy have very real effects on the level of demand. Do you take that view, or do you think that the application of monetary policy has had limited effects on the level of activity?——I should have thought that at the moment one could say that monetary policy is having definite effects upon the level of activity. But in order to make monetary policy effective it seems to be necessary to follow it up with other more direct measures which have a downward effect on home demand, such as restriction of bank advances, or restriction on the investment activity of nationalised industries. One gathers that these are felt to be necessary when monetary policy is applied, in order to convince foreign speculators and others that the authorities mean business.

10366. Would you have said that these monetary measures had any effect on the level of output before 1957?——It is not obvious that they had.

10367. So that, when you speak of the degree of restriction on internal demand in paragraph 6, you are thinking specifically of the last few years?——Yes.

10368. And associating that in your mind with the pressure that the drift to convertibility has exercised?——Yes. I am thinking, I must admit, mainly of the last year or two.

10369. Is it your view that the monetary authorities have been influenced by the violence of the movements of gold and dollars, and not to any extent by what has been happening inside the country, such as the fall in gilt-edged prices and so on?——I should have said that they have had their minds particularly on the state of the gold and dollar reserves.

10370. Surely some would say that the rise in the Bank Rate to 7 per cent. last autumn resulted from a lack of confidence in various quarters in the pound, brought on in part by the fall in gilt-edged, and in part by the large adverse balances of some members of the sterling area. In what way do these two forces, which I should have thought were of considerable importance, link up with the analysis which you have given us here?——The analysis that I have put forward suggests that, had we had a greater gold and dollar reserve, or had it been more difficult for foreign holders of sterling to convert their sterling balances, then the crisis would not have been as bad. We should have been able to get through it, not necessarily without internal restriction, but without so great a degree of internal restriction as was thought to be necessary.

10371. I am not quite sure that I see how the second force can have operated, since one would have thought that the swing in commercial credit was the principal factor at work; and that is not very obviously affected?——No; I agree with that.

10372. Perhaps I should turn to some of the positive suggestions which you put to us later in the paper. You think that something might be done to regulate purchases of imports of food and raw materials from abroad, and that there should be a standing machinery which could be brought into operation, if necessary, to regulate those purchases. If that machinery did exist, and could be made operative at the right time, would the index on which it would move be the state of our balance of payments?——The state of the sterling area balance of payments.

10373. So that there would be stocking-up when we had a favourable balance of payments, and de-stocking at other times, that would, in effect, compensate the movement of gold?——Yes.

10374. Would it not be impossible to combine this with other proposals that have been put forward for attempting to stabilise the price of food and raw materials through buffer stocks? Would not the index governing stocking-up be quite different on that assumption from the index that would regulate purchases on your proposals?——Yes, unless the proposals for buffer stocks were themselves linked with some provision for purchasing on credit, in a way which I am not very clear about at the moment.

10375. What sort of commodities do you think should be subject to quantitative licensing?——Mainly industrial raw materials imported on a substantial scale. I should need to study the list of commodities which are imported on a large scale, and the extent to which home substitutes exist.

10376. You are thinking of procurements from outside the sterling area?——Primarily.

10377. That does rather limit you?——It does.

10378. *Chairman*: If you concentrate part of your scheme on food stocks, are we habitually elastic in that? Is there fat that we can live on for a time, if you impose your system?——I should have thought that there were stocks of reasonable size, even of foodstuffs, which are held within the country.

10379. Assuming that there is no administrative difficulty in getting even an existing skeleton of control, how do you envisage it would work? Your idea is, when there has been pressure on the balance of payments, to make those who have stocks in the country live for the time being on their fat?——Yes.

10380. And thereby ease the current pressure. How do you think they would react to that? Would they cheerfully go ahead living on their fat, confident that they would be allowed in due course to replenish their stocks before it was too late, or do you think there would be a remarkable and rapid slow-down in their consumption of existing stocks, because they did not know where they were?——It would depend on how long the restrictions were maintained.

10381. They would not know when you started. You would be introducing suddenly an apparatus of control and uncertainty?——The purpose for which the restrictions were being used could be made clear, and it would be stated that it was not intended permanently, or for any long time, to reduce the level of imports of those commodities, but was intended for use against a temporary balance of payments deficit.

10382. Do you think it would be enough to give an assurance of that kind, to enable people to go on using up their stocks in the expectation that, in due course and before it was too late, they would be allowed to replenish them?——I think so.

10383. *Professor Cairncross*: Other countries use a system of pre-deposits in order to regulate imports of raw materials and foodstuffs, and sometimes of manufactured goods. Would there be anything in the possibility of introducing a system of that kind, under which the importer would have to put up the money himself for part of the purchase? The pre-deposit system usually means paying over to the central bank which is involved, and it therefore puts pressure on the commercial banks. ——I have not thought about that one at all.

10384. You recognise the difficulty of getting an apparatus of control into being, even though it is not being used?——I do indeed. I should like you to regard my suggestion as being subject to investigation. I should like to look further into what goods this could be applied to with profit to the sterling area balance of payments.

10385. That brings me to some questions on the sterling area, as you see it. You visualise making use of the sterling area right away, if I understand you rightly, as a discriminatory club, and not merely bringing it into operation in that way at some later stage. It has, of course, been used in the past for purposes of discrimination against non-sterling sources of supply. Do you think that it would be easy to obtain the agreement of other members of the sterling area to a revival of the type of discrimination that was practised earlier?——I do not know what the reactions would be of Ministers of Finance, and Treasury civil servants to a proposal to do this, but it seems to me that there are certain interests which the countries of the sterling area have in common, which would make behaviour in this discriminatory way preferable to any other action that we might be compelled to take in the face of pressure on the pound. I have set out some of these reasons towards the end of my paper.

10386. Is the object of this discriminatory action to operate as a substitute for more reserves, or to accumulate more reserves?——Not to accumulate but to act as a substitute for the lack of them.

10387. Is it a form of discrimination that you visualise continuing indefinitely, or is it something that would be accentuated from time to time?——I should hope that we might ultimately reach a time when it would be possible to abandon it. I dislike the idea of discrimination in principle. I have it in mind that it should be used as a measure which we might persuade the sterling area countries to adopt in preference to a deflationary policy in the United Kingdom or to a devaluation of the pound, should there be balance of payments trouble in the sterling area. It may turn out to be possible to get measures taken that would increase the reserves. It may be possible that an increase in the price of gold, an American loan, or some other such action may be able to be brought off. That is mainly a political question. That would seem to me to be the first priority. If that is not possible, then I think that we have to try to get the countries of the sterling area to act together in the face of crises, because to my mind the alternatives, such as deflation or devaluation, would be worse.

10388. *Sir John Woods*: Would you not agree that a sterling area discriminatory club would be highly unpopular so far as the United States was concerned, and not, I should have thought, immensely popular in Canada? Might it not boomerang back on us, and prevent or hamper the development of other policies, such as the one you mention of stabilisation, and things of that kind?——Yes; that is why I say that I think we should try the path of a stabilisation loan, first. I regard this as being an alternative should it not turn out to be possible to augment the reserves in this manner.

10389. *Professor Cairncross*: Since the war, as you indicate, there has been a progressive improvement in the United Kingdom's balance of payments. The same would to some extent be true of the sterling area; it was until recently in better balance than it had been in the immediate post-war period. So what you are suggesting to us here is an expedient that we used in circumstances that were, in many ways, more serious than now, and an expedient that, if the improvement were to continue over a period of a few years more, might no longer be necessary. Is that fair?——Yes, depending upon how many years you have in mind when you say "few".

10390. That brings us back to the discussion we had earlier on about the source of the pressure exerted on the monetary authorities to tighten credit. Your suggestion is that it is a recurring factor from time to time; it is recurrent, presumably, in circumstances of an improving balance of payments, looking back over the past twelve years?——One would hope so.

10391. Is it not to be assumed that there might be rather more confidence abroad in the capacity of the British monetary authorities to maintain the value of the pound, and maintain some form of equilibrium in the country?——Yes; but we must remember, when we speak of the improvement in the sterling area situation, that as far as this country is concerned it is to some extent at the expense of internal production. We are running at a level somewhat below capacity; we have in a sense sacrificed some output of goods and services, for the sake of maintaining the improved position in the last year or so. If we were to expand, as I hope we will, then these troubles might well crop up again. One would hope that there would be a continuous improvement over the longer period, but I do not think that one can possibly visualise an improvement of a size which by itself would bring our gold and dollar reserves up to the desirable level in relation to the liabilities.

10392. You seem to presume two things, which I should have thought were questionable: (1) that we can ignore what is happening in the outer sterling area to countries like India, whose deficit last year was a source of weakness which presumably cannot affect us in quite the same way in the near future; and (2) that the reduction in the level of activity is prompted by external difficulties rather than domestic considerations. Have there not been a number of factors at work dominating the monetary policy of this country, of which external pressures have been only a part?——Yes, indeed, particularly the wage/price problem; if we are able to solve this, then perhaps we can hope for some improvement. It is a little early to say whether the measures recently taken will successfully have coped with that. I should be pessimistic in the longer run about the possibility of achieving any dramatic stabilisation of wages and prices, and to this extent I should not be confident that an improvement there could bring any rapid improvement in this country's balance so as to get the reserves up quickly, which seems to me to be the necessary thing. This is a long-term question; and, while I would be optimistic about the long-term possibilities of improving the balance of payments, they are, I think, very long-term and cannot be relied upon in solving the sort of problem which I have in mind, which seems to me to require something to be done about it urgently.

10393. Would it be your view that we should get to work at once to tighten up discrimination against non-sterling purchases? Would that include European purchases?——Whether it would include European purchases depends partly upon whether we can get the European Payments Union softened. If we can, then there will be to that extent less necessity to discriminate against European purchases. This is all part of the bargaining with regard to European free trade. I should very much hope that we should be able to go into European free trade together with some agreement on the softening of E.P.U. Whether we should get to work at once on discrimination depends, as I said, on exploring two possibilities: (1) the possibility of augmenting the reserves directly by a loan, about which one can say nothing without consideration of the terms; and (2) the political

reactions in other sterling area countries, to the possible return to having the sterling area as a discriminatory club. I might have to admit that the political reactions in sterling area countries would be so unfavourable that one might have to abandon the possibility, though I think one could put up a strong case to them suggesting that it would be in their interests.

10394. Suppose that the sterling area countries said: "We will be prepared to co-operate with you, if you will furnish us with the capital we require for our own development"? How would you regard that?——I would point out to them that we are doing this on a substantial scale. If they wished to press for more, there are two things we could do: (1) we could negotiate agreed releases of their sterling balances, because undoubtedly some part of these are regarded as capital funds for use, and not simply as international liquidity; and (2) there might be a case for tightening-up the export of capital to non-sterling area countries, and we should be able to divert some capital towards the sterling area countries in this way. This is not necessarily desirable in itself, but if we had to do it as part of a bargain, it is a line which we might proceed along.

10395. This would include Canada?——This would have to include Canada.

10396. How do you foresee the operations of the European Payments Union in future, if a free trade area comes into existence. You want to see it rather softer than it is now. Would you think that it should be an organisation that should hold funds, or would you regard it as an organisation that simply grants drawing rights as at present?——I would prefer to see it as an organisation which holds funds. It would hold some gold, because in this case I think it would be possible for it to be used as a supplement to the gold reserves, for the purpose of accommodating temporary deficits with countries outside the European area.

10397. Suppose, however, that it was only possible to negotiate on the basis that there were 100 per cent. settlements in gold? Would you regard that as putting the proposal out of reach of this country?——I think I would.

10398. You think there should be some automatic credits included?——Yes.

10399. If you take the opposite assumption, and suppose that there will be no free trade area at all, on what basis do you think our relations with European countries would be regulated?——I think that it would still be possible for us to press for a softening of the European Payments Union. I admit that in that case we would have little to bargain with, except the possibility of withdrawing from the European Payments Union.

10400. Other countries might take the same view. Has not Switzerland already expressed a view on this subject?——Yes, indeed.

10401. Would we continue to be members of the Union, when at least six of the countries in the Union could and would discriminate against us?——The trading position would be extremely difficult, but that would arise out of the decision not to join the free trade area. That decision would arise independently of anything that was done about the European Payments Union. In any case, we should have this difficulty.

10402. The upshot of this is that (1) you regard the sterling area as something which is real and should be kept in being, and that we should go to some trouble to make it operative, even if operations include discriminations; (2) you would be hopeful that we could reach agreement with Europe in favour of a softer E.P.U.; (3) you would hope that we could secure a loan from the United States, or some other action on her part, to increase international liquidity. Is that fair?——Not all of those things at any one time. I would hope that, if we could obtain a loan on reasonable terms (I agree that "reasonable" is an ambiguous word), it would not be necessary to regard the sterling area as a discriminatory club. If, on the other hand, it is not possible to augment the reserves directly in that way, then I think we must consider that as the basis of the possible steps that we might take to overcome our problem of lack of liquidity. That would, as Sir John Woods said, involve difficulties with the United States, and for this reason I do not think that we want to try it until we have explored the possibilities of a loan which would directly augment the reserves.

10403. *Chairman*: Does you view of the desirability of working for a softening of the E.P.U. settlements, once we have got the transferable rate out of the way, depend on the view that we shall naturally be in deficit with the area, or is it on more general considerations?——It does not depend upon that. Indeed, if we are rather naturally in deficit with the area over a time, although it would be nice if they would let us pay in sterling, I do not think we could complain if they did not.

10404. *Professor Cairncross*: You simply want longer time to pay, because of the seasonal or other intermittent pressures?——Yes.

10405. *Lord Harcourt*: You mentioned getting a stabilisation loan on reasonable terms from the United States. What would you consider reasonable terms, as regards rates of interest and length of loan, assuming that no other conditions were attached, such as were attached to the 1947 loan?——I should have thought that anything above 3½ or 4 per cent. would be rather stiff, and anything less than 35 or 40 years would be too short.

10406. In what amount do you think such a loan would be, in order to do the job?——The present level of the reserves is slightly over a quarter of our sterling liabilities; one would like to raise it to at least a half. That would involve £1,000 million. I do not know whether it would be possible to press for that sum. I should have thought that somewhat less would have to be accepted.

10407. If we revived the sterling area as a tight discriminatory club, would you anticipate that the rest of the world would accept that, or do you think that the rest of the world would immediately discriminate against us and against the whole sterling area?——I think that the rest of the world would accept it, if it was made clear that this was to be a means of maintaining incomes within the sterling area, and was the alternative to other kinds of action which we might have to take. The other kinds of action, such as deflation in this country or devaluation of the pound, are particularly against the interests of the sterling area countries, but they are also measures which the rest of the world outside the sterling area would not like, and therefore one could present to the rest of the world the idea of using the sterling area as a discriminatory club as being the alternative to other measures, which would have to be taken if we did not use the sterling area as a discriminatory club. It would not be something which they would welcome, I agree, but something which, compared with alternatives, would be tolerable.

10408. You think that they would prefer that we should maintain incomes within the area but discriminate against all their trade, rather than that we should allow incomes to fall slightly but go on trading freely?——To go on trading freely, but possibly on a lower level of incomes, meaning either less trade or possibly a lower exchange rate which would give a more competitive position in world trade for sterling area exports.

10409. *Sir Oliver Franks*: I was interested by the way in which you seemed throughout the paper to attribute importance and effectiveness to monetary policy, because I think the general line was that again and again since the war our vulnerability on the external front has caused corrective action at home, and that this has mainly been through credit policies, which are restrictive in their application; that they have their effects on demand, particularly of course on investment demand, and that the end product is stagnation and this is bad, especially when the economies of our neighbours are growing, some of them very rapidly and steadily, and that we must find ways out of this difficulty. Is that a fair summary of the main part of the argument?——Yes, except that it would be a truer interpretation of what I said to say that it has been mainly done by credit policy *in recent years*.

10410. Some of the people who have given evidence to us talk as if credit policy bad no teeth. They say that it has little effect, if any, on consumption, and that even on consumer durables it only has a once and for all effect, and, once that is exhausted, the appetite for consumer durables is satisfied. They are inclined to say that the effect of scarcer and dearer money on stocks has been

over-estimated, and that they do not seem very responsive; and that about half of industrial investment is not directly responsive to credit policy, because it is a matter of administrative decision by Government, while in the other half interest rates at any level that we have seen are in most circumstances not enough seriously to cut back investment, partly because the Chancellor of the Exchequer pays about half of the interest, so that, if the project is a good one, the return that the entrepreneur hopes to get from it is so much larger than the rate of interest that he has to pay net, that he would not hesitate for that reason. This comes to an argument, not so much that credit policy in a restrictive sense may lead to bad results, as that it just breaks in the hand, that it is an ineffective instrument. This does not affect your analysis of the external vulnerability of the economy, but the point is that the measures which have been taken in the last five years have in fact had these bad results, which might mean they have been effective in producing them. Do you think that credit policy is an effective weapon or not?——It is partly a question of definition, of what you include in credit policy. If one extends the definition of credit policy to include restriction of bank advances, then I should have thought that it was certainly more effective a weapon than many people suggest.

10411. After the Chancellor's letter of July 1955, bank advances fell quite sharply over the following six months. That is a case where the weapon was used. How is it effective?——First of all, a number of businesses, particularly small businesses, rely upon advances from banks for the purpose of fixed capital formation, at any rate in the early stages of their development; so a direct effect is exerted there. Secondly, I think that there can be an indirect impact of restriction of bank advances, in that it is taken as an earnest of a restrictive policy being exerted. If bank advances are made more difficult to get, people will interpret this as a sign that a deflationary time is coming. If I may go on to the broader aspect, apart from the restriction of bank advances, one must remember the effect of a restrictive monetary policy on the gilt-edged market. It may be that a number of organisations are proposing to finance development out of accumulated reserves, which may be invested in some way or other; they will take a beating when there is a restrictive policy. In these ways I should have thought that credit policy can have its effect, but especially, I think, if the prevailing opinion is that monetary policy is the best thing to use in a dangerous balance of payments situation, and that those who are using it will make it effective. If the authorities are committed to the view that monetary policy is preferable to the alternatives, then I think that they must adopt whatever degree of restriction of bank advances is necessary to make it effective. It may be that we shall have to raise our sights about what is considered nowadays to be a restrictive rate of interest, and make it much higher than before.

10412. If we disregard the two symbolic things you have said (that the very act of Government in restricting bank advances is taken as a symbol of intention, and the fact that the Government in employing monetary policy shows that that is what they are going to do, and therefore the will is taken for the deed) we are left, in terms of what you said, with two points: (1) the direct effect of restricting bank advances, which falls more particularly on small companies, and (2) the effect on the gilt-edged market, the fall in prices and the rise in interest rates. How far do you think the effectiveness of these two points is conditioned by, and possibly limited by, the general liquidity of the whole economy? Suppose that a large number of industrial companies are in fact pretty liquid. Suppose that there is a good deal of money about, and that it is not awfully difficult to find another source of borrowing, though one may have to pay a little more. Does this, in your view, alter the weight of the two points you have made? Do you not think that that was the position in 1955? So are you clear that these things were effective?——It certainly alters the weight of it. If you list all the possible capital projects in order of their profitability or their desirability, then the more liquid industry is the less far up the list one will get in trying to cut them off by monetary policy.

10413. Did you think that in the twelve months after July 1955 there was empirical evidence of the effectiveness of the Government's action?——That I could not say. I have not looked at the figures sufficiently.

10414. On the other two points, where the symbolic character of the action is important, would it be fair to say that that symbolic character might attach equally to other measures, if the Government had decided to take them? They might be fiscal in character, or they might be direct controls, but I suppose that in both cases it would be possible to argue, as you did in the case of monetary measures, that you could take the will for the deed, that the fact that the Government was doing this would be taken as a sign that it would make it effective, so that the result would in fact occur. Is it fair to say that, in this respect, it does not make any odds whether the measures used are monetary, fiscal or physical?——Yes, I think so. I do not think people always think that; it depends on how the Government puts it across. But the Government can certainly put it across in a way which convinces people, as I think was done in September.

10415. Would you say that it took them rather a long while to get themselves into that position?——Not knowing the ins and outs of it, I could not say.

10416. Judging from the history of the credit squeeze, it was, I suppose, three years; people did not take the will for the deed for quite a long time?——No.

10417. *Chairman*: And yet each time the Government made its announcements, or took its actions, it presumably intended people to believe it would carry them through; so it became rather unpredictable as to which action it thought would be effective?——Yes, but the severity of the action it took last September was so much greater than what it had done before. That may have indicated that the Government was getting through to the fact that nowadays we may have to think in terms of a higher level of interest rates, and a greater degree of restriction, as being the normal thing. Sir Oliver Franks mentioned the view that the public sector in investment is influenced by Government decisions, and not by rates of interest. I do not think that one should go too far with this view. I think that many public authorities are influenced by rates of interest. I sit on a local authority committee which is concerned with expenditure, and I always find myself thinking: "Ought we to enter into this, at a time when rates of interest are so abnormally high?"

10418. What kinds of expenditure are you thinking of? ——Educational expenditure.

10419. Do you find that in your authority you measure the expenditure which you have to face by the current interest burden?——I have not been concerned with it long enough to draw up a rule, but I should have said that it was a serious consideration.

10420. I do not doubt that, but I wondered whether it in fact led to the abandonment of action which otherwise would have been taken?——I cannot pinpoint any precise case.

10421. *Professor Cairncross*: In paragraph 10 you suggest that it might be possible to requisition U.S. securities held in this country, market them, and in that way expand our gold and dollar reserves. Is this a suggestion that you would press on us, or is it thrown out tentatively?——I would not like to press this. I think that it is a very drastic action to requisition property. May I just add one correction to what I said at the end of paragraph 10 with regard to the United Kingdom portfolio of United States securities? I said that it amounted to £186mn. I am afraid that I rather quickly lifted the figures out of the Bank of England's calculations; this is, of course, a very considerable under-estimate of the total, as I saw by looking at the United States figures for the same thing. So the argument I put out does to some extent fall to the ground; I still cling to the *possibility* of requisitioning and marketing U.K. owned dollar securities; but the possibility of marketing a considerable proportion of them without a slump in their prices is limited.

10422. It is because the true figure is clearly a good deal higher than you stated that I was putting it to you. If the amount were only £186mn., it might not be worth pursuing; but if the securities were worth several times that, the proposal might be worth closer examination. Is it one that you are putting to us seriously, or one that

you are merely suggesting?——In the order of priority I should put it well behind augmenting the reserves directly by means of a loan; if that were not possible and it also turned out not to be possible to persuade the sterling area countries to work together, then I would put this suggestion.

10423. *Sir John Woods*: I think that you deliberately framed your paper round the external situation, and, if I have it right, you are saying in effect that it is a great pity that, in order to deal with that situation, we have to take measures which reduce the level of activity at home, and affect investment and growth. You do not mention in your paper the general home situation: the continuous rise in prices and the general inflationary process. Do you regard that as relatively unimportant, or do you hold the view that, even if that is the situation which falls to be dealt with, it ought not to be dealt with by restrictive credit measures, some attack upon demand and some slackening of the rate of activity?——I would not like it to be thought that I did not regard this as important. But I do not regard it as particularly relevant to the problem of fluctuations in the balance of payments. It is said that one of the causes of the crisis in September last year was the wage-price spiral. Personally, I do not believe this. It seems to me that wages had been rising very rapidly for the last two years without anybody abroad noticing it, and I cannot believe that there was some sudden acceleration of this process in the autumn of 1957, which suddenly persuaded speculators abroad that it had got out of hand. Furthermore, to the extent that we do have sudden uncontrolled upward movements of wages in relation to prices, and to the extent that this does cause a deficit on the balance of payments, if we had larger reserves or other means of insulating the internal economy we could absorb this better.

10424. I was not talking primarily about rises in wages or costs. I was talking of rises in prices, and I was not concerned with whether you called it demand inflation or cost inflation.——To the extent that this happens more rapidly here than in other countries, we have to do something. The question then arises whether we should cope with this by restricting home demand, or whether we should make some other approach. My own preference would be for making some other approach, such as some attempt to persuade trade unions to moderate wage demands first, rather than for restricting demand, because it seems to me that restriction of demand is directly wasteful of productive capacity. To cope with the wage-price problem, which is, I think, predominantly a struggle about the distribution of income, by measures to reduce the size of the national income, seems to me to be the wrong approach. If it should turn out that the trade unions could not be persuaded by any method at all from increasing wages, then one may have to go to the demand restricting technique, but I should very much hope not.

Chairman: Thank you very much, Mr. Sargent. We are very much obliged to you.

(*Adjourned until Friday, 25th July, 1958, at 10.45 a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-THIRD DAY

Friday, 25th July, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

PROFESSOR F. W. PAISH, M.C., Professor of Economics with special reference to Business Finance in the University of London, called and examined.

10425. *Chairman*: We are very much obliged to you for your paper*, Professor Paish; we would like you to enlarge on some aspects of it, if you will.—*Sir Oliver Franks*: We have just received a memorandum of evidence on Britain's monetary and fiscal policies since 1945†, of which you are one of the authors with Mr. Laurence Robson and Mr. Graham Hutton. It is there said, and it has been said to us by others as well, that one of the continuing difficulties in our economy has been the super-abundance of liquid assets, and that this has been so considerable that it has been difficult for the ordinary instruments of credit policy to contain it; and further that the Government has frequently been compelled to resort to more short-term borrowing of this character because of the vast job it has of financing nationalised industry, and the fact that it could not always finance it by proper long term borrowing, by funding in the strict sense. In your own paper, which we are discussing this morning, there is an extremely interesting table about the ratio of the net national money income to clearing bank deposits, the yield on consols, etc., from which it emerges that there has been a very large diminution in the proportion of bank money to the national income since the war; we are now at a percentage which is lower than we have had for more than thirty years. Could you explain to me how, with so little money in relation to the national income, there can yet be a problem of over-liquidity?——*Professor Paish*: I ought first to say that my share in the joint memorandum to which you referred was very small. I would answer your question this way: where there is over-liquidity, it is necessary to have a smaller amount of ordinary money to get the same effect; and if there is a great deal of Government short term debt maturing, it is much more difficult for the Government to get down the quantity of money. If £900 million or so of short bonds are maturing every year, it is a good deal bigger effort to raise enough on long term on the market not only to meet the needs of nationalised industries but also to replace any maturing securities which are not converted; and the less liquid the authorities make people by reducing the quantity of money, the more reluctant people will be to convert. It has therefore made it necessary to go further, and it has made it harder to go, than if there had not been so much liquidity. I think that in fact we have gone so far that the shortage of a genuine medium of exchange has now gone far enough to offset the excess of substitutes for money for various purposes at different degrees; but we have had to reduce the ratio further than we should have had to if there had not been so much other liquid assets, and it has been harder to do it.

10426. *Professor Cairncross*: Would you say that, if you were to add in Treasury Bills or short-term assets of that kind held outside the banking system, the proportion would not show this fall?——I am not at all sure that, given the rise in prices, the public are very much more liquid than in the twenties. The national debt as a whole is in relation to national income somewhere round about what it was in the interwar period, and I doubt if the form in which it is held to day is more liquid than it was in the twenties, though I think it is more liquid than it was in the thirties after the very big conversion operations of the late twenties.

10427. In your table 1 you show a drop in the last few years in the ratio of deposits to national income to almost unprecedentedly low proportions. Sir Oliver Franks is putting to you that this seems to imply that we are less liquid than we used to be; are you pointing out that, if you add liquid assets held by the public other than in the form of money, the proportions may move in the opposite direction?——No, I would not say that at all. We are less liquid than we used to be; and if it is true (I am not sure that it is) that these non-money liquid assets are relatively more important than they were, then at 35 per cent. money we may be only as liquid as we would have been at 40 per cent. money with fewer outside liquid assets. I do not know whether in fact we have more of these outside liquid assets in relation to national income or whatever other criterion you use than we had in the inter-war period.

10428. *Sir Oliver Franks*: By outside liquid assets you mean Treasury Bills not held in the banking system but ordinary people?——Yes, and particularly the volume of short bonds maturing.

10429. *Professor Cairncross*: Again held outside?——No, including those inside the banks, because the shorter the bonds held in the banking system the harder it is to compress their liquidity and the harder it is to get down the quantity of money; if the short bonds held by the banks were 100 per cent. maturing in the next twelve months it would be extremely difficult to make the bank short of assets.

10430. We were talking about liquidity of the public. It is the impression of a good many people that since the war business has been throughout in a fairly liquid position, including even quite recent years. Would you feel that that was not so?——I would like evidence of that. I should have thought that there was some evidence that in the last couple of years business had become very considerably less liquid; that is to say that, though a large number of firms remain highly liquid, the proportion remaining so has fallen.

10431. During the period up to 1956 during which there was this tremendous drop in the ratio of bank deposits to national income, was there not considerable liquidity in business?——If there is so much liquidity, why are firms willing to pay very high rates of interest for raising long-term loans on the London market?

10432. They may expect prices to rise?——It is liquidity in relation to what they want to do. I would say that the long-term rate of interest is the inverse of liquidity.

* Memoranda of Evidence Part XIII No. 28.
† Memoranda of Evidence Part XIII No. 29.

10433. May we pursue that idea a little further? May there not have been a number of structural shifts in the demand for money over the period covered by your table 1? Is industry as dependent on bank credit as it used to be, and is it not possible that industry may hold less cash than it used to hold, given the higher degree of integration between business concerns?——I do not think that there is any very clear evidence of that over the long period. I do not know whether it is relevant, but the other day I took a rough scatter diagram of these figures [*see opposite*], and I found a very interesting pattern. The figures between 1920 or 1921 and 1933, and again from 1948 or perhaps 1947, lie on one very clearly marked curve, whereas the figures from 1934 to 1945, 1946 or 1947 lie on a much less well marked but clearly quite different curve. If there has been a change, I would say that we have changed back again after an interval to the relationships we were in in the 'twenties.

10434. Would this mean that you would feel that if you knew the ratio of bank deposits to net national money income you could predict what the rate of interest would be?——So long as the conditions remain, I would say almost exactly. But there can be very marked shifts in the relationships; in the liquidity preference, for instance, between the years 1934 and 1946.

10435. The puzzling feature of this to some of us is that you do not anywhere in this relationship make provision for expectations about the movement of prices, which is generally thought to have some effect?——That might very well be the cause of the shifts, but I do not know. I am not trying to explain it; I am just saying this is what the figures look like.

10436. The point you are putting to us is that there is an inverse relationship between the liquidity of the system and the rate of interest, liquidity being defined not just in the terms of the money supply, but to include near-money?——I would put it in terms of the money supply. One would expect the amount of near-money to affect the shape of the curve, but I would rather not include near-money, because there is no definition of near-money. There is an infinite series proceeding from the very short to the very long; it is only pure convention of the banks to include Treasury Bills but not short bonds in their liquid assets. I would rather stick to the money supply and say that these other changes will affect the relationships.

10437. In table 1 are there not quite long stretches of time where the relationships between the two quantities are not particularly close? You mentioned some in your paper; but I would have thought this was also so between 1924 and 1929, in 1933, 1934, 1935 and 1936?——Between 1924 and 1929 they lie so close together in a bunch that it is practically impossible to say anything about it, except that the whole bunch lies very close to the expected curve. There is quite clearly a different relationship between 1934 and 1946 and 1947. My explanation of the 1933-34 shift is that where there are expectations of changes in security prices the market yield is not in fact the true yield, that if one is expecting a rise in the value of Consols one is paying not just for the rate of interest but for the rate of interest plus the capital appreciation expected. So the effective rate of interest people were expecting to make in buying Consols in 1933 was very much more than the flat yield. It may be very much more expectations of change in security prices which affect the rate of interest than the expectation of changes in commodity prices. Another point that has been put to me as a possible reason for the aberration in the thirties is that during those years Consols were a very much less good indication of the general level of yields, because of doubts about future dividends and so forth, than they have been at other times.

10438. The issue is whether the relationship is sufficiently close and the lags sufficiently limited to allow of operational application?——I would say that in the short run one can get it down on pure expectations if one can persuade people that long term rates are going to fall and that they will have a heavy capital appreciation. There could be very marked temporary shifts on those expectations; but if the authorities wanted to stabilise the long term rate round about 4½ per cent., they would have to allow the ratio of bank deposits to national income to rise to more nearly 40 per cent. than 35 per cent.

10439. In a period of inflation it is surely rather difficult to exclude expectations of a rise in commodity prices?——I was thinking of the price of securities.

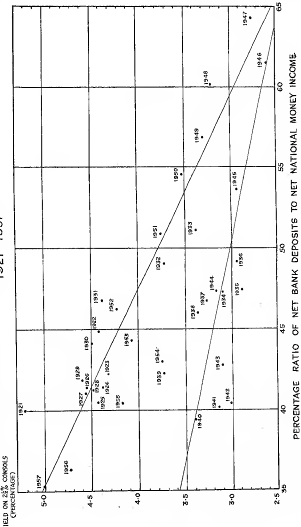
10440. Do not the two have a certain relationship to one another? If profits are high do not both prices begin to slide with them?——There might very well be an expectation of a decline in both prices, but I am doubtful whether commodity prices have an effect on this particular relationship, because both the quantity of money and the national money income would be going up very sharply, the latter probably faster with the increase in velocity and a rise in interest rates. All I would say is that there is a relationship, which differs from time to time, between velocity and the rate of interest.

10441. *Chairman*: I am not sure where the answer to the original question that was put to you took us to. I quite see that with a large volume of Treasury Bills out in the hands either of the banks or the public, and with this constant maturing of Government bonds each year, the control of the money supply is a difficult thing for the authorities to achieve; but I assume that it has been the policy of the authorities to reduce the money supply, and from your figures it would seem that by one means or another they have brought about a marked fall in the money supply compared with the national income?——Yes indeed; and there has been an almost continuous rise of interest rates during that period; but I would say that, whereas they could get a given rate of interest with a 40 per cent. ratio of bank deposits to national income if there was not very much near-money in the system, they might need 35 per cent. to get the same rate if there was a lot of near-money in the system. They would have to set off the increased liquidity due to large holdings of near-money by having less real money, in order to get the same effect on total liquidity.

10442. What agency in your view has been responsible for this reduction in money supply, in view of the technical difficulties of achieving monetary control?——It has not been an absolute reduction in the money supply, only a reduction of the money supply in relation to national income. If the authorities take measures which keep down both, they do not have an effect on the rate of interest. If they had complete control by mere budgetary policy and no other control, one would expect them to check inflation and keep down the rise in the quantity of money by using the Budget surplus to pay off Government debts to the banks. They would also be keeping down the national money income at the same time by taking it out of people's pockets. One would not expect that in itself to have an effect on the rate of interest; that only happens if they are checking the supply of money directly and not merely taking it away by taxation and cancelling it, because in that case there would be a fall both in the national money income and in the quantity of money.

10443. *Sir Oliver Franks*: If one assumes that the authorities have a responsibility for the way in which the clearing bank deposits have been held almost constant for six or seven years while the national money income has been going up steadily, one perhaps begins to see what a powerful instrument monetary control is: it has so decreased the general liquidity of the system that rates have been forced up to the extent that you described, and the ideas which we had that monetary policies were incapable of regulating the system are incorrect. But if you forget these figures, and think of what most of us have been saying at intervals over the last six years, we have been tending to say: "Too little too late"; that the Government have not been very adequate in what they have done, that monetary measures have seemed to fail in their effect and have had to be reinforced by the successive package deals. How do I reconcile on the one hand this and on the other the apparent success in dealing with the liquidity of the system?——In 1947 we started with a very large excess liquidity in the system. That excess liquidity was only possible without inflation while they could prevent excess demand from appearing by direct controls. Partly because controls became unenforceable and partly because the Government deliberately withdrew them, they have been releasing continuously ever since the end of the war the excess demand which was concealed behind these barriers, and this has continually raised the inflationary pressure, which has needed a continually rising rate of interest to keep it in control.

RATIO OF BANK DEPOSITS TO NATIONAL INCOME, AND YIELD ON 2½% CONSOLS
1921-1957



If they had taken off the whole of their controls in 1947, and had tried to institute a monetary policy which would prevent inflation, the inflationary pressure was so large, and the demand for investment in relation to saving was so large, that they would have had to have something like a 10 per cent. rate of interest to equate investment and savings by monetary policy alone. We have come to the stage where we have been able to equate it at approximately 5 per cent., very largely as a result of the spontaneous rise in saving, but monetary restrictions have been continually fighting the emergence of the demands concealed during and just after the war behind the controls. One of the big reasons for the last inflationary movement was the complete removal of building controls; not that I like a system of controls. I hate them, but when one takes them off one releases enormous pressures which are quite incalculable very often in advance.

10444. *Sir John Woods*: If that is right, is it also right to conclude that the main reason for the inflationary pressure and the continuous rise of prices does not lie in the excess liquidity of the system but in the gradual release, by abolishing controls, first of all of pent-up wartime demand and then of rising demand? In other words is the story of excess liquidity being caused largely by the issue of short-term debt by the Government not after all a guiding feature in the whole picture?——I would not agree with that combination. When there is so much money about that the Government can prevent people from using it and maintain stability only by physically preventing them from spending it, then I would say that there is excess liquidity in the system.

10445. From that it would seem to follow that in modern conditions, over the last ten years or so, in order to avoid excess liquidity one really needed a much lower ratio of money to national income than we were accustomed to in the 'twenties?——Yes. Immediately after the war, with acute demand for restocking, for making good shortages and so on, we should have needed a much higher rate of interest than in the 'twenties, if we had been relying on monetary policy alone, and probably a ratio of money to national income of 30 per cent. or less. Where liquidity is deliberately built up behind the barrier of controls in order to force demand in a particular direction, it is almost impossible to remove the controls quickly unless there is a wholesale destruction of money, something like the Belgians had, and the Government cancel or freeze half the bank deposits in existence. If one had wanted to take off the controls immediately after the war, one would have had to do something like that.

10446. *Chairman*: Do you regard this upward march of the yield on Consols from 1946 to 1957 as the product of market forces, the result of the struggle for capital among those who wish to achieve long-term borrowing when there is a comparative shortage, or is it a product of monetary policy?——The monetary policy means that people have to struggle to get it. If there was an unlimited supply they would get it easily, and that would just blow the lid off. It is by making money scarce and forcing them to compete for scarce money that the Government forces up the rate of interest.

10447. You do not think it matters in what market you make it short?——In the short run it does. The markets are by no means completely linked. In the longer run, in perhaps two or three years, it moves across even to such rather isolated markets as the building societies and that sort of thing.

10448. *Professor Cairncross*: You do not in your exposition make it very clear where the demand for capital comes into this. If there is a particular need for capital one would have expected that sooner or later to show itself in the rate of interest?——Unless capital is rationed. The Government can prevent the need from showing itself by building licensing and so on.

10449. I was not referring to that, but to relationships which you draw in your table between the rate of interest and what seems a larger monetary phenomenon?——I would agree, but if we did not have this we should not have the rise in the national money income. Because there is a continual tendency to over-invest there is a rise in the national money income.

10450. I do not quite follow. Assume that tomorrow the productivity of capital suddenly doubled, so that there was an increase in the demand for savings; would you expect that to show itself in the rate of interest or not?——It would certainly show itself in the rate of interest; it would also show itself in a very big rise in national money income. It would become much more profitable to invest. That would cause a good deal of money to come out of idle balances; that would cause an increase in velocity.

10451. The effect on the national money income would be deferred for a considerable time?——It would show almost immediately in the rise in demand for existing assets, unless the assumption is that existing assets would not have more productivity, and that the increase in productivity only showed itself, as a result of new invention, in new assets. Suppose that someone discovered in this country a major oil field. The effect of that would be no doubt a rush of the public to buy the shares of whoever it was who was lucky enough to have it. A good deal of money would be drawn out of idle balances for that purpose, and that money would fairly soon begin to come out into incomes. Possibly the rate of interest would go up first, but I think that there would be only a fairly short time lag before it emerged in incomes in some form or another.

10452. It is rather important whether the rate of interest to which we have to accustom ourselves is going to be higher or lower than in previous periods. Does not the normal rate of interest bear some relationship not just to monetary habits but also to something real: the rate of growth of population, productivity, inventiveness?——I would agree entirely. My own view is that, unless something unforeseen happens, we shall have to accustom ourselves to a rate of interest a good deal higher than we have been used to for the last thirty years.

10453. How will that show itself in the ratio between the bank deposits and money national income?——It will show itself in a smaller ratio than we have been accustomed to have for the last twenty to thirty years. I strongly suspect that we shall not manage under these conditions to do better than keep the rise of the national money income *pari passu* with the rise of the national real income, and that we shall need a relationship of the money supply to the national income much more like that of the twenties than that of the thirties, something like 40 per cent., and a rate of interest much more like 4½ than 3½ per cent. But this is pure guesswork, particularly about the attractiveness of investment here and abroad.

10454. Would you still hold this view if the Government through the Budget were making itself responsible for a much larger slice of the national savings?——No; with a much larger slice of the national savings there would be no need for this at all. If as a result of budgetary policy the Government raised the rate of savings to total national income very substantially, then undoubtedly there would be a lower rate of interest, and a higher ratio of money to national income would be consistent. That would depend on the demand on the other side; but, given that demand on the other side was unaffected by Government taxation policy (and it would have to be very carefully arranged that it did not reduce demand on the other side), I would say that, if instead of 20 per cent. of the national gross income saved we had 30 per cent., we should probably be able to manage with perhaps a 45 or 50 per cent. ratio of money to national income and a rate of interest of 3 to 3½ per cent.

10455. I should like to pursue the question of savings a little further with you, because you suggest that there may be a direct influence of interest rates on savings, and that this influence may have been perhaps underestimated in recent years?——I do not think I said that. I think I said that it is possible that interest rates may have had some effect on savings, but that this effect is likely to have been small. I think that the influence of the direct effect of interest rates is not likely to be a major one.

10456. *Chairman*: You only link it here with the "annual cost of ownership of durable consumption goods".——I think that it is much more likely to be effective in so far as it is an absolute scarcity, because very few durable consumption goods, except houses, are so long lived that the rate of interest is very important.

10457. *Professor Cairncross*: The explanation in the next sentence about the slackening in the demand for labour does not help me very much to interpret the figures. Gross personal savings almost doubled between 1954 and 1956, but I would not have thought that there had been any quiver in the labour markets to express an advancement of this kind?——Certainly not in 1955. I have not got the figures in front of me, but my impression was that there was a substantial rise in unemployment in 1956.

10458. A rise of about 50,000.——This is a purely tentative suggestion, and I am not prepared to stand by it; it is merely put forward as a possible hypothesis.

10459. *Chairman*: Is it not rather odd that such a phenomenon as the leap in the gross personal savings should go almost without an explanation?——The reason for the rise in 1952 can fairly plausibly he said to he the end of the post-war personal re-stocking move. Whether that was only partial and there was a further rise on this account in 1956 I do not know. There is very little doubt that some phenomenon of this sort occurred; otherwise it is extraordinarily difficult to make the other figures make sense, but the causes of it are purely a matter of guesswork. All one can do is to put forward possible hypotheses and hope that somebody will be able to do something about them. I myself am quite incapable of giving what I would regard as a satisfactory explanation of the 1954-56 rise. About a third of it is due to hire purchase restrictions; hut that does not explain why there was a further rise in 1957 when hire purchase restrictions had been partially released. It merely transfers the problem. It may be that saving is a function much more than one thinks of changes in real income in the short run. There has been a very remarkable rise in real income since 1952. That would not account for the 1952 rise, but it may be that the very remarkable rise in real personal income was the main cause of the 1954-56 rise, and that in fact saving is a very marked function of a rise in personal incomes.

10460. *Professor Cairncross*: Do you not think it equally remarkable that total investment or saving does not fluctuate in the way personal savings do, and that perhaps this provides a clue to what is going on? May it not be a shift in the people doing the saving rather than an increase in thrift?——It may be a change in the ratio between investment abroad and fixed investment at home. Total investment has of course moved with the saving, but there has been this very remarkable apparent movement in stocks and the balance of payments does seem to be to a considerable extent reciprocal: we seem to get the balance of payments we can afford.

10461. *Mr. Jones*: How do you contend that a probable explanation of increased savings may stem from insecurity of employment? What evidence is there of this in the figures you present in table 2?——None whatever in that. The only thing is that in 1952 there was a sharp rise in unemployment, and I was under the impression that the second half of 1956 showed a rather similar trend. If I was not quite sure of keeping my job, and if I had £50 in the savings bank, I should hesitate very much before I put it down as a deposit on a new television set. One would have to relate the total to figures not of unemployment but of expectations about unemployment.

10462. You give the figures of gross personal savings. I take it that those would include savings in pension funds, insurance funds, superannuation funds, building societies and so on. Would there be any means of locating individual savings?——If one takes gross personal savings and deducts from that the savings that can be accounted for in these other things, one arrives at a still more violently fluctuating margin which, up to 1952, was largely negative; there were visible savings in these institutions which disappeared in the total. One can only assume there was very large personal dissaving. In 1952 this large negative item largely disappears, and total personal saving is very close to the institutional saving. That almost certainly means fairly substantial personal negative savings, in the strict personal sense, because that includes the plough-backs of unincorporated businesses which is normally fairly substantially positive. It may be that the further rise is simply the disappearance of that residual negative item; I do not know.

10463. *Professor Cairncross*: Among the institutional savings a large part is surely found amongst the taxpayers. Do you not think that changes on the side of taxation may have something to do with this?——It is very difficult to know. We have no figures, I think, for tax reserves of persons.

10464. *Chairman*: Would tax reserves of persons he represented by tax reserve certificates?——I doubt if persons go in for them very much.

10465. What else would they be?——They are money which a man has at the bank at some time of the year because he has to pay his tax next month.

10466. *Professor Cairncross*: Private persons can hold tax reserve certificates if they choose to?——Large taxpayers might; with P.A.Y.E. it does not arise.

10467. I was thinking in terms of changes in rates of tax, and therefore of the income left to the taxpayer on which he might not have reckoned in laying out his income earlier?——The effective taxation of the higher income groups only came down appreciably last year. Up to then the effects of reduced rates of tax barely made up for the effects of inflation. If that had been the cause of the rise in savings, I should have expected to find the rise in 1957 or 1958. I personally expected to see the 1957 savings figures fall back a bit; the fact that they did not may be due in part to the taxation change.

10468. May we pass to the discussion in paragraphs 15 to 17 on the prospects of funding and the difficulties in carrying through funding operations? You point out that the effect of trying to carry through a large funding operation might he a sharp fall in interest rates and the temporary paralysis of the market. The alternative might be a very long and protracted fall in gilt edged which would also have unfortunate consequences. Which do you think is preferable, a short sharp break or a very long and protracted decline?——My own inclination would be towards a short sharp break. If one cannot sell anything on a market, the best thing is to bring the price down with a bump, and then it will begin creeping up again. It has been put to me hy people in contact with the market that, if the authorities do this, they run the risk (*a*) of bankrupting the jobbers and (*b*) of making people so frightened of holding Government securities that there might be very unfortunate long-term repercussions, making funding an impossible policy. My own view (and this is shared by other people) is that, if the Government want to sell something on a weak market, they should bring the price down with a hump. That is what the Government actually did, although not intentionally, when it put Bank Rate up to 7 per cent. It did exactly what I had been suggesting was the right thing to do: it hrought long-term prices down so low that nobody thought they could go any lower.

10469. *Chairman*: This long and gradual rise of the yield in Consols has been making people over the years reluctant to hold Government securities. Is it not a matter of contrasting one way of frightening them with another way?——Yes, but in the course of operations on the market people have much less sudden and unavoidable losses with a gradual slide than with a sudden drop. My own feeling is that people went on buying Government long-dated securities for some considerable time out of habit, and it was only in 1957 that they really began to appreciate the position. It is exactly the same thing as happened on a smaller scale in the early 1900s, when it was not until the fall in gilt-edged had been going on for ten or twelve years that the people who buy those things from habit began to wake up. I find it very surprising that people are so slow to wake up.

10470. *Professor Cairncross*: Would you regard it as more feasible or desirable to operate on the long-term rate indirectly *via* Bank Rate, rather than take some direct action as a means of making the long term rate move?——Purely for the internal situation I think a change in Bank Rate is unnecessary; it may be necessary from an external point of view, which is quite different. From an internal point of view, if it is true that when the Government broker goes into the House either with his hat on or with his hat off (I cannot for the moment remember which it should be) and looks as if he is going to sell, it is enough to make the market drop ten points,

I should have thought the thing to do would be to let him do it. Alternatively, if Consols have been standing at 55 and the authorities cannot sell at that, let them bring the price down to 40, the next day raise it to 41, and the next day raise it to 42, and so on.

10471. *Chairman*: The principle of the Sibylline Books?——That was not a really serious proposal; but that was in fact what they very nearly did when they dropped the price of Consols to 44.

10472. *Professor Cairncross*: Do you think the Government could do this twice?——I hope that it would not have to. It would be a very good warning to the Government not to get into the position that it did have to.

10473. It is rather like depreciating the rate of exchange sharply in preference to defending the higher rate until forced to go to a rate which may in the end be lower than if one depreciates sharply?——Provided that one brings it up again, and does not peg it at the new rate. I agree that, if a country which had a very weak rate of exchange dropped it quickly and then started bringing it up, it could probably stabilise it higher than if it tried to defend the original rate and was forced off.

10474. *Chairman*: One of the problems that is going to result from changing a rate of interest is uncertainty as to what level it may go to. When Bank Rate went to 7 per cent., I think it was a general assumption that it was very improbable that the rate would go higher, and it therefore established an attractive force in the market because people thought that they could not do better by waiting. Do you think it conceivable that you should have, as it were, three speeds, a low rate, a medium rate and a high rate, and not an infinitely variable range of rates, so that people would have a certainty?——I do not think that one can ever have a certainty, because it depends on how profitable investment is. Unless the Government has very marked control on saving by an extremely flexible budgetary policy, I do not see how there can be any guarantee unless one knows what is going to happen about the demand. If there was something developing which looked like being extremely profitable if people could get in now, I do not see how the Government could stop interest rates going up unless it could match savings with its own obligations.

10475. *Professor Cairncross*: This uncertainty must mean that the Government may be compelled to repeat the operation of bringing about a drop in gilt-edged prices?——Once it has got the thing under control, the difficulties will be very much less than they have been. If the range of variation of the ratio of bank deposits to national income is between 35 and 40 per cent., then the problem is very much more amenable than that of getting it down from 60 to 65 per cent. of national income. The extreme difficulty of the problem has been due to the fact that we have had a quite unstable position in relation to money.

10476. How seriously do you take these funding difficulties? The gilt-edged market has after all over the past ten or twelve years had to meet the requirements of the nationalised industries, and yet the Government has done some funding. Do you put it to us that the Government could not have done just that little more that might have made a substantial difference?——It could have done, but not on the sort of criteria it was prepared to work on; it wanted to avoid causing a collapse, and only funded when it could sell securities on a market that was prepared to absorb them without a serious drop in price. I think that that was probably wrong, and that the Government should be prepared, if necessary, to see the long term rate go up pretty sharply; that would have done the job without necessarily funding. If the end-object of the operation is to raise long term rates one should not be annoyed if they go up; but they have been frightened throughout of causing any very rapid rise. My own view is that it is very unfortunate that it has taken so long. If we could have got our own inflation out of the way, and our investment down within our own saving, a couple of years ago, before the American recession developed, it would have been very much pleasanter getting the sort of balance of payments we need as a result of a rise in exports than as a result of fall in import prices; and we should not have been faced with the problem of dealing at a time when we ran considerable risk of temporary recession with the resources which we squeezed out of the system in order to make them available for more exports. It would have been very much better if we could have got this squeezing operation over a couple of years ago.

10477. Do you think that the operation would have been speeded up if the authorities had had rather different views about the normal rate of interest, if they had been prepared to see the long term rate of interest substantially higher?——I am not sure whether it was the level of the rates or the rate of change they were afraid of. It was put to me that they were afraid of a very rapid rate of change in the rate.

10478. There were years in which the long term rate fell?——There were two or three years, but before the squeeze, in the period of relaxation. That goes a long way back. I am only going back to the end of 1954 when the Government had begun to tighten up again. In 1953 and 1954, with the very big rise of savings there had been, they thought that they were safe in letting the thing rip, and they greatly under-estimated the pressure of investment demand. That is the only rational explanation I can make of their policies, that it was just a miscalculation; they had a margin in 1952–53 because of the big rise in saving, and it was safe to relax restrictions on investment to a certain extent but not to the extent in fact that they did, in view of the subsidiary rise of other forms of near-money.

10479. You would feel that it would have been safe to have withdrawn some of the controls over building, provided that simultaneously action was taken to tighten up the gilt edged market?——Yes, or even to withdraw all controls over building; but if they were going to withdraw all of them they ought to have taken steps to tighten up the gilt edged market simultaneously. They allowed this fall in 1952, but they did not know there was going to be such a remarkable response to their advocacy of higher industrial investment.

10480. In paragraph 18 you suggest a scheme of compulsory deposits which appears to have been acted upon in the meantime. How do you view this action that has been taken in relation to your proposal? Does it give effect to it?——Almost exactly. I hope that I made it clear that it is desirable, if possible, to avoid all measures of compulsion; this is, I think, the least undesirable form of compulsion that I have been able to think of.

10481. You suggest in paragraph 19 that the special deposits should carry a rate of interest appreciably higher than that currently yielded by Treasury bills. Do you feel that this is important?——There is a certain risk even in the present scheme that it might encourage the Government to fund on the cheap by compelling the banks to make these deposits. I put this in as a way of discouraging the Chancellor from using it as a cheap way of raising money.

10482. *Chairman*: It is really a penal rate?——A penal rate on the Government so that they shall not use this as a means of raising money, but merely as a means of cancelling money when all else fails.

10483. *Professor Cairncross*: The higher rate of interest that the banks would then earn might to some extent be regarded as in compensation for the advances that they did not make?——Certainly; or for the less liquid form in which they would be compelled to hold their money as compared with the Treasury Bills which they would otherwise have held.

10484. Leaving aside whatever interest the commercial banks would have in this, would you not feel that the Government would normally be reluctant to resort to this measure in any event?——Some Governments would.

10485. You think that, if not reluctant, they would be deterred by the penal rate of interest?——I think it would be a consideration.

10486. *Mr. Jones*: Have you visualised the amount to be frozen in this way?——I hope that it will not be necessary to use this technique; but if it had been used in 1951, instead of persuading the banks to take up £500 millions of gilt-edged bonds, as an alternative way of getting the money out of Treasury Bills into a less

liquid form of asset, they could have said: "We want £500 millions of your Treasury Bills to be converted into special deposits at the Bank of England."

10487. *Chairman*: You would not allow the banks to fund all their current overdrafts at the rate of these special deposits? That would make it very gratifying! ——I was thinking of probably one per cent. over Treasury Bill rates, so that the Government should not choose it as a cheap way of funding. There would, I hope, be no risk of ultimate loss to the banks on this, whereas there is always a certain margin of risk on overdrafts; so I should have thougbt the overdraft rate would be higher. I should have thought that a rate much more equivalent to the long term rate than to the bill rate would have been appropriate for the special deposits.

10488. You suggest that the special deposits should be obligations of the Bank of England instead of the Treasury. I see the difference of form, but when we have a system under which the Bank of England is acting in effect as agent for the Treasury, does it make a real difference?——I think that it does indicate that this is a means of sterilising money and not a means of Government borrowing. It can be used in exactly the same way; the Government could borrow from the banks, and then sterilise the proceeds, but there would have to be two operations instead of one. And I think that the Bank of England, although nationalised, does on occasion have its own independent point of view, and this would help it to emphasise the difference that still exists.

10489. *Professor Cairncross*: A system of special deposits exists in other countries, particularly in Australia. It is surely not the practice there to pay such high rates of interest?——There is no Treasury Bill market there, I think. The rate on these deposits there is extremely low. That is one of the things the banks complain very bitterly about. But there it is used very largely to sterilise rises in overseas reserves, so that they do not get a multiple expansion of credit as a result of an overall surplus on the balance of payments.

10490. *Chairman*: In paragraph 17 you are talking about the first half of 1955, and you say that what pressure on bank liquidity did take place then was due not to the operations of monetary authorities but to the increased purchase of Treasury Bills by non-bank holders? ——I would like to modify that a little; I have looked at the figures again since then. I would say now that the fall in the banks' liquidity ratios was due not only to funding operations but also to non-bank purchases of Treasury Bills. There was a drop in the tender Treasury Bill issue of £200 million; from that one would normally expect a drop of £100 million in bank holdings, but there was in fact a drop of £300 million in bank holdings. A minor part of the drop of £300 million would have been the £100 million that one would expect merely from funding, and the other £200 million must have been a switch in the way the tender Bills in issue were held.

10491. What made the outside world at that time a more effective competitor?——A lot of firms were still very liquid, and Treasury Bills looked a very profitable way of investing temporary idle funds as compared with whatever other way they had previously been holding them, probably on deposit at the banks.

10492. It was an accident of circumstances, not something the Government could engineer?——I think that they could nearly always engineer it by pushing up the bill rate sharply, thus making bills a very lucrative form of holding as compared with other forms of holding money.

10493. Would not the other forms possibly follow suit? ——That depends very much on the relationship between the bill rate and deposit rate; where the bill rate is appreciably above the deposit rate, I think that would tend to happen.

10494. You could get a temporary switch out of bank deposits into Treasury Bills?——Yes. On the other hand a high deposit rate at the banks tends to be disinflationary, because it reduces the cost of loss of income from holding money idle. If one cannot get interest on bank deposits, then the difference between investing it outside and holding it idle is the whole of the rate one earns outside, whereas if interest is paid on bank deposits it is only a question of the difference between the two rates.

10495. *Professor Cairncross*: Does it not depend where the savings deposits come from? If a man takes money out of a Post Office Savings Bank account and puts it on deposit account with a commercial bank, that surely is not disinflationary?——It reduces the cash reserves of the savings banks.

10496. It obliges the Government to issue short Treasury Bills?——I think that is probably true, but only because it happens to be the Government. If it was not the Government people could not issue Treasury Bills. It enables the public to put pressure on the Government to expand the quantity of money and make them inflate. That is where the real problem comes.

10497. It is sometimes suggested to us that the Government should take measures to develop the market outside the discount market and the commercial banks for Treasury Bills, in order to get more leverage. One way of doing that would be to exercise control over the deposit account rate at the commercial banks. Would you favour action of that kind?——No, because it is not inflationary to move money from the Government on to a deposit account at the bank. It may not be disinflationary, if the Government has to create additional money to take the place of what has been sterilised, but it is certainly not inflationary. So long as Treasury Bills have a special value for the banks which they do not have for the public, because of the arbitrary definition of liquidity, I should be very surprised if, except in rather exceptional conditions, the public were willing to pay as much for Treasury Bills as the banks are. That gives them a special value to the banks which they do not have to the public; there is not nearly as much difference between a three months' bill and a six months' bond to the general public as there is to a clearing bank. With this liquid assets ratio, so far as it really exists, Treasury Bills have really become a secondary form of money for the banks but not for anybody else. For others there is a continuous series, whereas for the banks it is cut off at a particular point; anything below that point is secondary money, and anything above that is not.

10498. You are aware that the creation of a bill market in other countries often requires as a prerequisite control of the deposit rates paid by the banks, in order to limit the competition they offer?——Yes, but that is not desirable as a means of maintaining control over the inflationary tendencies of the system. It might be desirable on other grounds, but it would not be disinflationary to sell more bills to the public at the cost of baving a higher proportion of deposits on current account.

10499. If you are going to exercise control of the monetary system *via* open market operations you want to develop a bill market?——You want to develop the means of selling Government obligations of all sorts outside the banks. Whether that will be in the form of Treasury Bills of the type which are suitable for banks' liquid assets I rather doubt. I think that it would have a more disinflationary effect to raise the rate of interest on Post Office savings deposits to 5 per cent. than to sell Treasury Bills outside the banks at 5 per cent.

10500. There is a difference between open market operations in bills and bonds, in that the bill market does not get jammed up. The funding problem that we have been discussing is confined to the bond market?——That is because banks are willing, bills being a secondary form of money, to take them without limit, whereas they are not willing to take even short-dated securities without limit, because they are not a secondary form of money. But this is due to the quite arbitrary drawing of the line at three months.

10501. It would surely not be sufficient to rely on open market operations in bonds, if you are afraid that when you indulge in these open market operations you will bring dealings to a standstill?——The same is only true of bills because the banks will take unlimited bills, because they are part of their liquid assets. If it was not true that the banks would take unlimited bills, if they worked strictly on a surplus cash reserve method with bills lumped in with everything else, then there would be exactly the same problem if the banks were short of cash. It is only because the banks can turn bills into

cash always to unlimited amount that the authorities can always sell bills.

10502. I do not think we are at cross purposes on this. The point I am putting to you implies that the Government has underwritten purchase of Treasury Bills in the first place; the banks will buy Bills without limit because they know that the Government and the Bank of England stand behind them and will handle them if necessary?——Exactly.

10503. That means from the Government's point of view that it really has not got a market at all?——The same is true, as far as the Government is concerned, of short bonds. There is no real difference between a six months' Government bond and a three months' Treasury Bill, but because one is included in the banks' definition of liquid assets ratio and the other is not there are times when a bank will be willing to buy a three months' bill and not be willing to buy a six months bond.

10504. I am putting to you that the Government must have some outside market of one character or another that it can rely on, to which it can dispose of its obligations; in the case of bills it has not got it, and, in the case of bonds it sometimes has not got it?——The reason why it has not got it in bills is because of the special value of bills to the banks. For that reason the bill rate always tends to be lower in relation to the six months' bond rate than the actual difference in liquidity to the general public justifies. The yield will be sufficiently below the six months' bond yield to make the general public normally prefer the bond, because the bill has this special value to the banks.

10505. I see the difficulty. Do you see a way round it?——No, I do not think it is necessary. The Government needs to have access to the public; it might be willing to sell a three months' obligation to the public which carried a higher rate of interest than Treasury Bills, but was not eligible to the banks as liquid assets, and that would be perfectly possible.

10506. *Chairman*: I am not quite sure what that would be. Why should not the public turn it over to the banks later?——Because it would not count for the 30 per cent. liquid ratio. The bill rate might be 3½ per cent., and these would be at 4½ per cent., and the difference would be manageable because the banks could not include them in the liquid assets ratio.

10507. *Professor Cairncross*: There is a proposal in your last section for taking the gold reserve and dividing it into two, passing one to the Exchange Equalisation Account and retaining the other with the Bank of England. I see that it may be important to direct attention to the way in which movements in gold may be offset by movements in sterling balances, but do you feel that it is necessary to proceed to actual physical partition rather than to the construction of two separate accounts?——I do not think that it is necessary; I think it might be useful, in that it would give something definite to watch in the Bank of England figures every week. It could conceivably direct attention earlier, or make it impossible for people who did not want attention directed to it to prevent attention being directed to it.

10508. You are implying, as I understand you, that if one wants to see the true reserves of this country one should first look at the sterling balances?—No, I think that it is not fair to say "the true reserves"; but it would be fair to say "the true changes in reserves".

10509. Would you think that to be right even in the absence of complete convertibility? It has been put to us by other witnesses that the right thing to keep one's eye on is the movement in gold reserves less the sterling balances held by non-sterling area countries?——I would not say that, unless we could prevent sterling area countries from spending their sterling balances outside the sterling area, which we have no power whatever to do. In that sense the sterling balances earned by sterling area countries are fully convertible so far as the U.K. is concerned, except for the very small amounts that are still blocked.

10510. I imagine that, if we had any obligations to the International Monetary Fund or the Export-Import Bank, or anything of that kind, you would again wish to take account of those in looking at the reserve position?——The International Monetary Fund, but I think not the Export-Import Bank. I should have thought that a loan from the Export-Import Bank ought to be classified as assisting us with our trading account rather than as an addition to our monetary reserves for the banking account. It is a bit of a wangle, since when we got the loan from the Export-Import Bank it was in fact to help our reserves; strictly speaking the year in which we ought to have had a loan from the Export-Import Bank was 1955, when we had an adverse balance of payments.

10511. *Mr. Jones*: Does not the proposal in paragraph 26 seem to tie bank liquidity and credit to the flow of gold?——Not to the flow of gold. I was deliberately excluding the flow of gold due to movements in and out of the sterling balances, and trying to adjust the Exchange Equalisation Account to what was the theory when it was first set up, which was, I understand, that we could completely offset movements in short-term balances but should allow long-term movements and balance of payments movements to have an effect on the rate of exchange. I am proposing to leave the first part as before, but to say that we are now in effect back on the gold standard and should take movements of gold on the trading account into the reckoning in determining internal credit policy. I started off by saying that internal credit policy and external policy would be consistent; that is to say that, if we could stop inflation, we should not have balance of payments troubles. But if they are not consistent, then this would pose the question very sharply: which are we going to follow? Are we going to maintain the international exchange value of the pound, or are we going to stabilise internal prices? I have said elsewhere that my view is that, if they did seem in the long run to be inconsistent, and if we could only maintain the exchange value of sterling by forcing down the level of prices in this country substantially, it is unlikely any Government would in fact be willing to do that.

10512. If this policy had been operated in the last two or three years you would say you would have taken the same action as has in fact been taken?——Almost exactly the same. In fact it would have made us do what we have in fact done, except that we might not have restricted so much as the result of the withdrawal of the sterling balances. I would hope that we would have sufficient gold reserves to enable the sterling balances to fluctuate like a fiduciary issue freely within the limits that those who hold them want to keep, and that, if India in one year ran down its sterling balances by £200 mn. or £300 mn., we could allow her to take that amount of gold up without having to do anything about our internal restrictions, in the expectation that in due course somebody else would pay it in again, and we should not, to go back to the analogy of the merchant with the shop and the bank, have to run down our stock-in-trade in the shop merely because our customers were drawing out all their balances from the bank.

Chairman: Thank you very much, Professor Paish. I think that concludes our questions.

(*Adjourned until Tuesday, 7th October*, 1958, *at* 10.45 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-FOURTH DAY

Tuesday, 7th October, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

W. F. CRICK, ESQ., General Manager for Research and Statistics, Midland Bank Ltd., called and examined.

10513. *Chairman*: Mr. Crick, we have all read your main memorandum* and the various other documents which you have sent in to us†. We are very grateful to you, and have found your paper very interesting, if I may say so. Is there any additional material you would like to add before we start our questions?——*Mr. Crick*: I would like, with your permission, to make two remarks. First of all I would like the opportunity of underlining the fact that I appear in a purely personal capacity; anything I say this morning, like the contents of my memoranda, is simply an individual contribution for which I alone am responsible.

Secondly, as to my approach to the problems confronting the Committee, I would like to say just this: for 35 years now I have been watching the course of monetary affairs in this country, and the impression has deepened itself in my mind that in these matters we habitually expose ourselves to the consequences of putting new wine into old bottles. We did it in 1925, and the bottle broke in 1931; it broke again in 1947 and yet again in 1949, and it has come perilously near to breaking once or twice since then. Despite this tendency to put too much reliance on assumptions and methods and mechanics that were suitable to earlier times, the pressure that has been exerted by political and social and economic change has forced us, chiefly by way of improvisation under pressure, into progressive development of the practice of monetary management.

Looking at the system as it is now, I do not believe that there is much lacking in the instruments available for managing our monetary affairs. No doubt some improvements could be made; they always can be in a system that is adapting itself to changing conditions. But the necessary instruments and gadgets seem to me to be all there, and they are sufficient for their purpose if we are prepared to use them openly and objectively. The much more important questions, in my view, are questions of the disposition of authority and responsibility, and the manner of exercising these functions; and so it is on the working of the system in that sense rather than on matters of mechanics and technique that I have concentrated in the memoranda I have submitted to the Committee.‡

10514. It would follow up that thought if we went to the end of your paper, because that is the part which deals with the distribution of responsibility, and the proposal you throw out for a new monetary authority. The basis of your thinking is the feeling that this kind of activity is not under present conditions appropriate to current parliamentary control?——Neither appropriate to parliamentary control nor to the very limited control the Bank of England can now exercise.

10515. Do you envisage freedom from parliamentary control as being consistent with the subject being debated from time to time by the Commons?——Indeed, yes; in the same way as and perhaps with greater frequency and greater regularity than the affairs of the nationalised industries are debated in the House from time to time.

10516. If one recognises, as perhaps one must, the freedom to debate the conduct and results of monetary policy in the Commons, can you have a system under which the results of a debate cannot be reflected in executive action?——The results of debate are likely to reflect themselves in the conduct of the monetary authority, but the freedom of the monetary authority from day-to-day direction by the Treasury would give it a far higher measure of autonomy, and would at the same time encourage more objective debate in the House of Commons.

10517. If the debate is recognised as a major one, who is to speak for the action and decisions of the monetary authority in Parliament?——Undoubtedly the Chancellor of the Exchequer would be the spokesman for the authority, but no more than a spokesman, in the same way as the Minister of Power is in a sense the spokesman of, say, the Central Electricity Authority.

10518. What exactly would the status of the Chancellor of the Exchequer be? He would be the spokesman for the authority, its decisions and its reasons; but is he to champion it, and let his own position stand or fall by the result of the debate, or is he merely to say: "This is what these people did, and why"?——It seems to me that the analogy with the nationalised industries goes a very long way. A debate in the House of Commons on a nationalised industry is based upon the report of that industry upon its performance during the past year, and that report covers a great many matters other than matters, such as the volume of capital investment, the capital-raising performance of the nationalised industry, and so on, which are within the control of the Minister himself; and the Minister is the spokesman of the nationalised industry in that he seeks to defend the objectiveness of the performance of the industry and its conformity with the powers laid down by Parliament under the nationalisation statutes. I should visualise something of the same sort here.

10519. You think that, if his ultimate duty was to establish the authority's objectivity, its impartial pursuance of objects given it by statute, his responsibility for it would end there?——Certainly.

10520. Supposing the parliamentary debate results in an adverse view of the action taken by the authority; what is to follow? Is there any power of altering the constitution or the membership of the authority?——No. A Government would then be responsible for considering in the light of the debate whether any legislative changes were required in the constitution or the duties of the body. Beyond that, nothing happens except that the authority itself would take account of the course of the debate and amend or not amend its ways according to its judgment.

* Memoranda of Evidence Part XIII No. 5.
† See introduction to Mr. Crick's memorandum of evidence.
‡ But see Appendix F to Mr. Crick's memorandum of evidence, on *Alternative techniques of regulating bank credit.*

10521. *Professor Sayers*: Suppose that in the debate in Parliament the view gradually emerged that the action followed by the monetary authority over the previous year had been to quite a serious extent responsible for a sharp growth in unemployment, which is a matter on which any Parliament is likely to be very sensitive; what would follow in the way of consequences for the powers of the authority and its actions? What would follow for the Chancellor of the Exchequer? Would he be in a position in which he would have to consider himself resigning, or would he call for resignations from the authority?——He would not himself resign, as I envisage the situation, because he himself would not be responsible for the activities of the authority. He would not call for resignations from the authority, because he would have no power of appointment and therefore no power of dismissal.

10522. *Mr. Woodcock*: What are you thinking of, when you speak of these things in the reports of nationalised industries that are not under the control of the Minister?——I am not very familiar with all the statutes, but I think I am right in saying that his control over the pricing policy of the nationalised industries is rather informal than formal; his control over employment in the industry is probably nil. In the case of the monetary authority I should say that the Chancellor's authority is next to nothing.

10523. *Professor Sayers*: But if the authority's action was believed by Parliament, rightly or wrongly, to have had these consequences for the nation, is not this a consequence that is quite different in its political magnitude from the consequence of any of the normal actions of the present nationalised industries?——Yes, in the sense that the operations of the monetary authority would be all-pervasive; they would extend to every aspect of our economic life. In that sense the responsibility of the authority would be far greater than that of any statutory body in a nationalised industry.

10524. Does that not make its political position necessarily different?——I do not think it makes it different; I think it makes it rather more insecure.

10525. *Professor Cairncross*: You appear to envisage giving authority to the new body to direct the Treasury and the Board of Trade in the exercise of their powers. Does that not mean that the Chancellor of the Exchequer is then committed in advance to defending action which he has not himself ordered?——Yes, it does, but that provision which I have envisaged is designed to fit the immediate situation. Those powers are at present vested in the Treasury and the Board of Trade; it would be a much tidier and cleaner job to turn them straight over direct to the authority.

10526. *Chairman*: They would not therefore be exercised under the name of the Minister; they would be exercised under your set-up, under the name of the authority?——Yes.

10527. *Sir Oliver Franks*: The instance which Professor Sayers gave was that as a result of debate in Parliament there might be a general belief that the actions of the authority had had a large responsibility for a growing volume of unemployment over a period. The 1944 White Paper said in effect that the level of employment was a major responsibility of Government, and every Government of either colour which has been elected since has said, and very nearly always acted as if it thought, that it is the major domestic object of policy to maintain a high and stable level of employment. You envisage an authority a little on the side from the course of everyday politics, yet powerfully influencing by its decisions the course of employment and unemployment. Could a Government tolerate that position and yet adhere to the doctrines which since 1944 have been cardinal to any Government of any party? Is there not a real problem for your point of view here, given the kind of Government that electorates have in fact returned?——I agree that there is a problem, but I think it is met in part, at least, by the fact that the determinants of the level of employment are not wholly monetary, and that there are things which a Government can do in pursuance of its responsibilities under the White Paper which are outside the range of the monetary authority.

10528. *Mr. Woodcock*: But who decides whether the means of maintaining full employment, if that is what they are after, are wholly monetary or not, for practical purposes?——The Government is not powerless in the matter; it has, for example, its control over the volume of the capital expenditure of Government departments, local authorities, the nationalised industries. That is a very important power which is outside the range of the monetary authority, and which the Government can exert if it deems the situation to be calling for it.

10529. That leaves the ultimate decision with the Government?——Indeed.

10530. If a Government decided that it was not going to cut its own expenditure (which I would have thought was the right of the Government in this country, subject to the ultimate decision of the electorate) and that consequently certain modifications must be made in the use of your monetary instruments, should that decision be challenged, in your view, or resisted, or prohibited by some non-parliamentary or non-governmental body?——So far as monetary policy is concerned I would like to see that in the unqualified control of a non-political body.

10531. That means usurping or limiting the right of a Government to make a decision in these fields?——From day to day, yes, but not ultimately, because a Government can always force through an amendment of the powers and constitution of the monetary authority.

10532. They could dismiss the authority, no doubt, and replace them by somebody else; but that is a very cumbersome way of achieving your object?——It is meant to be cumbersome.

10533. By you?——Yes.

10534. *Chairman*: Our questions are critical, but this is a very critical point for our inquiry. I am not yet clear why, accepting some of the drawbacks of an acute party system, the conduct of monetary policy should be entitled to be exempted from the consequences more than any other activity which is important to the economy of the country today. One might say for a great many other things which are the subject of acute political debate that they should be out of the hands of the politicians. What distinguishes the conduct of monetary policy?——*First*, the fact that monetary policy is all-pervasive, that it affects every branch and every aspect of economic life. *Second*, the fact is that monetary matters have to be dealt with on the basis that the conditions which whoever is responsible now confronts are different from any conditions that ever existed before, and that therefore they cannot act upon a judgment of past situations in the given situation. *Third*, there is the point that these monetary matters are immensely complicated and need to be approached all the time with complete objectivity of judgment. That, it seems to me, is not obtainable by entrusting these matters to a political authority, because its judgment will not always be objective, in the sense of a balanced judgment of what is right or wrong in the given circumstances. The judgment may be wrong; everybody makes mistakes. But the chances of its being right are better than if responsibility is vested in a political authority.

10535. *Sir Oliver Franks*: Why do not these considerations apply equally, for example, to fiscal policy? Taxation policy is all-pervasive; it is surely a complicated matter adjusting the whole taxation schedule to the different desires and policies of Government in relation to the economy as a whole; it should be done objectively; and I suppose that since the war the conception of the Budget not simply as the housekeeping account of Government but as a major policy force in the shaping of the economy means that the past gives very few lessons to the present. I am trying to argue the similarities, because I would like you to pick what I have said to pieces, in order to show why the status you wish to see given to monetary policy can legitimately be given to it without the argument applying equally to fiscal policy?——I would not attempt to pick your argument to pieces, because on the argument as you have stated it I would be in almost complete agreement with you. But I would point out that I do envisage certain powers in respect of fiscal policy being exercised by the monetary authority, because it seems to me that fiscal policy to a large extent in these days is part and parcel of monetary policy. That is why I would like to see, though I confess not very hopefully, the transference of certain fiscal powers to the monetary authority, subect of course to parliamentary control and review.

10536. *Mr. Woodcock*: Fiscal powers as to what?——I have in mind particularly the power to vary the excise duties in the broadest sense, including purchase tax; and powers of variation of contributions under the national insurance system, as envisaged in the 1944 White Paper.

10537. Purely internal matters?——Yes.

10538. *Chairman*: I think you envisage that whatever statute set up your monetary authority would give some definition to the purposes it was to pursue; you could not envisage it being set up without such a declaration?——I think not; one must have a definition.

10539. You would recognise that those purposes would have to be various, and not merely confined to securing a stable relationship between money and prices?——Yes. If I may pursue that question of purpose, I think I cited the Commonwealth Bank of Australia as one example of a definition. There is another one I would like to give the committee: the Bank of Canada. The preamble to the Bank of Canada Act says:

> "Whereas it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit, and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion; therefore . . . etc.".

That is another example of the kind of definition that might be formulated. I think that it is extremely important in formulating that definition of objectives to be quite sure to convey the sense of compromise; in other words, to lead no one to expect that all those things can be achieved all the time to 100 per cent.

10540. *Professor Cairncross*: Can you name any country where the monetary authority is of the character that you envisage here, made up of independent persons and Government officials, and where the Governor of the central bank might not take the chair of the authority, though it exercises control over the central bank?——I do not think I can. The Federal Reserve Board has influenced my thinking in this matter, but there is great danger in trying to transplant an organ from one country into the situation of another country, and there are certain aspects of the Federal Reserve Board which would obviously be unsuitable for this country.

10541. Would it not be rather embarrassing to the Permanent Secretary of the Treasury and the Permanent Secretary of the Board of Trade if they were members of an authority whose policy did not necessarily command the approval of the Chancellor of the Exchequer and the President of the Board of Trade?——I suppose it could.

10542. Do you regard it as an essential feature of your proposal that officials of Government departments should be members of the authority?——Not a vital feature. Whatever the constitution of the authority might be, there must be obviously very close working contact, and it seemed to me when reflecting on this that the easiest way to secure that would be by direct representation at the official level. Maybe it would be better to keep them off, for the reason you mention.

10543. What would happen to the Court of Directors of the Bank of England in the arrangements you propose, and the Committee of Treasury; would it be your view that these should be dissolved and replaced by some other body?——I should find it difficult in the scheme that I have set down here to envisage that the Committee of Treasury at the Bank would have any functions. I still think that a Court of Directors would have important functions, along the lines that the Governor has set down.

10544. You have thought of this as an independent body exercising executive and policy-making functions, not merely as an advisory body. Would you see advantage in having some committee made up along the lines you set out here, but exercising purely advisory functions?——There would be some value in a body of that sort, but incomparably less than in having an autonomous body exercising the powers itself.

10545. *Chairman*: Would you accept that the Federal Reserve Board is conceived as something which is wholly free from the Executive but is a delegated agent of Congress?——No, certainly not a delegated agent of Congress. It is much closer to the kind of situation that I envisage for my body. It is a board which exercises executive functions in respect of the central banking system. Its appointment is by the President, for unusually long terms. It has responsibilities to Congress, for expounding to Congress what its policy has been and what action it has taken to carry out that policy. But it is in no way, I should say, under the effective control of Congress.

10546. I did not say that it was. The view I put to you was that it had been created by Congress, with a trust for which it had to be responsible to Congress?——That is true in the very broad sense; its powers are statutory and its composition is statutory, and Congress is always at liberty to alter the statutes. But it is true in no greater sense than that.

10547. *Mr. Jones*: Do not your proposals seek to set up an organisation which in effect would mean a corporate state?——I should find it difficult to reply to that question unless "corporate state" was defined for me. If you mean that it would be setting up a power above the powers of Parliament in a democratic system, I would say not at all.

10548. The authority would have certain *ex officio* members: the Permanent Secretary to the Treasury, because of his association with economic and financial policy; the Permanent Secretary of the Board of Trade, because of his intimate association with the economic life of the country and its internal and external trade; and the Governor of the Bank of England. In addition there would be members appointed by the Lord Chancellor on a non-political basis, who would give their whole time to the work of the authority; they would be selected in a personal and non-representative capacity. Where are we likely to get with an institution like that, with powers conferred upon this authority set forth in paragraphs (*a*) to (*e*) of Appendix D of your paper?——I would hope that where we would get would be the execution of a monetary policy which is directed solely and exclusively to the objects set down by Parliament. I would remind you that I say that the authority

> "should be required to report to Parliament—and thence to the public—annually (and at irregular intervals if circumstances should, in its own judgment, make a special report desirable); its expenses should be borne on the Treasury Vote; its financial operations, together with those of agencies under its control, should be subject to audit by the Comptroller and Auditor-General and to review by the Public Accounts Committee."

If other safeguards can be devised and would be thought necessary in addition to those in order to preserve the sovereignty of Parliament in this matter, so much the better; but Parliament surely has sufficient protection in those regulations that I have suggested.

10549. *Professor Sayers*: Would the fundamentals of your system be reasonably provided for if, instead of having an entirely new authority set up, there was a reform of the composition of the Court of Directors of the Bank of England?——I think not. The whole tradition of the Bank of England is of such tremendous lasting power that all that would happen would be a reshaping of the machine, with exactly the same sort of performance.

10550. You are thinking that we must have an entirely new body, because we are not starting with a clean sheet?——Yes. As I read history, there has been rising dissatisfaction with the system under which monetary policy is in the hands of what I call for these special purposes an "irresponsible" body. That system has obviously not worked and has been judged lacking. The only solution to that problem which has been adopted so far is to switch the responsibility to the Treasury. We have had in recent years a "pull devil, pull baker" system, in which the Bank of England is always striving to establish and confirm its autonomy, and the Treasury is always striving to keep the responsibility in Whitehall. It seems to me that both of these things are unsatisfactory, and somewhere we have to find a solution for that tug between the old and the new authorities.

10551. *Chairman*: Do you think that the system adopted in 1946 of relying for Treasury and therefore indirectly for parliamentary control on formal directions

issued, is a satisfactory way of dealing with this relationship?——I do not. I do not think that directions from one authority to another can ensure an effective independence of judgment; and of course it can create great friction.

10552. I was assuming that it did not allow for effective independence of judgment in the final analysis; you make the point that it generates friction rather than harmonious working?——Yes, indeed.

10553. *Professor Cairncross*: How do you envisage the "pull devil, pull baker" disappearing on your suggested arrangement? If Bank Rate were under debate, would we not have a revival of covert war between the Treasury and the new monetary authority, with the monetary authority obliged in effect to consult the Treasury before it agreed to a change in Bank Rate?——There might well be a difference of opinion between the Bank of England and the Treasury, but the final resolution of that difference would be in the presence of other members of the authority of equal status, one of whom would be the chairman of the authority.

10554. *Mr. Woodcock*: I do not think that you have taken sufficient account of the very limited extent to which, in other fields which are perhaps not as pervasive but certainly are quite important, any Government will allow an authority to act independently, or appear to be acting independently, as related to the control which the Government has over the authority itself. For example, recently there was trouble in the National Health Service about a wage increase, where a body set up by the Government to discuss wages recommended an increase, and where the Minister put his foot down and said: "No". Any demand which has been put forward that an external, non-parliamentary authority's decision should be binding is met with the assertion of the Government that in the last resort its will or decision is incontrovertible, if it does not wish to accept the authority's decision, even if that means that the authority must be reconstituted to consist of a majority of people appointed by the Minister. I think that you are making an assumption which is very difficult to swallow, that monetary measures somehow ought to be independent of the objective which we seek to produce by them. I do not think that the objective can be set out in some charter. It is an objective which may vary itself. In economic policy, monetary instruments are one means of achieving an economic end; surely no Government is going to give up control, or even make its control remote, over those monetary instruments when they are fundamental to the achievement of economic policy?——You are really assessing the political probabilities of ever getting an authority such as this set up and left alone to do its job.

10555. Probability, and desirability, too?——And practicability. In all these matters one has got to think of what would be the most desirable system *if* it could be achieved. It may well be that you are right; your political judgment is very much better and more informed than mine. I am suggesting that this is a scheme that at any rate has virtue from the point of view of managing our monetary policy. It may well have political weaknesses and impracticabilities which are insuperable; I do not know.

10556. You are not quite on the point I wanted to make. Monetary instruments are instruments which are used for the achievement of the very broad objectives of economic prosperity, progress, health, call it what you will. What constitutes economic health or progress is ultimately a political decision: it is something for which ultimately the Government must be held responsible. It seems to me that your scheme would involve the Government submitting the decisions on the use of these instruments to an irresponsible authority, whose decisions it could only overrule by proposing changes in the constitution or membership of the authority which would have to be incorporated in the normal legislative fashion in a statute. Is that not involved?——Yes.

10557. *Chairman*: I would like you to say a little more about what you think is fundamentally astray in the present system. You suggested just now that the history of the last twenty years or so shows that the Bank of England does not enjoy public confidence today in the way that it did. Do you think that that is corrigible or incorrigible with the present set-up?——With the present set-up it is probably incorrigible. If I may put it in a rather brutal way, I think that the Bank of England is the victim and the prisoner of its own history. It seems to me that every move which the Bank of England makes towards the progressive recognition of its public functions is made with the utmost reluctance and long after the circumstances would be deemed to require it according to an objective judgment. One example is this business of an annual report; a very simple business, surely. When the Bank of England was nationalised, arrangements were made for the issue of an annual report. We have now had eleven of these reports. They have contained very little information that is not already available. They contain practically no commentary. They contain some formulæ, such as a recognition of co-operation by the joint stock banks, and that is all. They are, from the point of view of observation, study and intelligent appreciation of the general monetary policy of the country, practically worthless. This is the result of eleven years' effort. Criticism might be made also of the general public-relations sense of the Bank of England. There is the greatest reluctance to adopt any of the normal techniques of public relations which one now finds accessible in Government departments and businesses of any magnitude or significance. When, for instance, the Bank Rate is changed the arrangements for giving background information when the change has been made are pathetically inefficient, as any financial journalist would confirm. The Bank of England has this ingrained resistance to change, which makes me after many years almost despair of ever having a monetary system which is really abreast of the demands to be made upon it.

10558. *Mr. Jones*: But does that not make the Bank of England responsible for the mystique about all this business?——Very largely.

10559. *Chairman*: When you say that there is a lack of public confidence, what sections of the public are you speaking for or about?——I have no title to speak of groups, but I should say that amongst the academic fraternity this position is clearly recognised, though it might not be expressed in such strong terms as I have used this morning. I should suppose that in the labour and trade union movements it is very widely held, though I am open to correction. If there are many friends of the Bank of England in that movement, I should be a little surprised. And I think one finds all over the country, in industry for example, continuing and sometimes very outspoken criticism of the way in which the Bank conducts its affairs, not on any ground of lack of objectivity in its judgment, but rather on the grounds of the creation and maintenance of what Mr. Jones has called the mystique of monetary policy.

10560. *Professor Cairncross*: Is it your belief that the mystique would be removed if the Bank of England's public relations practices were altered?——Very largely removed, I should say. After all, what is mystique but a product of fostered ignorance?

10561. In your article in *The Bankers' Magazine* for July, 1957, on "The Scope and Limitations of Monetary Policy", you twice made reference to speeches by the Governor, and on both occasions you made it apparent that you do not have a copy of the full text. Is that a normal situation which you face, that you, as a responsible official of your bank, do not have access automatically to a copy of speeches made by the Governor?——This is an interesting example of faulty public relations. It is very difficult to get, on the morning of newspaper reference to a speech by the Governor, a copy of the text of the speech.

10562. And there is no channel through which the Bank of England could itself make available the full text, except in the form of a Press release?——One would suppose that a Press release would be available to anyone who was prepared to ask for it.

10563. *Chairman*: Is the distinction between having it available in a Press office in the Bank, and the Press office itself giving adequate circulation of mimeographed copies?——I think it is important that any responsible enquirer on the morning of publication should be able to go somewhere and get it.

10564. But you say you cannot do that?——Up till recently, no. I am not sure of the last speech, but certainly there have been occasions in quite recent times when it has not been practicable to get a copy.* Later on it is very probable that the full text would appear in *The Bankers' Magazine*, or somewhere like that.

* *Note by witness*: Shortly after this evidence was given an important improvement was noted in the Bank of England's practice in this matter.

10565. *Mr. Woodcock*: That sounds like technical inefficiency rather than anything else?——Yes.

10566. *Professor Sayers*: Have you felt that those texts have been very helpful when they have come?——I have not always felt totally convinced that the content was altogether satisfying, from my point of view; but maybe I am an excessively inquisitive person.

10567. *Professor Cairncross*: Do you feel that there would be great reluctance or great difficulty in this country to conduct the kind of discussions that take place in the United States between officials of the Federal Reserve Board and academic economists and journalists and others? Ought there to be any more difficulty here?——I think there ought not to be. I think it would take a long time to develop that degree of freedom of exchange of views which is found in the United States; in this country bankers generally (I am not speaking solely of the Bank of England at this point, but of bankers generally, with apologies to Sir Oliver Franks) are not quite so forthcoming in their private expression of views as they are in the United States. There is a greater degree of reticence and reservation about the expression of views and exchange of facts.

10568. Do you think that this has any connection with the responsibility of the Bank of England to Parliament, the difficulty of disclosing facts here compared with other countries?——I would not have thought so. I should have thought it was more traceable to two elements in the practice of banking in this country: the extreme sensitiveness of the English banker to the confidential nature of his relations with his customers, and the still very keen competitive spirit in banking, which makes bankers very hesitant about saying anything in company which might be conveying information to their competitors. At a conference which I attended in the United States in March 1957, which was attended by heads of fifty or so of the biggest banks in the United States, the discussions rested largely upon the disclosure of facts about the operation of individual banks which made my ears positively burn, not because it was of any interest to me as associated with an English bank, but with surprise that bankers should get up and talk about their investment policies, their charges and their lending operations with such freedom.

10569. *Professor Sayers*: Is not this something that we could not change by reconstituting the monetary authority or by attempting to infuse a new spirit into the Bank of England on public relations, but a matter of very fundamental difference in financial practice that we should have to accept as one of the background facts?——True.

10570. *Sir Oliver Franks*: Taking the general theme of the inadequate public relations of the Bank of England, do you attach major importance in this regard to its effect on the reputation of, and therefore the degree of power possessed by, the Bank of England, or do you think its major importance is in relation to increasing the effectiveness of monetary policies themselves? One could say that good public relations would enhance the position, stature, and therefore power to act, of the authority, but one would not necessarily say that by themselves they would make the particular measures adopted more effective because they were understood; equally one might say that the main point lay in the second leg· that they would make the measures more effective just because they were understood. Would you be willing to say just a little about where you find yourself, either in differing between the alternatives or combining them?——I do not think on the whole that better public relations would in themselves make the measures more effective; but I think indirectly they could have an appreciable effect along that line, because it seems to me that poor public relations have been largely responsible for the mistrust which envelops not only the Bank of England but the whole banking system and the whole business of monetary policy. That mistrust is very widespread. There is abroad, as I judge it, a feeling that there is some sort of a racket here, and we shall not get very far in the best utilisation of monetary policy until we dispose of that notion. That is why public relations are so immensely important. It seems to me that we have arrived at the stage when monetary policy must be discussed as something that can be understood by the ordinary man, and something about which the ordinary man is put in possession of the facts upon which judgments and action are based.

10571 *Mr. Woodcock*: Just the facts?——And the considerations that have led to conclusions. In other words, I think the central bank, as the monetary authority at the moment, or the new authority which I am suggesting, should be required to explain what it has done and why it has done it, and the balance of arguments which have led it to certain conclusions and decisions.

10572. *Chairman*: In paragraph 3 of your memorandum, you question the rightness of a completely sceptical conclusion about the movements of Bank Rate and their effectiveness, and then in (c) you say:

> "In present conditions, for example, advantage is to be seen in terms of continuing domestic monetary policy, in establishing long-term rates at an attractive margin above short-term".

There is an assumption in that that there is under our set-up power in the monetary authority to establish a desired relationship between the long-term rate and the short-term rate, and therefore to maintain it. Are you satisfied about that, from your observations?——Yes. As I see it, we are going to need for a long run of years in the future an immense volume of funds to finance capital expenditure, largely at home but also abroad. A large part of that flow of capital finance will have to come out of forced savings, through budgetary action. For the rest, and so far as the determination of capital activity is within the hands of private enterprise, and so far as the flow of saving is to be fed by voluntary savings, we may expect that the structure of rates on long-term capital will tend to be higher than it has been in the past. Therefore one should in my view foresee that the broad pattern of rates may be rather more dispersed than it has been in the past. What worries me in this situation is that, while it may be necessary within the territory of private enterprise to maintain rather high long-term rates, there should be a pull upwards upon short rates for purposes that are related rather to the current conduct of affairs than to the problem of capital provision. I think it would be a pity if, through the costliness of capital, industry had inflicted upon it a high level of interest rates on short-term credit. Of course it may be that in the operation of the monetary system from day to day and month to month the authorities will need at times to jerk the short-term rate up quite high, but I have never felt altogether satisfied that we should be happy with the close integration of short and long-term rates that would lead one to suppose that short-term credit has always got to be dear, because long-term capital is expensive.

10573. *Professor Sayers*: Given a highly developed financial system, in which there are many large institutions which are ready to move the distribution of their assets somewhat as between the long and the short, and there are also people who are prepared to shift in some measure the distribution of their liabilities between the long and the short, are the two rates not fairly closely bound together? I do not mean that they must always be in exactly the same relationship to each other, but that over a period of time they cannot be persistently out of step with each other. Is that not so, and am I not describing a system that is more or less the English economic system when I talk of institutions that are in fact ready to move the distribution of their assets or their liabilities?——I think that is perfectly true. You are speaking of a system in which also many large institutions have a very high degree of financial autonomy, and in which borrowing is becoming less and less representative of the normal procedures of conducting trade.

10574. *Professor Cairncross*: How would you propose to use Bank Rate? You certainly do not want to keep the short rate down at a low stable level, for you envisage changes in it from time to time; are you suggesting to us that it should be jumped up rather more violently and down rather more violently than in the past?——Yes. I envisage Bank Rate as having a function which in these days is much more appropriate to our international relations than to our domestic situation. For example in the kind of position which we had last September there is an obvious case for shoving up the Bank Rate stiffly, as one of the very few demonstrations by which we can change the psychology of the person outside the United Kingdom who is having a rather important effect upon our situation.

10575. Purely for the psychological effect, or because something real happens at the same time?—At the moment I should say almost entirely for the psychological reason; but there may well come a time when its practical effect would be greater than it is now, though it is not negligible now.

10576. *Chairman*: But if in the course of time the foreigner heard you talking, and realised that you were thinking only in terms of his psychology and not supposing that any practical result in fact followed, would be not lose his psychological reaction?—It is strange how this business of the Bank Rate seems central to the thinking of so many Continental people. It still has that symptomatic value, which is of great importance. I think that the banker abroad is beginning to look more and more to other things, and to ask: "Are they putting their domestic situation right?"; on the other hand there are crises in our international relations which are not very obviously and closely connected with our domestic situation, to the outside point of view.

10577. *Professor Cairncross*: Looking at the way in which Bank Rate has been used in the past two or three years, you feel that it has not been used sufficiently boldly, and that we have moved the rate steadily upwards, instead of moving up and then down?——I would have said that on balance we had done better on the up side than on the down side.

10578. Could we have got it down without running risks?——I think we could have brought it down a month or two months earlier this year with advantage.

Chairman: Thank you very much, Mr. Crick; I think that has finished our questions.

(*The witness withdrew.*)

PROFESSOR H. G. JOHNSON, Professor of Economic Theory, University of Manchester, called and examined.

10579. *Chairman*: We are much obliged to you for your memorandum*, Professor Johnson; there are one or two questions we should like to ask you, by way of getting you to enlarge upon your comments. There are two main headings: "The public explanation of monetary policy" and "The use of Bank Rate and open market operations". I should like you to enlarge a little upon what you have said about the public explanation of monetary policy. Let me ask you one general question to get your background first. If one accepts that there are defects in the presentation at the moment, and one can see the possibility of establishing altogether better public relations, and much wider explanation available for the public interested as to what is done and why it is done, what do you think is going to be the main benefit reaped from that improvement?——*Professor Johnson*: Two sorts of benefit, one of mainly political significance and the other of longer run significance. The immediate one would be that we might get a more cool public discussion of these issues, and more scope for a rational arrangement of policy methods. I think that we are still suffering from the acrimony of the 1930s in this respect. With the full employment economy the rôle of monetary policy is bound to be different, and we need to work that out. In the longer run we need to get more information in order that people like myself and lots of others interested in monetary policy should have the facts, and be able to test their hypotheses and get a better understanding. I am very conscious of the shortcomings of my own knowledge in this memorandum; I am arguing some things which may not be true, but the information is not available. I would hope that this situation would be remedied in the long run by the accumulation of work on these matters and understanding of how the thing works.

10580. It would be in your mind that monetary policy, to be effective in the economy, must require the active co-operation of a great many people?——Certainly as one conceives it now it must, and probably that is true for the economy in general, largely because of the centralisation of the financial system in this country. With only a few banks, and a few discount houses, there is not the possibility of operating in a market quite as impersonally as in some other countries. With a few institutions whose actions are of great significance the authorities have to have co-operation. Whether they get it most effectively by present methods I do not really know.

10581. The main benefit of the change or the advance you are suggesting would be to achieve greater effectiveness in monetary policy by getting people to co-operate with it through understanding?——I have put two points; one is greater effectiveness in current operations and perhaps greater flexibility; the other is better understanding of what the tool itself does. This requires a great deal of experience and work. It is not a benefit we should get immediately, but with more information available more people would be led to think about it, analyse it and see how far their preconceptions and assumptions about how it works were really justified.

10582. *Professor Sayers*: So you would get more satisfactory formation of policy?——I would hope so; as a longer-run benefit better understanding, and better policy operation more immediately. The case for more information always has to rest on faith that more information will lead to better use of it. This is an argument which you must be considering fairly seriously. It is a question how far one is justified in imposing, say, the cost of collecting statistics without a demonstration that they will be useful. Of course, professionally I have an interest in more information, but I can quite genuinely say that I think and hope that this would lead to better understanding of the whole thing.

10583. *Sir Oliver Franks*: What about the explanation of the why and wherefore, the background for a current action? How important do you think that is? Suppose, for example, that after a period of fairly level going the authorities put the Bank Rate up, say by 1 per cent.; theoretically one could think that it would make a great deal of difference whether they just did that and left everybody to form their own opinion about why it bad been done, or said: "This has been done because we detect growing symptoms of demand inflation in the economy; we are worried about pressure of resources, and we are going to do a number of things we think will relieve that; this is the first measure, and we shall continue and go as far as may be necessary to get the effect we think should happen." In the first case everybody makes up his own mind what an unexplained action stands for; in the second case the Government goes to a great length to say that it is an instalment of a policy which relates to a given view of the economy. Are you advocating the second?——I am in favour of the second, subject to some problems which I have mentioned very briefly in this document, for two reasons: (1) that on past occasions failure to provide that sort of explanation has led to difficulties of various kinds which were unnecessary, and has caused confusion, and (2) that unless we are told why things are being done it is very difficult to evaluate whether they work or not. One of the difficulties I have found since 1951 is that according to whom one picks one can be assured that monetary policy has worked with speed and efficiency, or that something else did the job and monetary policy was incidental if not an obstacle to the other things. We need to form as good a view as we can whether monetary policy works or not.

10584. I think we are on a slightly different point. You are speaking from the standpoint of the impartial observer, say, the professor reflecting on the subject. But put yourself in the position of a business man with his plans, hopes, fears and expectations about markets and so on, who receives a change of Bank Rate accompanied by this explanation. Is that not likely to have a relevance beyond establishing how far a particular action or policy of Government did in fact take effect? Is it not likely to do something in relation to whether it has effect? If the person who is affected really believes that more will happen unless he acts in a certain way, then is not the action with the explanation liable to be effective in a way in which the action by itself would

* Memoranda of Evidence Part XIII No. 18.

not be? Or do you think this line of reasoning is mistaken?——It depends on what they are trying to do. So far as small business men are concerned, I do not imagine many of them read the papers each morning to see what the Government is planning to do about Bank Rate. They are influenced more by the things that affect them directly. On the other hand if the authorities are aiming at such things as foreign confidence or the attitudes of the big institutional investors, it will make a difference. This is one of the difficulties in this whole matter, that the authorities are by their explanations influencing reactions. I think that this is a legitimate and normal technique of monetary policy and one that ought to be used, but it does create a difficulty. If they say honestly what they are trying to do, they may not achieve it. If they admit that they really are worried about the internal situation and say this at the time, this may make the reactions adverse to their policy. I certainly would allow for that. It would require the exercise of some discretion, but nevertheless I am in favour of as wide publicity as is possible, partly on the grounds of building up knowledge of how things work and partly on the grounds that I do not think that one really hides what one is doing if it is really vitally important.

10585. *Chairman*: If they were very frank about the situation as they saw it, it might be regarded as an alarm signal, and they would do more harm than good by a statement; that is the sort of thing you mean?——I think so. In this kind of thing where one is influencing an opinion one often wants to take a position one does not really hold. One may say that the situation is more grave than one would really honestly tell oneself, in order to convince people to take certain actions and so forth. I am not entirely happy about the implications of this kind of action but I recognise that it may well be a necessary part of central bank technique at crucial points of time.

10586. You attribute that to the fact that the Bank is "an operator in the market"?——I would not restrict it to that. When I wrote that I was thinking more of its influence on investors than on, say, foreign confidence.

10587. *Sir Oliver Franks*: Do you distinguish here between operating in the market in the sense of directly altering interest rates by changing the Bank Rate and operating in the market by buying and selling bonds, as the Government does at the short end now and might do at the long end?——They can do both. They can operate in the market to change interest rates without doing any transactions at all, if they let it be known that they have changed their minds about the future and people assume that they will take action.

10588. Do you differentiate between the one type of action and the other in terms of the liability to be misunderstood, or alternatively of frustrating their own action by being candid?——The argument applies much more in those cases in which they are stating a position, as when they shift Bank Rate, than when they are dealing in Government securities without making a special point of it, so to speak. Where they change Bank Rate it does make a big difference, as in the example you put to me a little while ago. If on the other hand they are conducting day-to-day operations in bills then it is much less important.

10589. *Professor Sayers*: Is it necessary to regard altering Bank Rate as one of the inevitable weapons? What you are saying is emphasising very much the psychological dangers of the moment at which Bank Rate is changed. Suppose that in the discount market as in the long-term securities market the Bank of England were simply operating from day to day, never making a public announcement but letting the discount houses know the rate at which it was prepared to operate; would these difficulties you are now talking about melt away?——I would expect that they would. This is the kind of question I do not like to commit myself on because it assumes a great deal of knowledge and also requires prediction; but I would think that a great deal of the problem comes precisely from using Bank Rate in this particular way: changing it on one day with a great deal of discussion among the people concerned beforehand and changing it by a lot. I would certainly expect that, if they did not do that and give it significance, or if it was a daily rate or something of that kind, we should not have this problem. At this stage I was talking about the way things are going on now; in the second part I discussed what I think should be done about it.

10590. *Professor Cairncross*: You mention in paragraph 7 the problem of joint responsibility of the Bank and the Treasury. Do you think that it is the function of the Bank of England to explain what is involved in current monetary policy?——I think that it should be the function of the Bank of England to give regular reports to explain what it is doing. If you make the word "current" too precise, of course, you may be restricting its powers; this is the difficulty I recognise early in that paragraph. I think that the Bank should be responsible for explaining what it is doing. For one thing it is the Bank that is doing it, and the fuller the explanation the more it will be a matter of financial details, which I do not think would be appropriate for other agencies of Government to comment on. The Bank would be the informed source of information.

10591. Have you in mind in this and the following paragraph chiefly the annual report of the Bank and its inadequacies, or are you thinking quite as much of the limited amount of information given to the public about individual acts of policy?——Both. This again raises problems. I think that the Bank should publish some regular review of its actions which would serve as an account and be a source for those who wished to understand how it worked; but this could be published with some delay which would eliminate the problem of giving away the Bank's hand. On the other hand when it makes a particular change (I am here thinking of Bank Rate mostly) which is intended as a signal to the markets, it should explain what it is trying to do in so far as it can do this without raising the problem I have been talking about.

10592. When you say that a review might be issued by the Bank of England, do you mean a document that would appear at regular intervals?——That would be probably the best way of doing this. The difficulty with irregular publications is that they acquire great significance at times. If this kind of publicity is to achieve its least disturbing effect, I think that a regular publication, which is sometimes dull and reports that nothing very much has happened, is desirable.

10593. It is sometimes suggested that there should be a statistical publication devoted exclusively to financial statistics issued by the Government either through the Treasury or the Bank of England. You would favour a publication by the Bank of England?——Yes.

10594. Whether exclusively statistical or not?——Yes. One reason for that has nothing much to do with this particular argument, but is simply that the statistics are becoming so numerous and I think probably so difficult to manage as publications, that to collect one group of them together and put them under some separate authority might be the best way of keeping them to manageable proportions. Also I think that until one comes to the preparation of statistics one often does not define one's ideas very clearly. The definition and collection of relevant statistics is itself an educational process, as I found myself when collecting statistics on money supply in this country. It might be presumptuous of me to suggest it, but publication of statistics by the Bank might perhaps be of some value in this way.

10595. *Chairman*. You spoke of the drawback, in connection with the publication of a review, of the Bank giving away its hand. I am trying to weigh what that amounted to. What is the real difference between making plain what your policy is and giving away your hand?——They may want to influence the market by attaching more importance to a particular move than they themselves attach to it. They may want to make a change of policy with quite a big splash, to convince people the situation is really serious, and they may want to over-dramatise its seriousness; or again they may want to make a move and give less emphasis to it than they seriously think, so as not to disturb some people.

10596. *Mr. Jones*: Could this mean the supporting of policy by stealth?——Let us not introduce these judgments, but let us say that they should use every means they can. Quite often one wants to bluff, which I do not think amounts to stealth, or simply to exaggerate a little one

way or the other in order to influence other people. I think this is inevitable in a centralised system in which a great deal of money may hang on people's interpretations of the Bank's actions.

10597. Then there must never be reports that reveal conflict between, say, the Treasury and the Bank?——No, I say quite the opposite. I am in favour of reports that reveal conflict of this kind, if conflict exists; for one reason because I do not think one hides this sort of thing, for another reason because I think that, if there are honest disagreements about policy, they ought to be aired rather than settled in private and then justified by everybody afterwards. Going back to the main question, in the kind of situation I am thinking of, as I conceive it (I have not been on the inside), it is often a matter of influencing other people's opinion of oneself; in this case one does not want to admit that one is trying to give the impression that everyting is under control, precisely because it is not under control unless one can give that impression.

10598. *Professor Cairncross*: Does not this arise particularly over speculation on the rate of exchange? What they say or how they say it may be more important than what they do?——Anywhere where speculation is easy, and depends on what people think that the authorities will be doing. The Bank may run into the problem that it cannot confess, at that moment anyway, what it has in mind: but I would hope that in my regular publication the Bank would be prepared to confess occasionally that it bad tried something on, if only because people know that it was tried on and if the Bank tries to hide this fact it does not really get away with it.

10599. *Mr. Woodcock*: You mean an annual publication?——This gets on to the question how regularly one wants to go to the expense of a publication. I would think myself that annually would be too infrequent. We are moving generally towards quarterly publications of information of various kinds; and a great deal happens in a year in this country.

10600. In the second part of your paper you are arguing for much more extensive use of open market operations. There would be a lot more actions, on your assumption, for the Bank to have to explain?——They would not have to explain every individual transaction, but they could explain, say, that in the first quarter of the year they wished to make money easy. To account for every transaction would be more than any reasonable man could hope to cope with, but I think one needs an explanation more regularly than annually. Probably quarterly would be a reasonable basis.

10601. *Mr. Jones*: Have you got in mind a situational report as well? Looking at the events, say, after September last year, would you call for a report in circumstances like that as a means of cultivating the best possible public relations and understanding of the situation?——I would look rather for a twofold approach on this: that at the time when they took that sort of crisis action they should give an explanation of why they were taking it, but that in the quarterly or annual publication they should look back over the experience, trace the developments that led up to it and explain the decision and also, I hope, try to envisage the consequences as far as they could. This may be calling for rather more than the Bank of England would like to offer, but I think the double approach seems desirable. This is all hypothetical, because we do not have this kind of document in this country and obviously it is something that would have to be developed in the light of experience.

10602. *Professor Cairncross*: It is your view that most other countries where financial operations are important have a review similar to this?——Yes.

10603. *Sir Reginald Verdon Smith*: In paragraph 7 you speak of this explanation being the responsibility of the Bank rather than the Treasury, and you say that this might give rise to conflict with the constitutional responsibility of the Bank to the Treasury, and some modification of this relationship might be necessary. Would you enlarge a little on that?——I was afraid someone would ask that! I am not really well qualified on these constitutional questions. I mentioned it as a problem rather than posing a solution. As I understand the possible problem, if the Bank is responsible to the Treasury, and if it publishes something then presumably the Treasury is ultimately responsible for it. Just how serious a difficulty it might give rise to if there was some difference of opinion, only time would tell, but it might be necessary to loosen the relationship between Bank and Treasury so that the Bank could publish these documents without the Treasury necessarily being committed to every statement. I really am reluctant to go on very far with this because it is an area which I am just not competent to discuss.

10604. *Professor Sayers*: If your view that public relations and explanation of policy should be developed along these two lines were accepted, what consequences would you foresee for the Bank of England internally?——Again, this is taking me far out of my field of competence. Obviously one requirement would be an increase in the number of people concerned with the collection of statistics and their analysis, and the presentation of these to the general public in, as I suggest, a quantitative form of discussion, as compared with people concerned with the actual market dealings. This would presumably mean a change in the recruitment policy of the Bank, because, if this became fully developed, they would need to have a fairly large staff of competent economists and statisticians which they would recruit from the universities where such people are trained.

10605. Would the development of public relations of this kind lessen the case for part-time directors?——That depends on what the case for part-time directors rests on to begin with. In so far as a large part of the Bank's work is dependent on its contacts in the City, the trust with which it is regarded by financial institutions and so forth, I do not think the case would he at all impaired. On the other hand there would, I think, be some possibility of conflict between the ideas of these people as to what public relations consist of and what I think they consist of. This is one aspect of the situation which I start from, that public understanding of the Bank and its activities is not in too healthy a condition. I think that this is perhaps one of the reasons; one sees from the evidence given to the Parker Tribunal, that the way in which financial people explain themselves is just a different way from the way in which many other people explain themselves, and this gives rise to misunderstandings.

10606. Would you think it important that in addition to these published statements the Bank of England should cultivate economic discussion with academic people?——Very definitely. I do not want to state too much of a professional claim, because economists tend sometimes to want more influence than they are entitled to; but I think there should at least be more exchange between Bank of England people and economists. I think there bave been some very good developments in the last year in this respect.

10607. *Chairman*: What would they be?——If one could, for example, occasionally have a Bank of England expert along to a university to give a talk on current policy problems and so on. Mr. Mynors has been very good in that way, but the stock of people is small and the opportunities few. A more far-reaching suggestion is the one I make in paragraph 9, that economists should actually come into the Bank to work. How far that would be useful unless the Bank's own position changed towards much more professional economic activity, I do not know; but one feels that whereas one can talk to the Treasury people without any great difficulty, talking to bankers is an experiment rather than a habit.

10608. May we look now at the second half of the paper, on the use of Bank Rate and open market operations?—*Professor Cairncross*: Could you tell us exactly how you think monetary policy takes effect on the level of demand?——It works in a variety of ways. One thinks first of the impact on bank lending; there one thinks less of the rate of interest than of what the banker says to the people he has in his parlour. Perhaps one thinks too much of this, in the sense that this is the institutional arrangement, the way we always think about the banking system working. Probably nowadays we get as much influence in a general way, through the direct impact of monetary policy on rates of interest and particularly on security values, and on the people holding these things.

10609. The view you take in these paragraphs appears to rest largely on the influence of changes of long-term rates of interest on the level of demand rather than the influence of changes of short term rates. The first suggestion you made just now related to the rates on lending followed by the banks and their willingness to grant short-term credit. That I thought on the whole you were tending to play down?——In this argument, yes.

You asked for a general account. Here I am suggesting what I think are improvements in the control of the economy. So far as control of the banks is concerned, this is probably fairly effective, not necessarily because of the mechanics of it but because of the powers in the Bank of England Act to give directions and the fact that the banks are rather timid in their reactions to statements on what they should be doing. I think the banks are well under control, probably too much so for their own good and the effectiveness of the monetary policy. I am suggesting that for effective monetary control the authorities need to be prepared to move against other institutions as well, that the method of supporting short-term rates does not do this so well, and if they were to get into open market operations in long-term securities, they could get at these institutions more directly.

10610. A number of our witnesses think that changes in rates of interest have very little effect on the level of demand. You do not share that view?——I find it difficult to express a view on this because a great deal of thinking, including my own, about monetary affairs is rather confused by not distinguishing between the kind of rate changes one might think of as normal and the kind one might think of if one was trying to make an all-out use of rates. I think, as I implied at one point here, that with a full employment economy we lose a great deal of the effect on expectations, and with high taxation and so forth we lose a great deal of the effect on costs. That implies that small changes of interest rates as in the past are less effective, but does not necessarily mean that bigger changes would not work or that one would not be safe in using them.

10611. It is still important to know which sector is likely to be most sensitive; you may assume that one can bring pressure on demand for short-term credit more readily than on capital investment, but which do you think that one should try to influence by monetary policy?——I would rather put it the other way round. One starts with a problem which tells one what one wants to try to influence; one then tries to find out how to influence it most effectively. If the authorities rely always on control of short rates in banks they are not doing the best they can. I would prefer not to think of what one is trying to influence by monetary policy as the first question. They are faced with a policy problem which may take one form or another; monetary policy is one of the techniques for dealing with it, but they can use others, and I think others are often more effective in dealing with short-term difficulties. The use of monetary policy is dependent on the problem and what one thinks monetary policy can do. My recommendations here try to make monetary policy as flexible in this general battery of methods as possible.

10612. *Chairman*: But on any particular occasion when a problem arose they would have to have in mind what their objectives were?——Yes; that is one of the points I would like to make. They are nowadays aiming at a rather complex set of objectives; not only thinking of the balance of payments, but also about the growth of the economy, the balance of industries and a number of other things. This makes it desirable to be selective in the use of methods and also to deploy monetary policy as they think most effective.

10613. *Professor Cairncross*: I get the impression that underlying this section of your paper is a belief in the effectiveness of monetary policy, not necessarily by any means to the exclusion of other ways of influencing demand, and without commitment to the particular section of demand influenced by monetary policy. I get the impression also that you feel that monetary policy would be much more effective if action were brought to bear across the whole board of liquid assets from the short end to the long end, that you feel perhaps that it has been a mistake in the past to operate through very large swings in short-term rates which have been costly in various different directions. Is that a fair expression of your view?——Yes. But I would rather speak of the potential effectiveness of monetary policy. My general view is, and here again I may merely be reporting my own state of mind, that our attitudes on monetary policy have been very strongly influenced by the inter-war experience, that in a regime of full employment and so forth we need to re-consider the role of monetary policy and see what can be done with it. One wants to take a neutral attitude towards it, so to speak, as an instrument along with other instruments. One wants to see what it can do. Most of our economic theories suggest that it can be influential. On the other hand our assessment of past experience has been very much in terms of preconceptions which we ought to clear out of the way. I would be quite prepared to find that monetary policy was not very effective. I do not want to take a position on this, but I have myself been slightly converted from earlier views by experience of the last six or seven years.

10614. It is possible to argue for low stable short term rates of interest on the basis which assumes that monetary policy is entirely ineffective and that there is therefore nothing to be said for making short term rates high. It is possible also to argue for low and comparatively stable short term rates on a quite different footing, that there is no reason why a movement in short term rates need be prolonged more than is necessary if its function is to bring about or match a movement in long-term rates. As I understand your view, it is of the second character rather than the first?——I agree with that.

10615. *Professor Sayers*: You would in general lean towards attention to the long-term rate rather than the short?——Again, I would like to get back to the problem we are starting with, in deciding on policy. My point is that, if one wants to tackle long-term rates, one ought to do so directly rather than indirectly. But there are possible situations in which one wants to tackle short-term rates without touching long term.

10616. *Chairman*: The way to the long-term rate is not through the short-term rate?——That is my view.

(Adjourned until 2.15 p.m.)

PROFESSOR H. G. JOHNSON further examined.

10617. *Chairman*: You were pointing to a possibility of operating directly on the long-term rate?——*Professor Johnson*: Yes; but I would say long-term rates, in the plural.

10618. In effect I suppose that would be a combination of open market operations in the appropriate securities, coupled with debt management policy?——From an analytical point of view there is no difference between the two. It is a question of who does it, except to the extent that debt management is done more clearly than open market operations.

10619. With our set-up how far do you think that the authority in deciding to operate that way could achieve their results and be masters in their own field?——I do not like this kind of question. I really doubt that the question whether they would be masters or partial masters is a useful question to ask. Whether they are masters or not they have to do something, and the question is how well they can do that with different techniques. I say that, if they approached long-term rates of interest directly, they would do better than if they approached them indirectly; they would get a more immediate effect and they would see what effect they were getting.

10620. If they are going to use this sort of technique you must consider the market that they are going to operate on; will they get a result unless that market is active and prepared to be operated on?——This is a vexed question in the whole theory of this subject. An inactive market is one in which prices can be pushed around more easily than they can in an active market where people are prepared to speculate. Again, thinking of longer term objectives and particularly if they wish to move supplies of funds from place to place or encourage that process, if they make interest rates move about too much they may raise difficulties for these other objectives.

10621. *Professor Sayers*: Are you thinking there that they may weaken the financial institutions that are operating in that market?——They may weaken them, or

induce them to stay out of that market and therefore bring about a restriction of credit in that market, which has then to be supplied at greater expense and less efficiently than it could be. This is a general question, of course. I think the question the Chairman is getting at is that to run this kind of policy they have to have full knowledge of all these markets. If one works in one market only, then one only has to know that market and one can devote all one's energy and talents to that market. If the Bank of England was going to operate in other markets it would have to know, for example, how insurance companies do their investments; it could not confine itself to those who deal with Treasury Bills. It would also have to take an interest in building societies, and in a broader field in company investments, particularly the bigger companies which hold substantial assets of a monetary and debt nature. I see no objection to this, unless one takes the line that the aim of monetary policy is to interfere as little as possible with anybody except those with whom the authorities traditionally interfere; and I do not think that this is a proper precept for monetary policy in the general context of economic policy.

10622. *Chairman*: Is there not a point of view which says: "We have always played about with these traditional areas, and they understand the game and are not frightened off by what we do; but the situation would not be the same if we began to have an avowed policy in other areas which are concerned with investment in medium and long-term securities"?——That argument leaves me cold. I do not see any reason against interfering if the aim is to interfere. People become used to it, and if it is done in a certain way it does not seem likely that they will take exception, particularly as they know that the things the authorities want to control, with general objectives of economic policy in mind, are outside their own range. It is a question whether the authorities are trying to do it with the least fuss for people they care about or trying to be effective. That is putting it in hald terms; but if one is trying to influence the economy one has to know where the influence will work and apply it there. If one looks at the history of the discount market and the banks and so on, in this country and overseas, for at least the last thirty years there have been tremendous changes, and each time people have become used to it. One finds financial journalists saying that we have always done these things. Tradition is something that can be developed very easily when one is working on a day-to-day basis.

10623. *Professor Sayers*: If this change in the technique of monetary policy did have the effect of destroying or seriously narrowing the market in long-term gilt edged securities, how serious a disadvantage would you think that?——The question is whether it really would do this. I am not too worried about that. In so far as monetary policy is effective in its objectives, it is going to influence the long-term market, and those operating in that market will have in their minds what they think monetary policy will be doing. It is a question whether monetary policy is doing it indirectly or directly, and I do not think it would make that much difference unless you are thinking of a major change in the effectiveness of policy influencing that market. In that case one would be arguing about the change in the effectiveness of policy.

10624. Would you go further and say that, if the monetary policy is effective, then the fluctuations in the long-term gilt edged market are likely to be less rather than more?——I would not be prepared to judge on that one. Some kinds of fluctuations would be less and other kinds would be more. Fluctuations due to panic reactions and so forth might well be less.

10625. Suppose that the effect was a serious narrowing of the market; would you consider that a serious disadvantage?——For Government debt I do not think I would, because Government debt is in a way an instrument of policy itself. In the other speculative markets one has predominantly private operators lending to other operators, but in so far as Government debt is concerned it is really between institutional investors on the one hand and the Government on the other. There might be an increase in the average cost of financing the Government but I think this would be small compared with the other effects. After all, if one's sole concern was to finance the Government at the least possible cost one would run monetary policy quite differently. One has to accept that some problems with the cost of Government debt are the price one pays for using it as an instrument of monetary policy. It is not anyway all that clear that the gilt edged market is so perfect a market, judging from the evidence of the Parker Tribunal.

10626. *Sir Oliver Franks*: Do these general considerations look after the actual situation that we are in, with the problems of the maturing debt year by year, of raising funds on Government signature for the nationalised industries, and now, whatever it may come to, of finding funds for development of countries in the Commonwealth? Do you think that there would be any serious risk of some of the major institutional investors who now invest in these securities being frightened off by the problem of dealing with these different forms of new debt which have to be created in a situation where the price is felt to be very much a function of what the Government might make it from day to day?——I do not think that there is any action on the part of monetary authorities which will remove governmental influence from the gilt edged market. In fact, one could argue the opposite case: if they knew that the Government was specifically aiming at that market and where they were on the market, institutional investors would have a better time of it than if they could not tell whether there was going to be a reaction to action taken elsewhere by the authorities. The authorities in a sense would be assuming some sort of responsibility towards this market by operating in it. I certainly do not believe that institutional investors have had an easy path in the last ten years, even though the Government has not been intervening in this market very extensively.

10627. *Chairman*: Is it your view that in the market as it is conducted today the Government's activities are not regarded as being an important influence, or do you think that they are inescapably important in our set up?——I think that Sir Oliver Franks could answer that question better than I could: it is a question of how people who are handling funds think. My impression is that there have been quite serious and quick reversals of trend and other changes which have bothered them; reading the financial commentators one gets the impression that there have been upsets in the market due to perhaps unintended and certainly unexpected reaction to changes in the rates on the longer term securities. Whether they spend all their time worrying about what the Government will do next, I just do not know; but, if I were operating in this market, I would be thinking occasionally of what the Government was likely to do on the Bank Rate and monetary policy, and I would be quite worried from time to time. But in this question of fact about how these people behave I really have no authority to describe their behaviour, since I have not observed it closely.

10628. *Professor Sayers*: But if the Government were known to be continuously active in this market; if, moreover, it were continuously explaining and defending its policy, would there not be at least a reasonable chance that institutional investors would find the market more rather than less attractive?——I would be inclined to think so.

10629. *Professor Cairncross*: Would you be quite happy if, given the financial commitments of the Government in respect of the nationalised industries, the Government should find itself obliged to finance its capital commitments through extensive creation of bonds? The Government is a net borrower, whatever we may think about it; it must therefore finance its programme in some way or another. Normally in the last few years it has been in the posture of a seller of bonds, and is virtually obliged to sell those bonds. Is it your opinion that the Government would be at least as successful in disposing of its bonds if from time to time it sold in order to force on the market a reduction in the price of its own bonds as it is when it behaves as it does now?——I do not see any reason why it should be in extra difficulties for this reason. There is a problem, that if you think of the Government's narrow function as a borrower, then it wants to squeeze every drop it can out of the market. There is a frequent conflict between the Government as a borrower and the Government as a manager of the economy.

10630. I was not thinking of that, but of the importance in all this of expectations on the part of existing holders and potential purchasers of assets. We are dealing with a regime where expectations are absolutely of importance, and it might be urged that the authorities would disturb these expectations in a serious way, if from time to time they entered the market and announced a new and lower

price for their own bonds, and that this disturbance would be of a character that would reduce their success as a net seller. For instance, it might be put that it is only possible to sell bonds on a large scale in a rising market?——I do not find myself in sympathy with this whole philosophy, if I may say so, because you are dodging about; you talk about control of the money supply and managing on the one hand and on the other hand you are looking at the authorities as facing a kind of market in which they have no great influence. If they are a borrower like other borrowers coming to this market, and if they behave so as to create confidence in themselves, things are better for them than if they do not. My attitude would be that this assumption about the nature of the market is implicitly a definition of the way in which the monetary authorities should approach it.

10631. Let us suppose that the monetary authorities are anxious to sell bonds, whether or not that is assisting the objectives of monetary policy or detracting from them. Is it your view that they would be as successful if from time to time they pulled out the stop and let the price sink than if they coaxed the market in the way in which they traditionally do?——If one looks at it solely in that narrow way, then one can say that by definition they are not going to do better by my policy than by the other. But I say that to look at it in this way is inconsistent with the whole point of monetary policy. The money supply, directly for a large part of it or indirectly for another large part of it, is Government debt, and monetary conditions are conditions for Government debt. That is the way one has to look at it. I would be very suspicious of the other argument, because it would seem to me to be trying to sell me a different view of what the Government is trying to do which I would not regard as appropriate to the whole objective of economic policy. I do not think that one can regard the market as an impersonal force and assume that the Government appears only as a borrower; one must regard the money market as a focal point of certain kinds of economic activity, on which the Government operates to influence the economy.

10632. That may be true, but if the only way in which monetary policy could take effect were by substantial operations in long term rates of interest, that might move one to be rather critical of the use of monetary policy at all given that in the past long term rates of interest have normally, except for war time, moved within reasonably narrow limits?——I would not decide the question on that amount of information. If the authorities find that they are seriously losing money on this operation, then they compare the cost of the monetary policy conducted in this way with the cost of the alternatives, which may be fiscal measures or possibly controls. If there is a choice of policy, the costs incurred have to come into the picture, and I would want to know about that before I condemn one method or another on that ground.

10633. Do you know of any country where the policy that you are recommending to us is practised, other than a country where the gilt edged market is in a very primitive condition?——That is a loaded question. It rules out most markets, because most markets are in a primitive condition compared with ours and the United States. In effect, the question boils down to some Continental countries, but I do not know enough of them to say.

10634. I had thought that some of the European countries would provide a test bere. I do not know their techniques sufficiently well to judge?——I am afraid I am in the same position.

10635. *Sir Oliver Franks*: If changes in the long-term rates are thought to come about partly by reason of Government action in the short-term market and partly by reason of other influences, then I think that quite a lot of people feel that they have a fair chance of their judgment in relation to the long-term rate being as good as anybody else's. But if the attitude of Government changes, and instead of leaving the long-term rate to be determined in part by these other influences which play upon it and in part by the indirect effect of changes of short-term rates, they operate directly, then it might be said that the ordinary investor in long-term bonds would feel that he is playing the Government direct, and for that reason would feel much less certainty about where he was going and that the dice were loaded against him. You have been taking a completely rational view of the situation, and saying that whether the Government interfers directly or indirectly is much of a muchness as far as interference goes, though there may be important subsidiary questions of whether it costs more to do it one way or another and so forth. But it does not seem to me that these types of consideration exhaust the problem We have been told that the attitude of a great many people would be quite different if they thought that the Government itself was directly intervening in the long-term bond market. This outlook is a question of psychology rather than of straight economic theory; but what do you think?——This ramifies in so many directions. We have to see how much of this argument is an argument against Government intervention, perhaps based on the implicit assumption that, if the Government confines itself to this it will not be able to do very much more as compared with what it does now. My attitude would be that, given the same Government objectives, and given that the Government is trying to achieve them and is not prepared to give them up when there is opposition, the problem is pretty much the same for the people operating the market, because the Government is having to do the same in order to complete its objects. If the situation is that the Government finds itself at the mercy of the market, and says: "We cannot do very much about this; we are marginally operating in a situation which mostly consists of other forces", those people who look at the other forces will do better than if the Government is really influencing the situation. But it seems to me that an expert in the market, unless the Government is pursuing a very tight policy in that market, would be able to take into his calculations what the Government does. I am informed, for example, that there are still some people eking out a bare existence speculating in wheat, even though the price of wheat is almost entirely determined by governmental action of one kind or another. It would seem to me that, unless one makes a division of that kind between the kinds of policy we may have, the people who are worried about this will find that they can take it in their stride. It is certainly not in their interests to say so; it is in no one's interest to say that it makes no difference. But I do not expect this would be an important problem, given that the Government is likely to act in fairly predictable ways. Looking back at the developments of the past, it seems to me that the intervention of Government in other spheres has bad plenty of rather sharp and unexpected consequences for the gilt edged market. Government action has sometimes been necessary in the gilt edged market to remove or to soften the impact of situations that it has created, as in 1949, for example. This is really a question of how you interpret what people say and how they think. It is not an economist's problem, except in so far as one can say rationally that aiming at the same objectives with roughly the same degree of determination whatever method may be used would bave pretty much the same sort of impact. If it is not so, then one has to find out what it is that makes it different. There is one other point I should like to make: if people said that they would not interest themselves in Government bonds any more if the authorities intervened in the gilt-edged security market in this way, I should want to ask them what they were going to do instead.

10636. *Professor Sayers*: Given these possible reactions of private persons and private institutions if the Government is operating directly on the long term rate, there could possibly be a situation for a time in which the Government could only finance itself by creating more and more liabilities at the shortest end: more and more money. How alarmed would you be at such a situation?——I would not be too alarmed at it. The need to create the money is met by the creation of additional bank liquid assets. The authorities have to pay a price for that in getting money under control again later on. The main thing is for the Government to realise what it is doing, and to take account of the fact that, if the Government creates a lot of cash in a situation in which the creation of cash is interpreted as a sign of weakness, it will be in difficulties. It would be necessary to make it quite clear that the creation of casb was part of their policy.

10637. Do not these dangers become less if monetary policy is continually explained and defended and commands the support of technical, expert opinion?——I am certain of it. That is the kernel of my argument.

10638. This is an additional reason for better public relations?——Yes; and they bave to explain the connec-

tion which will not always be obvious. The paradox was put to us, when I was in graduate school at Harvard, that on the one hand public opinion condemned the great calls for credit that accompanied the American war effort, while on the other hand it was very proud of the fact that Americans had saved so much cash and liquid assets in the course of the war. There are balance sheet identities which can easily escape the attention of the general public which have to be explained.

10639. *Professor Cairncross*: Unless the authorities are completely successful in this they run certain risks. They are operating in a market which is very much addicted to the fear of inflation. If they enter that market to sell bonds down they may be interpreted as meaning that they have now accepted a continuing prospect of inflation?——If they say nothing about why they are doing it they are certainly open to that interpretation. It all ties up with what Professor Sayers was saying; the more people understand what the authorities are doing, the better. These dangers arise when they maintain some reserve about what they are doing, and where they allow interpretations which look at them solely as a borrower

10640. But they are dealing with a market where people are particularly perverse?——I would not like to think that bankers and insurance people are perverse compared with other people.

10641. Looking at it from the point of view of policy? ——One can say that their actions were particularly awkward for policy at times, but whether they were perverse in terms of the time and the matters put to them, I do not know.

10642. I was thinking of the kind of situation in which it might appear that efforts to raise the level of activity in this country were accompanied by a fall in the gilt edged market as a direct consequence?——I should say that it could as easily be a consequence of the failure of monetary policy. It is only too easy to overestimate bow easy monetary policy was in the 1930s, particularly in the United States; even in this country it left a lot to be desired, even though the bill rate went down to three eighths of one per cent. At one point the money supply actually contracted because it did not pay the banks to increase it. If instead of pushing money through bills they had tried to do it in other ways, which would have been perfectly within the competence of the central bank, and particularly if they had not tried to fund a great deal of public debt at the same time and if a lot of other things had not been true, things might have been better. I do not think that one can say that it was all due to the perversity of the city in not knowing what we were about.

10643. When do you think there would be any funding? It is easy to visualise that the Government might pursue that as a right and rational policy, but can you see circumstances in which funding is not only a rational but also a practical proposition?——I think that, if you define it as a rational policy, it would also be a practical policy; I do not like this distinguishing between what is rational and what is practical. Certainly I see circumstances where funding would be practicable, but again I do not like discussing the question in this way, in terms of when funding is a good idea and when it is not. The issue to be decided in funding public debt is mostly a question of studying the structure for future monetary policy, making it rather easier to control the market than if there are a lot of bills outstanding that have to be met. The authorities have to adjust their policy by keeping an eye on what their future problems are likely to be as well as what they are doing right now. I would say:—"When something happens, go ahead and fund; and then, when it turns round, stop."

10644. Can you point to any period in the last ten years when you think a great deal more funding might have been carried through?——I think possibly more funding during the Dalton period might have been a good idea instead of what was done then.

10645. *Mr. Jones*: Is there any virtue at all in a substantial floating debt?——There is the virtue of necessity.

10646. *Professor Sayers*: We have been talking all the time as though, if the Government decides that it is the long-term rate it wants to move, it should do it by direct operations in the gilt-edged market. Are there any other steps that you think it could take with the same object in view?——Clearly if it were to operate on the holdings of various institutions in one way or another it would influence the long-term rate; for example, if there was some system of compulsory liquid ratios in the banks, and they raised these ratios, forcing the banks to switch over, then this would have an influence. If what the authorities are after is to influence the long-term rate they can influence it by their open market operations, or by forcing other people to do their open market operations for them. They can influence it also by whatever influence they can bring to bear on expectations, which may be done by almost any means the Government has at its disposal.

10647. Suppose that it is thought that the building societies' lending rates are particularly important for the purposes of policy; by what measures do you think the Government should seek to influence them as quickly as possible?——I understand (I may be wrong) that the Government already does have a certain modicum of influence over building society rates, at least over any suggestions whether they should be changed when other rates are changed.

10648. Is that the right way of doing it, or have you some better way?——I do not see anything wrong in the Government dictating rates on particular kinds of assets, but I suspect that they cannot go very far with it before they begin to find that the money is moving somewhere else; and unless they know where it is moving to and what it is going to do they may create lots of trouble for themselves. I think that in a sense we are in a position where we can go either way; either we go on as if money is a perfectly homogeneous commodity and let it flow where it wants to, insisting that everybody tries to price his credit competitively, or else, if we are going to have agreements fixing rates in relation to one another, then we want to influence where those rates are going to go. I see no real reason why we should have bankers' deposit rate fixed by agreement at 2 per cent. below the Bank Rate. There is no reason, if there is going to be competition for these funds, why the banks should not be in the game. If, on the other hand, we are going to have administrative rates, I see no reason why it should be confined to the banks simply because they are prepared to take it.

10649. You mentioned, in talking of building societies, that if the authorities moved rates the wrong way, they might find the money was beginning to flow elsewhere. Is not a solution perhaps that it is only by operations in the gilt-edged market that they can directly create market conditions that are right for a movement of rates, but that, having done that, they may by edict or by agreement hasten the movement of rates in particular groups of institutions?——Yes. My view is that we have neither a perfect market nor a completely imperfect market. With a few institutions, and with a stickiness of rates that operates against us, so that things have to be done by decision, there is a fair amount of scope for adjusting things. On the other hand, one cannot push water up hill, but one can impede or accelerate its flow down hill.

Chairman: I think that concludes our questions, Professor Johnson. Thank you very much for your help.

(*The witness withdrew*.)

NICHOLAS KALDOR, ESQ., Fellow of King's College, Cambridge, called and examined.

10650. *Chairman*: Will you have your memorandum* in front of you, Mr. Kaldor? We have all read it through, and there are one or two questions on it which we should like to explore with you. May I start with one question of fact which interested me in the opening part of your paper at paragraph 3, where you are baving some shots at those who maintain the quantity theory of money. You say there:

"Outstanding cash balances invariably contain large amounts held for purely speculative purposes, or out of the 'precautionary' motive (i.e., as hedge against unforeseen delays in the inflow of prospective receipts) as well as the so-called transaction balances proper."

* Memoranda of Evidence Part XIII No. 20.

It struck me as rather an interesting point, as one of the resistances which the system builds up against any immediate effect resulting from operations on the quantity of supply of money; how do you make that good?——*Mr. Kaldor*: One could make a shot, at any rate, at building up the size of transaction balances proper starting from the income side and proceeding in the usual manner. Assuming, let us say, that wages and salaries are spent at an even rate and received either weekly or monthly, one could make a shot at the transaction balances arising out of wages and salary payments. One could do the same sort of thing for dividend and rent payments. So there one has certain bases for estimating the income circulation of money. Apart from income balances there are business balances; there, of course, one has really much less to go on in making any quantitative estimate.

10651. Has such an exercise in fact been done? Has somebody tried to measure the magnitude of what I might call the inherent reserve in cash balances?——I am afraid I am not really an expert in this business. As far as I remember Keynes made some attempt in his *Treatise on Money*.

10652. *Professor Cairncross*: If one is to accept what you have said later in the paragraph, the answer to the calculation about the transaction balances would presumably not be in excess of the one half of one per cent. to which Germany had gone down in 1923?——There are two difficulties about this. First of all in Germany in 1923 substitute money was very common. I happened to be there as a child on holiday. It was one of the first occasions when my interest in economic problems was aroused; I had the chance of seeing wild inflation around and trying to understand what was happening. One of the things that happened was that practically every institution and every firm of repute issued substitute money of some sort which circulated quite freely. Now this substitute money, of course, is not included in this one-half per cent. Secondly, the settlement of accounts was very frequent. The German experience shows that when money is short one of two things might be happening: *either* people have not got money to settle their accounts and the settlement of accounts is slowed down, *or* there is a successful push on the other side (by creditors) to get accounts settled promptly. There is no doubt that in Germany during the great inflation the second of these forces was dominant. In any case it is habitual to settle accounts more frequently on the continent of Europe than in Anglo-Saxon countries, but certainly nothing like leaving a bill unpaid for two or three months would have happened during the great inflation. It would be presented within a week, was paid within that week, possibly within the next twenty-four hours. This illustrates that if everybody pays their bills promptly it does not mean that more money is needed for all these payments to be cleared; the velocity of circulation is greatly speeded up. I say in this paper that what the velocity of circulation is going to be will partly depend on this kind of pressure to which the system will be exposed, which in turn depends on how liberally or how sparingly it is supplied with money. The velocity of circulation, therefore, is not something that can be taken as settled independently—by custom, by institutions, by habits, such as the habit of paying one's telephone bill every six months and paying one's grocery bill every month. These are habits, but they are not sacrosanct, like constitutional conventions. They change, they react to circumstances. I am really asserting that a given quantity of money can be made to do very much more work, not, of course, without inconvenience to the user.

10653. *Professor Sayers*: The important point is whether the stress of circumstances under which the velocity of circulation changes itself brings in train other important consequences for the economy?——What it really gives rise to is a rise in the rate of interest.

10654. Yes, and your argument is, on the whole, that velocity changes so easily that the consequences for the rate of interest, given the change in the supply of money, are not great?——That proposition depends on where you start from. I qualified the statement by saying that, when the liquidity ratio (meaning the ratio of money supply to the national income or the national turnover) is within the range from 20 per cent. to 50 per cent., then appreciable changes in the velocity of circulation can take place without inducing spectacular changes in interest rates. That does not necessarily apply to the sort of situation in which Germany was in 1923.

10655. *Chairman*: If I follow your reference to Germany in the grip of conscious acute inflation, in those circumstances people would not keep reserve stocks of money; on the contrary, they would try to part with money as quickly as they could. They would not have this margin in the cash balance to which you are drawing attention as a feature of our system?——I am conscious that there are two opposing interpretations about great inflations, and particularly about the German experience in 1923: one says that the expectation of rising prices leads individuals to reduce their demand for money as much as possible and thus speeds up the velocity of circulation, and the other interpretation is the one that is implicit in my paper, that it is the very rapid rise in the volume of money payments which induces a scarcity of money. The money supply was not increased anywhere near in proportion, and the very high velocity of circulation was far more a reflection of a consequential scarcity in the money supply than of any conscious desire on the part of the money-using public to economise on money as much as possible.

I would, however, like to say that the experience of great inflations, what we call the galloping inflations, such as occurred in Germany in 1923 where prices doubled in a week, or sometimes even in a day towards the end, is in some respects quite different from the experience of countries which suffer from chronic inflation at more reasonable rates. The Latin American countries are the best example of this. In these countries a very appreciable inflation, with prices rising by the order of 10, 20 or 30 per cent. a year, has been going on in some cases for fifty years, without any clear tendency to acceleration, toward the whole thing running down or becoming a state of hyper-inflation, as happened in Germany. The interesting fact that emerges from the experience of Latin American countries, like Chile, Brazil and Argentina, for example, is that the velocity of circulation over time is remarkably steady, although the level of this velocity, or rather the value of the liquidity ratio, varies from as little as 15 per cent. in Chile to as much as 40 per cent. in Brazil. In both these cases, despite continued inflation, whose continuance moreover is fairly generally expected, there is no continued tendency for the velocity of circulation to rise.

That is a very important and interesting phenomenon which requires explanation, and I think the explanation contributes quite a lot to the understanding of these monetary processes. My own explanation is that individuals and businesses have considerable need of liquid resources in order to meet unforeseen commitments and in order to be able to make use of new investment opportunities which they know are bound to emerge in time. Nobody likes to be 100 per cent. committed at any one time so that one cannot take advantage of some new opportunity that emerges. In the broadest sense of liquidity any form of asset is fairly liquid if the holder can reckon on its being convertible into general purchasing power at short notice, and that, if he unexpectedly has to convert, this conversion will not take place on unexpectedly unfavourable terms. So in this sense, apart from cash, all short-term financial assets such as savings deposits are almost as liquid as cash. In a wider sense I would say all securities which have a ready market on the Stock Exchange are reasonably liquid assets. They have at least one important attribute of liquidity, namely, that the holder can sell them at very short notice without great trouble, whereas with money invested in factories or houses one may have to wait a few months for a buyer; one cannot just sell when one wants to. Commodity stocks are liquid in relation to the holding of fixed assets, such as factories, plant and equipment.

In these Latin American countries there are two preferred forms of liquid assets: gold and foreign exchange. Although these countries do have some form of exchange control, the controls are pretty loose in administration, and there is no difficulty for anyone to hold gold and foreign exchange. One would then expect, if inflation is going on at a constant pressure, that people would wish to economise in balances in local currency and hold only gold and foreign exchange; and yet, if one looks at the figures, this is far from the case. In Brazil, for example, where price inflation has been chronic for any number of years, the amount of money in cruzeiros in relation to the Brazilian national income is greater than

the amount of sterling currency held in England as a proportion of the British national income. The answer is, I think, a very simple one, that these superior liquid assets, if you like to call them such, such as gold and foreign exchange, precisely because they are a preferred form of holding assets in liquid form, rise in price in terms of the local currency not only absolutely, but relatively to prices in general. When there is an inflation the rise in the prices of gold and foreign exchange and suchlike is much steeper than the rise in general prices. Therefore at any one time the holders of gold and foreign exchange face the risk of a fall in the price of these things, because they have risen faster than they ought to have risen if their rise merely reflected the change in the value of money. It is this differential rise which keeps in check the desire to shift liquid assets from local currency into gold and foreign exchange, and which in effect maintains the velocity of circulation constant despite the fairly firm and general expectation of the continuance of the inflation.

What applies to gold and foreign exchange also applies to equity holdings of securities quoted in the Stock Exchange, which at any one time may appear to be over-priced in relation to prices in general, and may apply to various other ways of holding liquid assets. But the number of ways in which people can store wealth in fairly liquid form is limited, and for that reason it is possible for that group of things which are convenient as stores of liquidity to rise in price far more steeply than prices in general without that particular rise pulling the whole price level with it. So long as the rate of inflation is not too fast there is always a risk that these preferred liquid assets will fall in price, and this provides a mechanism which maintains the velocity of circulation, or maintains the demand for cash in local currency holdings at a stable level, and in that way enables the inflation to continue year after year without a tendency to acceleration. But once the rate of inflation becomes so fast that people discount the risk of a fall in the price of gold or foreign exchange in the near future in terms of the local currency, then one really passes a kind of threshold; the system breaks through some sort of sound barrier, and beyond that is hyper-inflation.

10656. What influences in these economies have contained the rate of inflation and merely made it a steady progress year after year? Is it conscious control?——No, I should not think so, except that from time to time there is an attempt to moderate inflation by traditional methods of strict control of lending through the banks and things of that sort. Then for a year or two they might get a fall in prices, or reach a plateau for twelve or eighteen months, after which the inflation is resumed. I think that the fact that this inflation does not happen at a perfectly steady rate in time is an important factor in preventing acceleration from taking place, because nobody can be certain what is going to happen to prices in the next six months, even when one is fairly certain what is going to happen to the value of one's money within the next five years.

10657. In these economies where the fact of steady inflation has become part of popular thinking what happens to the long-term money contract and the rate of interest?——There is no elimination of monetary contracts; I have not come across it in a single country. What happens simply is that monetary debt is all held by the banking system. Very few individuals outside the banking system hold contractual debt of a long-term character such as gilt-edged securities or bonds. In other words, the monetary debt which is held is all either money or close substitutes for money, that is to say, either cash, currency, circulating deposits or time deposits of some sort; nobody holds gilt-edged paper voluntarily. On the other hand, everybody borrows from the banks up to the hilt, to the extent that they can; and the banks gradually expanding their lending is, like in other countries, part of the process of supplying the system with currency. It is just an aspect of this process. But the individual rentier who saves, unless he is compelled to save by compulsory social insurance which in some countries is very extensive, only saves in the form of real property. Houses are a favourite form for the small saver. In countries like Brazil there are very extensive facilities by which a consortium builds a large apartment house and sells individual apartments to individuals who then buy them, partly financing themselves out of a mortgage secured from a bank. They try to save up by owning bits of land and bits of houses, or bits of real property of some sort.

10658. Does bank lending on medium or long-term mortgage compensate itself by very high rates of interest for the certainty of inflation?——No, I do not think it does. The banks in an inflation are in a unique position, because although their assets depreciate constantly in value so do their liabilities depreciate the whole time in terms of real value; and on account of the fact that both their assets and their liabilities expand rapidly in times of inflation I do not think they do badly from the point of view of real income, if I may use that expression. I think they are doing well, but not so much because they protect themselves by a high rate of interest; they charge fairly high rates of interest, but they also pay fairly high rates of interest on deposit.

10659. Do they take long-term deposits that are at all equivalent to their long-term assets?——I should not think so. There are all these types of savings banks which have savings deposited nominally with some six months' notice of repayment or something similar which does not necessarily mean anything as it is not really enforced. I suppose that on mortgages they charge a very much higher rate of interest than is current here; not inordinately high, but perhaps of the order of 10 to 12 per cent.

10660. *Professor Cairncross*: Do you not get very much higher rates in some countries?——Yes, it varies quite a bit between country and country, and it varies according to the sort of policy. Mexico has had as big an inflation as Chile or Brazil, but in Mexico the monetary authorities are extremely keen on damping down demand all the time and keeping money very tight, and that is reflected in a very low liquidity ratio. It is also reflected in high interest rates, and I maintain that these two are always associated. High and low interest rates are associated with low and high liquidity ratios and not just with the pace of inflation.

10661. *Professor Sayers*: Could I come to the experience of this country in the 1950s? We have had an increase in the velocity of circulation. This has been associated with rising rates of interest, as one would expect, and the rises in the rates of interest have been appreciably increased by deliberate action on the part of the authorities. What in your view have been the consequences of these rises in the rate of interest on the size and composition of the national income?——This is an extremely hard question to answer. My own feeling is one of considerable scepticism about the effect of interest rates on the pace of inflation, or even on what one may call inflationary pressure: the pressure upon resources at any one time. I do not believe that the cheap money policy of the Dalton era made inflationary pressure in the years 1947 and 1948 much worse than it would have been in any case, and I do not believe that the rise in gilt-edged rates had a great deal to do with the undoubted easing of pressure on resources which occurred in later years. It is not sufficient to point to a period when interest rates were low and at the same time the pressure on resources was high, and then to another period when the pressure on resources was lower and the interest rates were high, in order to establish that the one change was a consequence of the other. One also has to say in what way, by what processes, the change in interest rates has affected the pressure on resources.

10662. I wonder if you would like to comment on that?——In my paper I finally come down to the view that monetary policy and the variation of interest rates still seem to me the appropriate instrument for regulating investment in stocks: for preventing excessive inventory investment or counteracting recessional tendencies due to decumulation of inventories. I say that it is an appropriate instrument because there is such a paucity of other instruments, not because I believe it is a good instrument for the purpose; we have not yet invented any better one.

10663. *Chairman*: Do you think that it is an effective instrument for the purpose?——If one looks at the value of the physical increase in stocks in the national income accounts, one cannot point to any correlation between on the one hand changes in the Bank Rate and interest rates, and the various phases of credit restraint imposed on the banks, and on the other hand the trend of investment in stocks. In the years 1955-57, when the policy of the credit squeeze was said to have been officially in

operation, and was accompanied by a crescendo of exhortations to the banks by the Chancellor and any amount of publicity as well as by high Bank Rates and high interest rates, investment in stocks was considerably greater than in the three previous years, when money was relatively easy. I still say that this is a factor for which in theory credit policy appears to be the ideal regulator, but when we look at the facts in a period in which there were very considerable changes in credit policy, we find no visible effect of that policy on real expenditure on investment in stocks.

Coming to long-term investment and the long-term rate of interest, I would not exclude the influence of interest rates on certain types of investment. For example, the easy money policy introduced in the early 1930s after the onset of the depression undoubtedly had an important effect in the revival of building activities during that period. When it comes to residential buildings I would say that the terms on which and the ease with which mortgages can be had are undoubtedly important factors; but when it comes to businesses there is no evidence whatever that the cost of money is a factor of any importance. Any number of empirical inquiries both in England and in the United States directed towards eliciting the importance of long or short-term interest rates on business decisions concerning capital expenditure led to the almost unanimous result that interest rates are the least important factor which business men take into account when they decide whether to incur expenditure on a certain project or not, or how much to incur. We need not go very far for the explanation here, because there is this very big gap, which until recently economists have not appreciated or certainly have not brought into their thinking in any conscious way, between the standard rate of profit which a business man expects on any particular project, the rate of profit which any project must carry in order to qualify for adoption, and what one might call the market rate of interest. The one is of the order of 20 per cent. and the other is of the order of 5 per cent.

10664. Why does not that consideration also apply to his attitude towards the volume of the stocks which he carries at any one time?——I think it probably does, and that is why I was very guarded in what I said on the effects of changes of interest rates. There is, however, a difference: as I said earlier, investment in stocks is a relatively liquid form of investment. It is not as liquid as holding balances with a clearing bank, but in the parlance of the City, stocks are part of liquid assets, and there is a good justification for this terminology. A business man regards whatever is tied up in stocks of various sorts as far more liquid than the money which he has got tied up in his factory or in his machinery; and, because it is so much more liquid, he does not expect the same sort of return from these assets as he expects from his fixed assets. Again, any business man will tell you that it is the fixed assets of the business which earn the money. The stocks just have to be carried as part of the process of a business earning money. The earning power of a company, or the changes of its earning power, are normally measured in business by the growth of its fixed assets. Nobody would say that merely because a business carries more stocks its earning power is increased.

10665. The volume of stocks is a function of the activity of the business in general?——Exactly; modified by short-term speculative expectations concerning price changes, which can exert a very important influence.

10666. *Professor Cairncross*: May I turn to a different subject? You are the first witness we have had who is a whole-hearted believer in inflation, if I have understood your memorandum aright. You do not regard it in any way as a regrettable necessity but you seem actually to welcome it?——I would not say that. I do not know what I have said to suggest that.

10667. I thought I had found several passages in which that seemed to be the implication. In paragraph 10, which is headed "The Dangers of a Regime of Stable Prices", you say that price stability

> "may only be reconciled with high interest rates (or indeed, with any attainable level of interest rates, high or low) at the cost of economic stagnation."

This suggests that if we want to escape from economic stagnation we must reconcile ourselves to rising prices; is this your view?——Unless the economy is sufficiently dynamic to get us out of this dilemma.

10668. When you analyse what you think of our economy you come to the interesting conclusion that on the whole managements are not in this country sufficiently dynamic. One would have judged that the right way of treating that would be at source, by some method of galvanising managements. But you are putting your money not on a direct treatment but on a rather indirect treatment, through interest rates and profit rates?——I say that, given the present dynamism of the British economy, to keep the ship on an even keel and to prevent it from foundering may require doping it with inflation because its dynamism is low; but that does not mean that the way to increase the dynamism of the British economy is by giving it repeated doses of monetary inflation; I did not mean that at all. What I mean is this, and I will try to make the point in concrete terms in order to be as simple as I possibly can. I do not believe that a capitalist economy can grow year after year if the growth in total profits and money incomes is only 3 per cent. a year. The reason for that is that with a steady rate of growth of 3 per cent. the rate of profit is not high enough, especially given our present taxation levels, to give adequate inducements to invest, and the process of expansion will just not go on. Moreover if you look at the history of advanced countries such as the United States or Britain, it is difficult to point to a period of continued growth where the annual increase in money incomes was not substantially greater than 3 per cent. If you take long period averages that would not be true; but what I maintain is that it is difficult for a system to grow at these slow rates in money terms. Progress takes the form of fits and starts; there are a number of boom years during which production and incomes grow at much more than 3 per cent., something like 5 per cent. or 6 per cent., and then the growth potential is temporarily exhausted; rather than growing at a more modest rate which could be permanently maintained there is no growth at all for a number of years; there is a temporary stagnation, which takes the form of the trade cycle.

This is a very controversial view, very much my personal view, not something that economists, even specialists in my own field, would generally accept; but I maintain that what we know as the phenomenon of the trade cycle is itself a consequence of this. If the underlying factors that determine growth rates were adequate one would not get a trade cycle; one would get continued growth. It is because the system is not able to move upwards at such a slow pace that it has to move with fits and starts when the underlying factors are not powerful enough to give it an adequately high growth rate steadily year after year. When the growth rate is adequately high one can get continued growth. When there is this kind of trouble that the basic growth rate is not large enough to give continued steady growth one can dope the system by inflation; by keeping up a certain rate of inflation one can maintain a modest rate of real growth, say of the order of 3 per cent. a year, supplemented by another 3 per cent. or 4 per cent. of phoney growth due to inflation.

10669. But this is doping which is part of the normal diet, not just an occasional injection; and it is dope which people will sooner or later recognise as part of their normal diet. When you discussed the movements of the rates of interest in Latin America you argued, as I understood you, that they did not automatically reflect the expected rate of increase in prices; but I think you would agree that the highness of the interest rates in most of these countries in Latin America, for instance, is in part the outcome of the habituation of the economy to continued inflation?——Certainly.

10670. Therefore is it not likely that, if dope of this kind were applied here, interest rates would to some extent rise and destroy the objects leading you to apply the dope? You are talking really in terms of the margin between interest rates and profits?——You are absolutely right in your interpretation of Latin America. But the situation I was considering was one where the boot was on the other leg: not when inflation is so strong as to pull the rate of interest above the level at which it would otherwise be, but when in the absence of inflation the rate of profit would be so low as to require an unattainably low rate of interest. Inflation is here considered as a method of reducing the real rate of interest below the lowest rate to which monetary policy can reduce the money rate of interest; and that is the only sense in

which one can talk about a dope. This is the situation when, for example, given the real rate of interest, the level of taxation and the attitude of business towards liquidity, a minimum rate of profit of, let us say, 10 per cent. would be indicated. But when the yield on Consols being $2\frac{1}{2}$ per cent. the maximum rate of profit consistent with steady growth year after year is only 6 per cent., then a steadily growing economy is unattainable unless you reduce the rate of interest from $2\frac{1}{2}$ per cent. to minus $1\frac{1}{2}$ per cent. Minus $1\frac{1}{2}$ per cent. is not a gilt-edged rate that is attainable by the ordinary methods of monetary policy, but it is attainable by inflation, if you remember that the relevant rate is the real rate. If the money-rate of interest is $2\frac{1}{2}$ per cent. and the rate of inflation is 4 per cent. the real rate of interest is minus $1\frac{1}{2}$ per cent. When an economy has such a low rate of dynamism that it cannot have a real rate of profit of more than 6 per cent., then I maintain that in certain circumstances only a negative real rate of interest can be an adequate inducement; and that is the only way you can do it. That is a very different problem from Latin America where, as the result of inflation, the rates of interest are pulled up above the minimum levels.

10671. You are speaking in all this as if the only investment we are considering is investment in which the profit accrues to private property owners. What happens if the Government is itself the almost exclusive owner of three-quarters of the property of a country, and accounts for a very large fraction of total investment, and need not have regard to a specific rate of return on its investment?——None of this applies to a central controlled economy or a socialist economy, or any variant of those. The picture I presented here is essentially that of a capitalist economy which is in a fairly advanced stage of development, and in which therefore a steadily falling rate of profit is not possible, because the rate of profit has already fallen to a level below which it cannot fall, because below that rate of profit people refuse to invest; and where the investment decisions are made by individual business men or property owners guided by profit considerations.

10672. Would you agree that only about 25 per cent. of the total investment in this country answers to that description? The bulk of the investment is surely of the character of house building, on which no one thinks of getting 20 per cent., or building a power station, on which the Central Electricity Authority never gets 20 per cent., or an atomic energy plant. Do not utilities, residential construction and schools and so on account for about three-quarters of the total investment in this country?——Yes, but I would maintain that the growth of investment in these sectors has to be in some proportion to the growth of the rest of the economy; and the expansion of manufacturing activities, though perhaps quantitatively smaller, especially from an investment angle, may yet play an absolutely vital rôle.

10673. Is this true? If you take housing, in my own part of the country the level of housing bears now a very different relationship to the average level of incomes than it did before the war, and the amount of housing is quite a different fraction of the total?——That is because housing is subsidised very substantially.

10674. Is there anything against subsidies?——No, I admit your point. All the same, you would not be satisfied with the state of the British economy if all you could say was that every time there is a tendency to stagnation and manufacturing industry fails to expand, all you have to do is build a few more houses, increase the subsidies a little more, to provide the community with a better standard of housing. If we are to maintain our position in the world (and we depend on the world because we have to export such a lot in order to provide essential food and materials for imports) we cannot rely on things like housing to give us the growth which we cannot get in more competitive fields of the economy.

10675. I quite agree, but the point I want to put to you is that your method of reducing the interest burden on manufacturers is really a disguised subsidy. Are there not one hundred and one other types of subsidy one can think of, including investment allowances? And are there not other more direct methods of dealing with an insufficient dynamism on the part of the manufacturers, if that is the diagnosis of the fundamental trouble?——If the dynamism of the manufacturers is insufficient, then one may find that one will not get a growing economy at all without some degree of inflation. I am all in favour of increasing the dynamism of manufacturers; I do not think inflation is the way to do it as such. I think there are all sorts of other things that could be done; for example, tax incentives of various sorts, incentives to new investment. I think myself an important incentive is the earlier scrapping of old investment. I believe that the fabulous showing of countries like Germany and Japan since the war, from the point of view of the growth of their production and productivity, is clearly connected with the much greater degree of physical destruction which they suffered during the war and which gave scope for the installation of modern equipment, to a much greater degree than has been the case over here. I should say that if it was possible to accelerate the process of scrapping and replacement, even if it is by artificial means, by tax inducements of some sort, that would very much increase the growth of productivity year by year for a pretty long period, because it would increase the proportion of the working population which in any one year is switched over from working with obsolete tools and equipment to working with up-to-date tools and equipment. There are certainly all sorts of ways of increasing the dynamism*. All I meant to say was that if the alternative to having inflation is stagnation at least we ought to be clear about the relative advantages of the conflicting objectives, or the fact that the objectives are conflicting.

10676. Would the diagnosis you have put to us in this paper be similar if you were writing for an American audience?——Yes; in fact I have been to the United States this summer and put forward very similar views on the same problem of inflation.

10677. So that, as far as the exchange rate is concerned, if you had equal success in this country and in the United States we need not fear?——No.

10678. But if you had success here and none in the United States there might be a problem?——Problems arise out of the exchange rates in this country if our wage inflation is very much greater relatively to our productivity, surely. That is the only case when it does arise. One of the remarkable things in this world is the similarity in the rate of increase in money wages in different countries. In the United States the average increase in money wages has been around 6 per cent. a year, which is only slightly less than in our country, and this has been the experience of a number of countries in which experience as regards productivity has been so different; I have listed them in my paper. The general increase in the money wage level has been remarkably similar over the last six or eight years despite differing movements also in the cost of living. So I think it would be very much better if we took a sort of normal annual increase in wages as our starting point and tried to see how we could operate the economy in such a way as to avoid an inflation of prices, given this normal increase in wages.

The annual increases in wages of the order of 6 per cent. to 7 per cent. (you will find these figures in Table I) is a very intriguing phenomenon. I do not pretend that I know the answer to this; it is a puzzle. But I think that probably the answer is that there is something in the nature of wage negotiations and their frequency that brings about this result. I am subject to correction by those who know more than I do about wage negotiations, but all we have to assume is that every year, as seems to be the case in countries like America, England, the Scandinavian countries or Germany, certain key industries renegotiate their wages and this involves some minimum percentage in wages in those industries. They are key industries because they set the pace for the rest of the economy; they are key industries not only on account of the trade unions (the trade unions in other industries being keen to get the same increase of wages for their members as the trade unions got for their members in the key industries) but simply because there is a general pattern of wages in an economy which it is very difficult to alter. I believe in something like a supply price of labour for any particular occupation, which changes with the change in wages in other industries†.

* *Note by witness:* If these methods are successful, inflation is not of course a necessary feature of a growing economy. It would still be necessary to have an adequate rate of increase of money incomes, but that would no longer involve a continued rise in prices; it may even be compatible with falling prices.

† *Note by witness:* If wages, in the average, rise by 6 to 7 per cent. a year, this is probably because wage negotiations in the key industries take place at annual intervals (rather than once every two years or every six months) and because the minimum increase gained in such negotiations is of the order of, say, 5 per cent. rather than 1 to 2 per cent.

10679. But you regard this increase in wages as a very fortunate circumstance, as I understand it, because this administers the dope which you are prescribing in this paper. We need not do anything to bring about gradual inflation in Britain; you hold it out to us as something which is ineluctable?——It depends. Some of my colleagues would regard economic growth as having very low priority as compared with the stability of the value of money; it depends on one's set of value-judgments and social preferences. I would regard the sort of inflation we have been having of the order of 3 to 4 per cent. a year as a considerably lesser evil than economic stagnation or mass unemployment, or instability in production. It is quite possible to protect the weaker parts of the community against this evil without destroying the gain. A lot of my colleagues believe, and I know Professor Robertson has often said, that inflation necessarily depends on somebody being cheated, and that, if you take steps to prevent the man who is cheated from being cheated, then the game is up and you cannot go on with it. I do not accept that view. Individuals get cheated in some capacities and compensated in other capacities. It is not therefore inevitable that this cheating process should be done by some individuals at the expense of other individuals. We are most of us operating in numerous capacities at the same time, and I should have thought that it is possible, for example, to have the effect of inflation and a continuous depreciation in the real value of fixed monetary indebtedness, and yet not be able to point to any sizable group of the community which is left exposed to the full blast of this inflation.

10680. You leave me very puzzled, because I understood your original proposition to be that managers and property owners should be induced to undertake more investment by increasing the margin of profit open to them, and that the method by which you thought that could be done was through inflation?——I did not say method. All I am saying is that when there is inflation the rate of profit at any one time reflects the rate of increase in incomes in money terms; you can simplify the assumption and convert the one into the other. The rate of increase in incomes is of a certain value; the rate of profit earned on capital will also give a certain value.

10681. I follow all this, but are you not making this an entire illusion by the addition you have just made to your remarks, if you are going to compensate everybody and leave nobody better off?——I would not compensate everybody in all their capacities. I would not protect any individual, wealthy or poor, in all his aspects against inflation. I would look at the overall position and prevent the overall position from becoming bad. The most important group in the community who are exposed to inflation are the retired people; obviously they are the most important. Now I can easily imagine a pensions scheme which protects retired people against inflation. I do not believe that such a pensions scheme would mean that everything broke down and we got into some frightful muddle. After all, paying a pension is only a redistribution from those at work to those in retirement. Instead of having an actuarial system by which each individual saves up during his lifetime in order to get money after retirement, we could have another system whereby everybody clubbed together and paid some part, let us say 10 per cent., of his wages or salary in order to be handed over to the 10 per cent. of the people who are in retirement.

10682. *Chairman*: I can see that in the case of the pensioner you can fairly easily correlate the asset that suffers with the holder of it; but I do not think that conception easily applies to that enormous structure of money contracts which is distributed in a great many proportions among so many in the country. I cannot see any means of compensating all those who are *ex hypothesi* suffering by looking at the general overall position?——As a result of inflation all creditors lose and all debtors gain; but it is very difficult to separate particular classes of individuals and call them creditors in that sense and call another class debtors. An awful lot of these effects just cancel out as far as individuals are concerned. In some capacities, perhaps unsuspected, they are debtors, and in others they are creditors; and they simultaneously win and lose instead of being necessarily heavy net losers or heavy net gainers.

10683. *Professor Sayers*: It would depend on whether the various acts of compensation to which you feel driven would or would not impair the rate of profit and the attractiveness of that given rate of profit; is that not so?——Yes.

10684. And you believe that that is a manageable thing?——All I would say is that it is a manageable problem to protect the most obvious sufferers from an inflationary process. For instance, it is possible to protect the old-age pensioners or those who retire from industry or from public service or the professions to a considerable extent, even if not 100 per cent., without reducing thereby the stimulating effects of an inflationary process on the economy. But of course if you start with a more extreme line, if you wish to re-value all contracts, which was done in some countries under extreme inflation, then I withdraw. That would mean, in effect, that you decreed that there should be no difference between the money rate of interest and the real rate of interest, and of course the stimulating effect of reducing the real rate of interest would then be lost.

10685. *Professor Cairncross*: Would you agree that economists have not been sufficiently alive in the past to the wide margin between profits and interest rates? You would agree, I take it, that the wider that margin is the less effective it is to change interest rates in order to obtain an incentive to action that would not otherwise be taken. If one already has this wide margin between profits and interest rates, does one exercise very much influence on calculations of investment yields by making real rates of interest rather less?——One adds to the rate of profit in money terms. I know it is the same calculation; one can do it either way. But by inflation one can bring about much more substantial changes to the real rate of interest, or much more substantial changes to the money rate of profit. One either changes the relationship of the money rate of interest to the money profit, or of the real profit to the real rate of interest; and in either way the changes can be more substantial than one can bring about by instruments of credit policy.

10686. One's success varies with the range between these two rates?——I would not say that necessarily, because the wider is the range between the two rates the smaller is the need for what I earlier called the inflationary dope. Suppose that in the nineteenth century, when there was no taxation of any consequence, the necessary rate of profit in the British economy was a steady 10 per cent. This is what appears from the various empirical investigations that have been going on to have been the steady rate of profit in the second half of the nineteenth century, at the time when the yield on Consols was around 3 per cent. One could argue one of two ways. One could argue that this 10 per cent. was only attained because investment was telescoped into three or four years out of every ten. If it had been a continuous process they could not have earned 10 per cent.; they could have earned only 6 per cent., let us say. Then, assuming that my analysis is right in this section of my paper, the prescription would have been a rate of inflation of 3 or 4 per cent., not more. That would have made a consistently steady 10 per cent. profit with investment in all years and not only investment in a few years. But I would argue that, if in the nineteenth century, when there were no income taxes or profits taxes to speak of, the rate of profit was steady at 10 per cent., that is a clear indication that it reached a sort of minimum below which it could not have been brought; that it reached a level where, in the words of Ricardo, "it is no more than necessary compensation for the risk and trouble" involved in productive investment as against merely lending money in the financial markets; and that once that level is reached investment demand is limited by the emergence of new investment opportunity: it is limited, that is to say, by the extent to which one can invest without lowering the rate of profit below that figure. I maintain, that, if the gilt-edged rate had been 0 per cent. instead of 3 per cent., then the minimum rate of profit would have been brought down to 7 per cent., and 7 per cent. would probably have been consistent with uninterrupted growth and full employment. The same effect, of a zero gilt-edged rate, could have been reached by a 3 per cent. inflation. That is the point I was trying to make.

10687. *Chairman*: You touch on a point in paragraph 9, the aspects of which we are always coming up against. I would just like to draw your views on them. You say there:—

"... the relative stability of bond prices is a highly important feature of an effectively functioning capital market, and of the whole credit mechanism in a capitalist economy."

Do you think that it is as true today as it may have been in the past that the long-term investor requires relative stability of bond prices?——It is increasingly financial institutions rather than individuals that are the main long-term investors in bonds. This is partly a consequence of the inflation that has taken place and to which people are becoming accustomed, not necessarily because the public becomes conscious of the continued fall in the value of money, though that may also be true, but because their experience regarding holding of equities has become much more favourable as a result of a much more favourable relative showing of equities. That is a consequence of continued prosperity and of inflation. Equities are considered a far safer, more reasonable investment than they were before the first World War, so to the extent that long-term lending becomes concentrated on financial institutions and financial institutions behave differently, perhaps this point that I make here is less important.

10688. If these are mainly institutional investors interested in long-term investment, does that not tend to diminish the importance of the relative stability from year to year of bond prices?——I speak with some hesitation, but we even find our big insurance companies having investment policies which are far more speculative than one would care to assume from the nature of their businesses. It has a great deal to do with their investment management. They behave like anyone else wanting to do the best for their policy holders and their shareholders. All I am suggesting is that, if bond prices are more unstable, then it becomes far more important when to buy and when to sell bonds than *what* bonds to buy. There is a neat little calculation on the market which establishes a small margin between the bonds of the British Government and the bonds of municipal corporations; the municipal corporations stand a little lower, and then some other bonds, first grade industrial bonds, give yet a little extra yield. That must ultimately be based, so long as it is not the survival of old conventions, on a fairly neat calculation of balancing the extra income against any added risks incurred.

10689. Or lack of marketability?——Or lack of marketability. I am quoting Keynes here, and I quote him because I felt that this was a very apt point; the timing of purchases and sales becomes very important from the point of view of the true return to the investor, and the attention of investors becomes far more concentrated on this game of when to buy and when to sell, and because it is more concentrated on that it is far less concentrated on the more professional side of their job, namely of discovering the true investment opportunities, of measuring the relative advantages of one form of financial investment against another.

10690. *Professor Cairncross*: You would not describe the Government broker as a casino?——No.

10691. If the long-term rate of interest were to be decided upon by the Issue Department of the Bank of England, how would you regard that?——The Government broker is merely the agent of the Government in carrying out the policy of changing the level of interest rates. There are some people (for example in America, Mr. Riefler, Assistant to the Chairman of the Federal Reserve Board) who maintain that the very fact of operating in a long-term market creates speculative expectations and anticipations that have this far-reaching consequence, and that this makes the policy of using the Government broker to operate on the long-term market inappropriate. For that reason he prefers the monetary authorities to operate exclusively in bills and not in bonds.

10692. *Sir Oliver Franks*: I suppose these things can occur, as in last July, without the particular cause which you name. One can get speculation in the bond markets and the demoralisation of it without the proximate cause being Federal Reserve intervention?——Yes. I was trying in this paragraph to put my view, which is, I admit, a controversial view, that the stability of gilt-edged in the nineteenth century was a very important factor in the development of a capital market where the savings of some individuals can be channelled and brought to finance the investment of others. I believe that the stability of the long-term interest rate was largely a conventional phenomenon. Left to itself the gilt-edged market tends to be stable; fluctuations tend to be confined to narrow ranges. Once the price has fallen (or risen) a few points a sufficient number of people will believe on past experience that the price is now low (or high) and reverse the trend. In other words speculation itself stabilises this market or confines fluctuations within these limits. This is a self-generating, self-reinforcing process; the longer the stability of gilt-edged rates continues, the stronger are the forces tending to maintain that rate. I will not say it has any particular cause; it just happened that way. If the authorities wished to use the instrument of credit control more effectively as a general economic stabiliser, they would have to break that convention somehow or other. They would have to get the public accustomed to much greater variations in gilt-edged rates and prices than they learnt to expect on their past experience.

10693. *Professor Cairncross*: Surely the position today is not like that of the nineteenth century in respect of gilt-edged. We have had very great fluctuations in the last ten years, and the conventions of a hundred years ago really have very little to do with people's expectations today. Do you feel, given the fluctuations that already occur, that it would be possible to make use of variations in long-term rates to accomplish economic objectives?——Not if one wants to get rid of inflation. If one wishes to combine in this country a stable price level or a gently falling price level with reasonable prosperity and reasonable improvement, one has to get interest rates very low. I do not think that this sort of situation will be consistent with deliberately contrived fluctuation in gilt-edged rates. I may have been too pessimistic here, and deliberately so, in suggesting that one will not get it at all without some inflation; but even supposing that one can combine growth and price stability, one certainly needs to have interest rates very low. And low interest rates are not consistent with fluctuating interest rates; not only from a crude arithmetical point of view that when interest rates go up and down then the average is higher than when they do not go up, but also because the liquidity premium demanded on long-term investment when rates fluctuate is necessarily greater than when security prices are stable, because it is regarded as more risky the more it is liable to capital appreciation and depreciation.

10694. How can one discover how much greater it would be?——In the nineteenth century, according to Hicks's calculations, the long-term rate of interest was consistently 1 per cent. above the average of the bill rate in the money market. It was stable, because it was reflecting a seven to nine years' average of bill rates, but it was about 1 per cent. above it. After the first World War it was about 2 per cent. above it. Now I should say that that already reflects the much greater variability of gilt-edge prices in the period between the two wars than existed prior to 1913. If one wanted to make the interest policy an even more effective instrument, one might have to have it 3 per cent. But the moving average of the bill rate itself will not be all that low, if credit policy in the narrow sense is an active instrument of economic control; the moving average of bill rate will probably be appreciably higher than 2 per cent., at least 3 per cent., and one might have to add another 3 per cent. to that, as a net liquidity premium, to get the minimum average level of long-term interest rates. That gives a minimum of 6 per cent. I am willing to bet that prosperity in the U.K. at a stable price level is not consistent with a 6 per cent. gilt-edged interest rate.

10695. Although as you recognised, at 3 per cent. per annum the gilt-edged rate could not be held; it gravitated upwards until it was above 5 per cent?——Then I should say that we have had too much inflation. If the gilt-edged rate gravitates upwards resulting from inflation, it means that we just have too much inflation and could do with less.

10696. The dope has to be nicely adjusted?——Like any medicine.

Chairman: Thank you very much, Mr. Kaldor. We are much obliged to you for your paper and your evidence.

(*The witness withdrew.*)

(*Adjourned until Thursday, 16th October, 1958, at 10.45 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-FIFTH DAY

Thursday, 16th October, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
MR. R. T. ARMSTRONG, *Secretary*

THE LORD BRAND, C.M.G., called and examined

10697. *Chairman*: Good morning, Lord Brand. We are grateful to you for coming here today. I am sorry that our numbers are so small, but several of our members have overseas commitments which have kept them away. We have Sir Theodore Gregory coming later in the day, so we are to hear today the two members still available of the Macmillan Committee. We have been speculating which of us in twenty-five years would turn up in a similar position. I wonder if you could start off by giving us quite generally a picture of monetary policy since the study which the Macmillan Committee made of it, which has been a handbook ever since. What do you think are the major changes as to the conditions under which it operates today?——*Lord Brand*: We have passed since then through a tremendous crisis in the thirties, and a war after that with tremendous inflation as a result. That has made the whole problem perhaps more difficult. I would like to say what happened on the day we signed the Macmillan Committee Report, for which I was on the drafting committee, as was Sir Theodore Gregory; Keynes was the chief drafter. I signed it, and went back to my office. A partner of mine was alone in our partners' room, and I told him that we had all signed the Macmillan Committee Report. He said: "That is all right, but do you know that a great crisis is going to break out this week-end in Central Europe?" That was the beginning of the great collapse; everything had fallen, and a lot of what we had done was made back history almost at once. Between that date and this an enormous lot has taken place; an enormous amount of economic knowledge has certainly been gained. The whole Keynesian theory and practice has made a tremendous difference, and, generally speaking, people know more what they are aiming at; whether they get where they are aiming is another matter. I think there have been enormous changes, but the fundamental problems remain the same.

10698. *Professor Cairncross*: Would you say that the international position of London is as strong as it was at that time?——No, certainly not. After all, we had not gone through a great war, ended up the greatest debtor in the world and with not a very good balance sheet so far as the balance of payments was concerned. It is astonishing that we have come through as well as we have.

10699. Do you think this decline in the international position of London has been an important factor in the exercise of monetary policy? Take the use of the Bank Rate, for instance; do you think it now works in quite the way it did in the twenties and thirties?——It may not work quite the way it did, but I do not think that we can possibly do without it.

10700. *Chairman*: I should like you to enlarge upon this; we are always coming up against it. You would probably agree that to some extent the effect created by Bank Rate movements is psychological?——To some extent.

10701. Thinking of overseas at the moment, what do you think its effectiveness is in the mind of foreigners today? What does it stand for?——Its effectiveness is in one sense that it is more profitable to leave money here than take it away; but whether that is done or not depends on what they think is the future of sterling and what they think of our balance of payments. We have gained enormously lately by the fact they have not thought so well of the dollar. That is almost more important than what they have thought about sterling. The dollar is now not a refuge to which all go with certainty that they are right.

10702. But would you say that in post-war years, leaving aside for the moment the last twelve months, the confidence aspect has mattered much more than the comparative rate of interest obtainable in this country?——Why people put their money in America was because they thought it was a strong currency. It is a difficult question. America has inflated about as much as we have, I think, but still the dollar was strong and remains still, I think, a stronger currency than sterling.

10703. *Professor Sayers*: Have people outside this country thought of the Bank Rate as having a powerful effect inside this country?——Certainly; a powerful effect in damping down capital investment and generally making the industrial and business world feel that it has to be careful and look out. I do not think that it affects them so much in their pocket straightaway, if one takes what difference it makes to their profits to pay 7 per cent. rather than 5 per cent.

10704. Is that what the foreigner thinks happens in this country?——I think that the foreigner thinks we are alive to the great dangers of our problem and are going to take steps, including Bank Rate, but other steps too, to make the position of sterling stronger.

10705. Suppose that we took a number of steps but Bank Rate was not one of the weapons used; what would the attitude of the foreigner be?——I think it would be that we were not really serious about it.

10706. He does attach great importance to Bank Rate itself?——I should say so, yes; anyhow as an indication that we are prepared to take very serious measures to put ourselves right.

10707. He must think of Bank Rate as a very serious measure itself?——Yes.

10708. Do you think of it in that way too?——I think of it in that way, and I think of a high Bank Rate as something not to be kept on longer than is necessary.

10709. *Chairman*: Because of the internal effects that it produces?——Because it slows up capital investment, and generally slows up initiative and enterprise.

10710. *Professor Sayers*: Do you think it has these effects quickly?——No, I think they may be rather gradual.

10711. *Sir Oliver Franks*: Could we relate what you have been saying to the last few years? I have in mind first, the slowness and apparent uncertainty of when increasing rates of interest would bite on the economy from the beginning of 1955 on through to 1956 and in the end to September 1957, and secondly, the effect (primarily, I think, abroad) of the 7 per cent. Bank Rate in September 1957. As you were speaking I was trying to relate what you said to the circumstances of these three or four years. Should I be right in thinking that so far as the broad effects of a high Bank Rate are concerned your view would be that while the time it takes for a high rate to bite on the economy may be quite long, perhaps unexpectedly long, yet it will bite; and further, that the

height to which the rate has to go may be determined in part by the degree of confidence about continuing inflation, in part by the height of taxation and the extent to which the Chancellor of the Exchequer in effect pays half the interest on borrowed money; but that, when all these things have been said, it is in principle a very powerful weapon whose consequences can go deep into the economy?——Yes. I would say, broadly speaking, that it is a powerful weapon. It may be largely psychological but I think it is a powerful weapon, and I think that, if inflation is what the authorities want to stop (I have very strong views about inflation) there ought to be no instrument they should leave unused if they want to have the desired result on the economy. I do not feel very competent to express to you in detail the way Bank Rate works in, say, great industries like the one of which Sir John Woods is a director; whether the 7 per cent. Bank Rate has much direct effect on the decisions of the English Electric Company for further development, he could say much better than I can. But I feel convinced that the Bank Rate is an important weapon in the fight for monetary stability.

10712. *Chairman*: If you leave out the element of anxiety about the exchange position of sterling, do you see any signs since the war that the influence of a movement of the rate so far as foreign opinion goes is any less than it used to be?——No, I would not think so.

10713. *Professor Sayers*: Do you attach any importance to the height of the steps by which Bank Rate moves? There used to be something of a convention that, except in quite extraordinary circumstances, Bank Rate should go up by ones and down by halves. Do you think that that convention or anything like it remains appropriate, or do you think that the movement should be more abrupt or less abrupt?——That is a difficult question to answer. In the circumstances of the last big rise in the Bank Rate I do not think that I would have had the courage to put it up from 5 to 7 per cent. It was a courageous step, and I think in the circumstances has been proved to be the right step, because we wanted to give a shock to the world, as well as to ourselves, to indicate that we really meant business. Generally speaking, I should say that unless we face a sort of crisis we might easily have faced then with the balance of payments, so far as we are concerned internally, a more moderate rise would probably be sufficient and better.

10714. Do you think that there is any particular importance to be attached to the longer-term interest rates? Do you think that the effects of Bank Rate come about partly through the effects on longer rates and the possibilities of borrowing money on long term, and that therefore the authorities should give much more consideration to what is happening in the long term securities market?——I should think that so far as their own securities are concerned they do give particular attention; it is a matter of importance to them at what rate they raise money for conversion or other purposes. If one takes the ordinary issue business, of course, a high long-term rate dissuades people very much from making bond issues; on a twenty-five years' or thirty years' bond issue a high rate is a tremendous burden for the future. It therefore checks the long term market.

10715. When there is such a check in the long-term capital market, is one of the effects to slow down capital spending by would-be borrowers, or do they just get along with short-term money and various temporary devices and go on spending at the same rate?——It is extremely difficult to say. Circumstances are infinitely varied. A good deal of bond issuing took place after the 7 per cent. rise, because people had to raise money to meet commitments and so on. I think that generally speaking it would make them hesitate for the future. The issue business, of course, has fallen off lately.

10716. *Chairman*: You said earlier on in answer to a question I put that one of the changes that you thought was of importance since the days of the Macmillan Committee was that people knew a great deal more about the subject. I wanted you to enlarge on that if you could. How far do you think this knowledge extends outside the inner circle, as it were?——I think that this is enormously important. I should like to tell you a story, which I fear rather reflects on a former Governor of the Bank. This story shows what was the state of knowledge in high quarters when I went into the City in 1910 about what is now called the transfer problem, which was not known to a man like Poincaré at all; he thought that we could get more money out of Germany by invading the Rhineland. When I went to see Sir John Bradbury one day in 1919, he said: "Lord Cunliffe, the Governor of the Bank, has just brought me the Report of the Committee appointed by Lloyd George to say how much Germany could pay; and the figure is gigantic." I think it was £23,000 million. He said: "I asked Lord Cunliffe one or two questions. I asked him why he said that Germany could pay £200 millions of gold. He said: 'Because it is twice as much as they have got'." Then Sir John Bradbury said: "The second question I asked him was: 'How do you think they can possibly pay these sums?' Lord Cunliffe said: 'Do you know what the site value of Berlin alone is?'" That is an indication that the Governor of the Bank thought that we could move the site value of Berlin from Berlin into sterling and other currencies and with them we could buy food, raw materials and everything else abroad. That was a merchant banker who had spent all his life in banking. It indicates what was the case with many people. The vast mass of people had never questioned that sterling could alter in value. In my firm we did a lot of exchange business, and there is no doubt that the people in the foreign banks in London and the people who did foreign exchange (which the big five clearing banks did not do at all in those days) understood the elements of the problem; anyhow they knew what an exchange dealer knows, that currencies do change in value. I tell that story just to show you what the atmosphere was in those years, and what Lord Cunliffe had in mind when he and Lord Sumner went as our two chief reparations representatives to advise Lloyd George on the Reparations Commission. That would be quite impossible now. More or less everybody in the City knows what the transfer problem is, and that one cannot transfer site values from one country to another. They know that the strength of our currency depends on our balance of payments, our reserves, and our liabilities to other countries. The state of knowledge now is totally different from what it was then; that makes it easier for the authorities, since the British ought to know all about the transfer problem. What they do not know is what inflation can do. I saw it at close quarters in Germany. It is that which makes me always terrified of inflation. Inflation is not a thing that can go on at the same level; in the end it corrupts everything and becomes faster and faster.

10717. *Sir Oliver Franks*: Some people who give evidence to us would say that the objectives of economic and social policy to which budgetary as well as monetary measures must be directed are twofold: first, the question of the general level of the economy's activity, and secondly, within that, the balance between investment and consumption. These people would say that monetary measures must always be looked on as one of the alternative means of achieving the right answer in terms of these ends. From that point of view, I think, stability of prices is regarded as one of the things that the authorities play with rather than one of the set ends; they would be prepared to face rising prices if they thought that that was the cost of a right level of economic activity and a right balance between investment and consumption. Would you in the light of your experience wish to argue that relative stability of price was *the* end of monetary policy, or *an* end to be ranked with the two which I have mentioned?——I would say that one cannot treat any country by itself. We might have a price level which made consumption and investment just about right from the point of view of unemployment, for instance, and our internal situation; but we have to consider, if prices and therefore costs are rising, what effect that has on our relations with other countries and what other countries are doing. Are they doing the same thing or are they deflating? If they are not doing the same thing and we raise our prices then our exports will suffer and our balance of payments get into trouble. The questions of employment and investment here have to be looked at in relation to our external position.

10718. One could accept that, and say that the consequence was that one must not inflate faster than one's neighbours and preferably perhaps a little slower; but it would not follow from that that a stability of prices other than a relative stability was a major end of policy?——Undoubtedly. One can say that over centuries we are always going to inflate. The debtor always wins against the creditor, in the end. It is a question of speed.

I have seen cases where a country finally has lost any confidence in its currency, and then inflation goes at an enormous pace. I remember in Germany they said that it was no good buying one bock because by the time one had drunk one bock the other would cost more. Prices went up every day. They used to say that it was far better to hold a slice of ham than a currency note, because a slice of ham was worth something but nobody knew what the currency note was worth. I used to take a rucksack into the bank to get my change; there was a vast number of notes. Prices changed about twice a day. Of course that was a very extreme case, but still the rot begins as soon as the general public realises that money is not what they thought it was. When the Bank of England says on its bank notes that it will pay one pound if that note is presented, that is absolute "hooey"; it is nonsensical. Normally people do not think that way, but they do ultimately get to it.

10719. *Chairman*: Do you think there can be such a thing as a controlled inflation or is that psychologically meaningless?——I should think that a controlled inflation is possible, provided that the external position is so strong that one need not bother about it. But it always has to be kept in check.

10720. Do you think that people in general could believe in it?——It depends how fast it goes. At the time when the Bank Rate went up to 7 per cent., there were a few days when one could not sell more than £40,000 worth of British Government Securities at a go. One felt the beginning of a period when confidence in the currency and Government credit was beginning to disappear.

10721. *Professor Cairncross*: Would that situation, in which it was impossible to sell more than a certain total of British Government Securities, be one you had known in the past?——Yes, a few times. It might happen in a huge political crisis like the outbreak of the first war. When the first war broke out the American millionaires, who had always been protected from the world by having a wad of dollar notes in their pockets found that they could not even exchange a wad of dollar notes; but there were only a few days during which time they could not do that.

10722. *Chairman*: There was, in fact, a moratorium?——I do not think there was a legal moratorium; but I think for a few days at the beginning nobody could do anything.

10723. *Professor Cairncross*: I was thinking of a more precise set of circumstances where there might be difficulty in the bond market in disposing of a large block of Government bonds. Do you think that has happened from time to time to your recollection?——I cannot recollect anything; it may be that in 1931 there was a very bad market after the collapse, but I could not be sure.

10724. *Professor Sayers*: Do you think that we have in the last ten years ever reached a position in which the Government broker could not if he wished sell quite considerable amounts of Government stocks at one price if not at another price?——Generally that is absolutely true, of course; at particular moments he might find favoured customers and so on who would be willing to accommodate him at what they thought might be a loss; but I should think that *in extremis* the authorities could always sell a good deal. I was talking about what the brokers and the jobbers were prepared to do. It was no doubt quite a temporary thing, but it is an indication of what the lack of confidence means.

10725. *Professor Cairncross*: But apart from lack of confidence, is not the gilt-edged market rather restricted? Is it not a market where it is difficult to get rid of very large blocks of securities?——Sir Oliver could tell you more than I could about that. I should think that one can generally deal in very large amounts on normal days.

10726. *Professor Sayers*: You spoke earlier about the increase in knowledge over the last generation or so. Do you think that this has much altered the kinds of action that the central bank can take and the way in which it should take action, and the relations it should have with the Treasury, the City, the public?——There is a great increase of knowledge, but the knowledge has also brought the further knowledge that one never gets to the bottom of things; one is never certain that one is right. Take, for instance, what people think is going to happen now in the United States. There are economists and bankers galore studying this problem all the time; and who can say now whether they are going to inflate more or whether they are not? If I may make a general reflection, it seems to me a very unsatisfactory kind of civilisation where a large number of most knowledgeable people spend their lives in thinking: "Is it going up or is it going down? Are we going to have a crash or are we going to have a boom?" A tremendous lot of brain power is expended on very acute investigations into all these problems, but in the end nobody knows. If anybody knew he could be a millionaire very shortly, either by being a bear or a bull; but because we are dealing with human nature, with masses of human beings, we really do not know what is going to happen; none of this knowledge really tells us in the end what is going to happen.

10727. *Chairman*: Does not that throw into a highlight the importance of having great public confidence in the monetary authority, since these things are not ultimately capable of being forecast?——Yes, and in their judgment of what they do.

10728. Yes, that is what I meant. It may be that even what theoretically would be right decisions taken may fail in their purpose if the public has not got its confidence behind them?——That would have some effect, certainly.

10729. We should like you, with all your experience, to give us your views as to whether the set-up established since 1946 under the Bank of England Act is the best for this purpose. We are thinking of the relations between the executive Government of the day, with Parliament standing behind it, and the Bank of England, and of the way that the Court of the Bank of England is constituted.——You did mention that subject to me, my Lord Chairman, and I have thought a good deal about it. I have looked at other central banks, particularly the Federal Reserve (which I know personally) and the new German Bundeshank, which I think are the two important ones. The French are always rather different from other people, and the Bank of France is not so good an example.

I would say, generally speaking, that it is recognised in almost all countries, perhaps in all countries that enjoy an extreme democracy, that the decisions on monetary policy must ultimately be such as the Government will accept and agree with. I got from the Governor of the Bank a synopsis of all these different countries and how their Boards were created and so on, and it is clearly the case that in most countries the Government does in the end have the decision; the central bank cannot say: "We are going to do so-and-so regardless of what you say. If you very much disagree with it, that is your look-out." But we are dealing with a sphere of life which is very complicated and difficult. Nobody can form certain judgment about it; it requires a great deal of knowledge of a sort that does not come the way of Members of Parliament or members of the Government. Monetary and credit policy, I think, must in general be in the hands of a semi-independent body. The Government has to know that a body so constituted is likely to have a very widespread and well-founded influence and a good judgment, and every Government must feel it would be very undesirable indeed that there should be a definite public struggle between the two. The Federal Reserve Bank has very independent powers in many ways. I have a note of a speech by Mr. Martin, the Chairman of the Board of Governors of the Federal Reserve System, which puts it very admirably, I think. He says:

"The Federal Reserve Act of 1913 was the outcome of prolonged study of the history of central banking in other countries and of our own experiences. Congress, seeking to avoid either political or private domination of the money supply, created an independent institution which is an ingenious blending of public and private participation in the System's operations under the co-ordination of a public body. The question of independence has been thoroughly debated throughout the long history of central banking on numerous occasions when management of the Federal Reserve Banks was under consideration. The question has been re-examined by Congress and it has re-affirmed its original judgment that the Federal Reserve System should be independent: not independent of Government but independent within the structure of Government. That does not mean that the reserve banking mechanism can or should pursue an objective which is contrary to national economic policy. It does mean that within its technical fields

in deciding upon and carrying out monetary and credit policy it should be free to exercise its best collective judgment independently."

I think that that is a good statement of what a central bank should be, and I think one has to judge the constitution of the Bank of England and the Bank Act of 1946 accordingly.

I think on the whole that the Bank Act does that. I think the British habit of not trying to spell out the thing too clearly is a good one. The fact that the section is very general, defining the Bank's relations with the Treasury in terms of the Treasury's ultimate right to give directions, works pretty well because the real sanction is not in any words but in the fact that a Government faces or might face the resignation of the Bank and the Court of Directors; and that, since it is supposed to be, and is, the repository of a great deal of knowledge which the Government has not got, would be a very serious matter. I could not suggest any better form of words myself than is in the present Bank Act. I think it works all right.

If I may come on to the constitution of the Court, I never was a Director of the Bank of England; my partner, Lord Kindersley, was a Director for many years, and I may say in passing that I never found any moral difficulty; nor, I think, did he, in not telling me secrets. I have never asked questions about the Bank Rate. I used to see a good deal of Governor Norman. Sometimes he and Lord Kindersley did not see at all eye to eye, and they were both strong men. On occasions the Governor asked me whether I could possibly induce my partner to change his mind, but he did not speak on any confidential matters. I never found the slightest difficulty. I cannot see why one should regard bankers as any less moral than lawyers, accountants, doctors and so on, all of whom receive confidences that they cannot pass on. I did not agree with one or two of my partners who told the Parker Tribunal that it was very difficult.

It seems to me that we are lucky in not having the federal constitution that the Bundesbank and the Federal Reserve Board both have to have. We are luckily very small and united and do not want the representation of different districts that they have. But I would have thought that the constitution of the Court ought to be partly executive officers of the Bank, who have as wide a knowledge as anybody in the country, partly two or three merchant bankers, and partly representatives of the industrial and trade union world. There is a question about what should be the relationship of the clearing banks towards the Bank of England, and whether they should be represented on the Court. I think it is conceivable and quite possible that the chairman of the Committee of London Clearing Bankers should be on the Court, but he is only chairman for two years. Generally speaking I regard the "big five" as very powerful, big men whom the Bank of England has to keep in order; perhaps it is better they should face one another rather than mingle. The chairmen of the "big five" might very well prefer that they should be independent and be able to be freer to disagree with or agree with the Governor of the Bank, rather than that they should sit on the Court.

My own feeling is that the Court is quite well adapted for its work now. There used to be more merchant bankers on it; but perhaps that was in the days when the merchant bankers knew much more of what was going on in the world than anybody else. Nowadays the first-class men in the Bank of England, their highest executives, know pretty well as much as anybody else what is going on in the world; perhaps more in some cases.

10730. Does not that to some extent alter the importance of part-time directors, if the Bank of England has access to information from all over the world on a scale which could only be obtained in the past by adopting an individual contact in the form of a merchant banker? May there not be a case for more whole-time directors drawn from the kind of world from which the part-time directors are taken today? Is that feasible? Can you imagine that such people might go on the Board whole-time for five years or seven years or whatever period might be thought appropriate?——I would think that for these whole-time directors five years would not be a period in which they could acquire the necessary knowledge. It is knowledge acquired over years and through different phases, bad and good, that tells. You are not suggesting that the present executive directors of the Bank should only be on the Court for a short period?

10731. No, I was not thinking of that. I was thinking that the Bank would always need a core of persons making a permanent career there as executive directors, but I was wondering whether there was not a case for adding to the number of directors, apart from them, who are whole-timers for a sizeable period of years, giving up the whole of their time and effort to the work of central banking?——Would they merely be members of the Court, or would they be executive members of the Bank staff?

10732. They might have departmental responsibilities as well as that of being a member of the Court, but certainly that of a member of the Court.——I do not see how a man could be a member of the Court without either being either whole-time head of one of the big departments or completely outside. I do not see the sort of animal he would be. He would only have five years in the Bank of England, and then go back to some other profession or something like that.

10733. I quite see that a departmental headship might be a necessity to give a director proper knowledge in his whole-time life; but do you think it would be impossible for people to come in for a period of seven years or ten years for that kind of work, with the benefit, of course, of his outside training and experience?——I can see a man being appointed for seven years as a member of the Court and then leaving, but not taking any part during those seven years in the actual running of the Bank of England. He would be there instead of a merchant banker, for instance, for a certain number of years; then they would change and have another. I am not sure it would be a very great improvement on what happens at present. I think that they would still have to be during those five years in their own profession, in their own firm or whatever it was, otherwise they would lose their value; they could not be whole-time people working at the Bank of England.

10734. Unless they took on departmental responsibilities?——One could not have a departmental manager anywhere for five years. It would wreck an organisation, I should have thought.

10735. *Professor Cairncross*: What do you think the Bank of England gains from having on its Court part-time directors, people who are normally directors of other companies, or merchant bankers?——They get a lot of outside knowledge. It is just the same question what, for instance, a big clearing bank gets from its directors. Lloyds Bank, for instance, gains a tremendous lot in having representatives of all kinds of industry and so on on the board. The same is the case with the Bank of England. It is the whole system of company directors which is at question, I think.

10736. The director of a company is expected to apply a broad judgment to a variety of issues, and at the same time he brings special knowledge to the formation of that judgment. You are laying stress, as I understand you, on the knowledge that is brought by the director who has other responsibilities. Do you feel that in central banking the knowledge that is brought by outside people is of such importance, or is it the judgment that they possess from their experience that you value?——I do not think that one can have the judgment without the knowledge. The trade union director of the Bank of England has certain knowledge which on occasions might be very valuable to the Bank of England. A merchant banker certainly, if I might judge from my own firm, has a great deal of knowledge gained by constantly travelling around the world, seeing foreign bankers coming in every day and so on, and keeping in touch with everything that is going on in the world. I do not say that they know more than these executive directors of the Bank whose business it is also to know everything in that sphere, but they perhaps get a different aspect of it. Then I should imagine an economist or two could contribute a lot to the Bank of England.

10737. The chairman or one of the other members of the directorate of a large clearing bank might have more to contribute by way of knowledge than some of the persons at present acting as directors of the Bank of England, but he would be debarred at present by the convention from becoming a member?——It would be very difficult to have one unless one had all. They are strong competitors. They could have the chairman of

the Committee of London Clearing Bankers while he was chairman. The "big five" are enormously influential bodies. It is like the analogy of putting the boys on the level of the headmaster. The headmaster has to try and discipline these very big boys, and the question is whether he does that and whether they prefer not to be there. I could not say. I should have thought there was a good deal from their point of view to be said for remaining quite independent.

10738. *Professor Sayers*: One of the most disturbing things about the evidence we have received so far is the distrust of the Bank of England in quarters where one would like to see the Bank commanding full confidence, and the criticism of it that is often expressed in at least partial ignorance of the facts. It appears to me to be an unhealthy state of affairs, and to detract from the possibilities of a good monetary policy. Accepting that there is this distrust, what do you think might be done about the constitution of the Bank of England or its behaviour to lessen this distrust?——I do not believe that one could do anything much with the constitution, but I would say that probably a good deal, perhaps in the end a great deal, could be done by the Bank letting the public know what it does, and appearing not to be a mystery. I think it is much too much of a mystery. Before Governor Norman nobody bothered too much about it, but he made it rather a mystery. The Federal Reserve Board have pursued a better course in appearing at any rate to be much more forthcoming. Of course we have so much to read now that to keep abreast of what other people are keeping abreast of takes time, and one hesitates to suggest adding to the amount of paper; but I think that the Bank of England Annual Report suffers from being very meagre compared with a lot of others. The Treasury gives such a lot; there is the monthly Treasury Bulletin which is very informative, and all these huge amounts of national statistics. Nevertheless I looked at the monthly Federal Reserve Bulletin the other day, and I could not help thinking that there are a great many things that the Bank of England might spread itself on a bit and appear to want to give information rather than appearing to think that it is so mysterious and secret that it should not be given. It is not its fault, but there is a large class in every country which regards bankers as the devil. There is the famous "bankers' ramp", the idea that the bankers created the 1931 crisis. Of course they did nothing of the sort; they no doubt showed lack of judgment in something, but they got a black eye from it and they have never recovered since.

10739. *Chairman*: It is very deep in history that bankers have been regarded with suspicion?——And always will be by people who cannot get credit.

Chairman: Thank you very much, Lord Brand, on behalf of all of us. We are very grateful to you for your help.

(*The witness withdrew.*)

SIR ALEXANDER FLECK, K.B.E., F.R.S., Chairman of Imperial Chemical Industries Ltd., called and examined.

10740. *Chairman*: Sir Alexander, we are very grateful to you for answering our invitation and coming to give evidence to us*. You have my letter, which gives you an outline of the five subjects on which we want to draw from your experience. Would you like to make a statement first in answer to them, or would you like us to ask you the questions?——*Sir Alexander Fleck*: I would like rather to start the ball rolling, if I may. I have your five questions, and I will try and give you my reactions to them. First of all, I would like to say that I am by upbringing and by nature a scientific technologist, so that I approach all these things with a background of technology; as an unrepentant technologist, I should like to think that the financial people are part of the service of the development of technology. That is the background, and if any of my statements are possibly a little unorthodox that will be the basic philosophy. That is at the back of my mind.

Having said that, may I remind you of the kind of magnitude of figures I have to deal with in looking at the application of my technology. The company has a turnover of £460 million a year, of which well over £250 million comes from the United Kingdom, and the rest from activities that are worldwide, mainly in the Commonwealth. Those are the sales figures. Of the £250m. in this country £76 or £77 million is direct export material. Then in 1957 our total capital expenditure was of the order of £67 million for the group, of which nearly £50 million was in the United Kingdom.

So far as how we spend our capital monies in this country, I usually divide that into five groups. The main one is the extensions to existing plants. Obviously, if a company like ours is a manufacturer, the monopoly manufacturer, if you like, of such things as sodium carbonate and soda ash, we regard it as our duty to see that we keep our plants extended and extending to meet what we regard as the needs of the soda ash business. So quite a large amount of money goes in extending existing operations. Coupled with that, and interwoven with that in a way which is impossible to disentangle, is modernisation of plant; when we modernise a plant, generally speaking we are doing it because we foresee that this product is going to be in continuing demand, and it is almost inevitable that, as we modernise it, we do a little extension too. Nevertheless I think that the modernisation of plant is quite well worth putting as an independent heading. Then the next major block of importance is the money spent on projects that are new to our manufacturing range. The fourth division is the extending of the services to existing plant. If we have a number of new plants coming in, then the totality of our electric load, our steam load, our drain load, is going up; so we have always to have a block of expenditure on the services ancillary to the extending of our operations. Finally there is that other class of services, which is irritating in a way: we have to extend our offices, and we are always wanting new laboratories and so forth and so on; on these there is no direct calculable return on the money.

Those are the five branches that I naturally think about. I imagine that one of your particular interests is the amount of effort that goes into new plants. Going back to the end of the war, nearly 50 per cent. of our capital expenditure has been to manufacture materials and products which were not in the range in pre-war days. In considering that figure, I have to say that a great lot of that money was to deal with big things which had accumulated owing to being hung up by the war: such things as nylon, polythene, terylene and plastics, and so on. When we come to more recent times there has been capital spent on such new things, but not so much as fifty per cent. of the whole. It would be wrong to give you the idea that currently as much as fifty per cent. of our capital spending is on new projects. That is a comment, if you like, on the products of our research work; but nevertheless, even if we happened to go into a period in which our research work did not seem to be productive and fruitful, it would be part of my philosophy to go on making the effort, in the belief that one day the effort would yield its inevitable and proper fruit.

I would say that 25 per cent. of our sales today are of materials that were not on the manufacturing range in pre-war days.

You asked what are the main considerations which determine the size and content of our investment programme. With that background that I have given, the main considerations that determine the size and content do vary a bit. For the old-established things like soda ash it is all drawn and determined by trend curves, and so far we have no reason to question the wisdom of going on trend curves. The same thing applies to such well-established things as ammonia; when one comes to take ammonia, one gets involved in the agricultural situation, and the agricultural situation has developed in a way that to some of us has been very extraordinary in spite of the trend curves.

10741. Could you give any idea, when speaking of these trend curves, over what period of time they reach?——These trend curves go on for fifteen or twenty years ahead.

* See also Memoranda of Evidence Part XI No. 3, submitted after Sir Alexander Fleck had given oral evidence.

10742. *Professor Cairncross*: Do they also go back a long way?——Yes. I think the alkali ones go back to 1880. The ones that I have seen they certainly go back a long way. That does not apply in the case of ammonia and these matters. When we come to new products for which we have got no such trend curves, we have to do a great lot of market assessment. Judgment comes in, and we do our best; sometimes our best is good: sometimes our best is depressingly poor. So far as the technical and administration services are concerned, they follow the general trend of our activities. So I think the answer to the question what are the main considerations which determine the size and content of our investment programme is that trend is the big thing, and then judgment and market surveys and so forth.

10743. You said, I thought, that the proportion of your capital expenditure going to new projects is now rather below what it had been over the whole post-war period. Does this imply that some of the heavy capital expenditure that you have been incurring is of a once-for-all character, that you have had a particularly heavy stream in the postwar period, and looking ahead it may not be quite as heavy? Or is it your view that it will be just as heavy but may be devoted more to the established projects?——I would expect that the capital expenditure would be roughly as heavy as it has been. I think that the £50 million I have quoted for the United Kingdom for last year would be in the top side, but I would be surprised if in any year we had demands that were lower than £40 million. Of course we do undoubtedly have from a technological point of view waves, and it is our business to try and smoothe out the waves in order to keep the technical staffs, design staffs and engineering staffs employed at a reasonable level.

10744. A heavy part of your total expenditure in the last ten years must have gone to terylene, polythene, nylon and so on. If the expenditure in those directions were to slacken, or if you had not a large number of new projects or processes that were going to absorb equal amounts, would you be left concentrating more on making up arrears on your soda ash and caustic soda plants?——We have expenditure which for the purposes of what is in my mind we will call £12 million a year on research; even if there is a considerable block of that, something of the order of £5 million, which is devoted to technical services and therefore is not in any way approaching fundamental research, nevertheless, we have a big block of people who are devoting their brains to thinking out new things, and when they think up new things and produce a case for them it is our policy to go ahead to the best of our ability with them. While I appreciate your point of view, and I agree that it might be so, my hope would be it would not be so.

10745. You do not foresee a drop in your total capital requirements in the next ten to fifteen years?——I do not foresee any substantial drop in total expenditure. I expect that we shall go on somewhere about the level of £40 million a year.

10746. Would you find it necessary to reduce your capital expenditure if your sales were to drop?——Naturally. If we have backed a wrong horse, or if the nylon demand does not continue to go up as it has shown every sign of going up, then we have gone up an avenue which is not really worth the effort of going up.

10747. You would not regard finance as likely to provide an important obstacle?——That is my general view; if we can make the technological grade I have every reason to believe that we shall get the finance. Our whole philosophy is based on a developing technology.

10748. *Chairman*: May we then come to our second question: how far ahead does your organisation plan the size and content of its fixed investment programme?——We do our best to go on in a five-year programme; we might as well select five years as any other period, but by the third and fourth year what we are talking about is getting a pretty long way off, so at best we feel we can do two or three years as an effective plan, remembering, of course, that the trends go on further; but for the final summing up about three years is what we can effectively plan. That means that, speaking in broad terms, we have found that from the earliest stages of a project until it becomes effectively in production is about four years. When we get launched on a project, then the whole thing gets momentum, and it usually requires to go right through to the end. We do not like being deviated, because that is costly. Either to slow down or speed up on any of these projects is not in our experience good practical business.

10749. *Professor Sayers*: Before a project begins to acquire momentum, when it is in the stage of your just making up your minds to go into it, what kind of circumstance may lead you to change your mind at the last minute? What kind of circumstance leads you to go ahead or not go ahead?——I could illustrate that by some technical activities in the textile business. We have some projects ahead, and one of them at the moment has been just postponed for a little while before we get launched into it.

10750. What kind of circumstance leads you into such a postponement?——This is a new material. As you can imagine, before we go into this business large market surveys and forecasts have been made. If we see that the actual curves are not adhering to the forecast curves, then the general belief is that what is happening is a delay before we shall reach the level of consumption projected for five years ahead. We have gone over so many possible outlets with our market surveys that we have reason to believe that the market surveys will not be basically wrong in magnitude, though they may be wrong in time. So we hang back a bit, to ensure that the market goes ahead and is going ahead.

10751. Do statements on Government policies or on Government views on the health of the economy and so on ever influence these decisions?——Can I recall any Government statement where the economy was not in the long run healthy?

10752. That answers my question; you are emphasising that even before a project has acquired momentum you are thinking very much of a long view?——I am.

10753. *Chairman*: We hear a great deal about a jump in Bank Rate being a general warning to the world that is interested that trade is going to be difficult. It makes people pull in their horns and be anxious. In view of the way you plan your capital investment, is there anything in that you have to pay attention to?——Not a tremendous lot. So far as we are concerned we look upon that as essentially a temporary measure to get things back into balance. Once we get started on a business a jump in Bank Rate does not really influence us very much as a company. What does happen is that a jump in Bank Rate has far more influence on people's personal affairs, and that has a delayed action on our sales and activities; but I am of opinion that that is basically just a delayed action in the progress of our economy.

10754. *Professor Sayers*: Who are the people who are affected directly by the jump in Bank Rate?——The people who want to buy more motorcars.

10755. And that affects you indirectly in some measure?——Yes, because we sell paint and plastics of various kinds to the motorcar people; so there is an effect.

10756. *Sir Oliver Franks*: You are saying in effect that the direct effect on you of movements in the Bank Rate is small, but the indirect effect may be quite noticeable; it reacts back.—*Professor Sayers*: Does that mean that when you see the Bank Rate being jumped up you say to yourselves: "This is going to slow down the growth of our markets; we had better go slowly in the project"?——Not immediately, because when the Bank Rate jumps up I do not know how long it is going to jump up for, so I wait to see something more of what happens to trade.

10757. *Professor Cairncross*: Are there some occasions when you take a tougher line about letting something through than other occasions?——There are some occasions. You say "a tougher line"; we try to be balanced in our view, and to limit our capital expenditure to things that we believe are really necessary. The amount of excess capital that goes in amenities is very small indeed, so there is no sense, because the Bank Rate is going up, in making the washing facilities of an amenity block more austere. We should have our standards and stick to them. Then our people can usually put up a very strong case for new laboratories, and they are extending. When this kind of tough occasion arises the Board may satisfy its conscience by having a crack at it, but it holds down to the fact some offices are delayed and work is continued in some huts which were more or less condemned.

10758. *Sir Oliver Franks*: What you really pay attention to is changes in the physical effects; on the whole you regard the monetary variations as relatively flexible and therefore not likely to be very significant?——Yes.

10759. *Chairman*: When you are considering any particular programme of capital expenditure and the costing of it, your plans at some stage bring in, I suppose, a rate of interest on the capital?——Not just in that simple way. We naturally look for an adequate return on the money. In the early days in this business we used to bring the rate of interest in, but to the best of my knowledge I think that is now removed and we look at the gross return on the capital.

10760. *Professor Cairncross*: What do you regard as a figure to look to as the minimum?——That is a question incapable of being answered. Sometimes capital expenditure which only yields two or three per cent. for various other reasons has to be gone on with. In other cases the figure is vastly different. It is really impossible to give a general figure; but I think I may go this far, and say that, taking our divisions as a whole, we began to sit up and take notice and ask a great lot of questions when they get somewhere down towards nine per cent., but that, if they are up around twelve per cent. we are inclined to say: "Good boys, well done; get on with it." But, as you know, I.C.I. is divided up into something like thirteen manufacturing divisions in the country, and things differ from one to another.

10761. Suppose that these divisions put in one year a very large number of projects to you, far more than in previous years, and all quite good; do you still decide to go ahead on the same footing?——We naturally ask them if they have the capacity to carry it out; the answer to that under the circumstances you postulate would appear to be no. They cannot have engineers lying around doing nothing. It might be that they would have such a good case that we would deploy people from one division to another; we certainly do that from time to time, and more particularly if a division is running into a slack period.

10762. But you do not start from an idea of a fixed ceiling if you do get rather better projects put forward in a bad year?——We would undoubtedly set about getting an organisation to carry them out, provided that it was not an organisation that was going to soar way up and stay up for eighteen months and then go flopping down again. That would be wrong.

10763. In those circumstances you might find you were obliged to go to the market for far more capital than previously?——By and large we regard 70 per cent. as a kind of workable figure of the capital which we get from the proceeds of our business, and we look for 30 per cent. from the market.

10764. But these ratios would inevitably change if you found you were having a run of good projects coming in front of you, if you sanctioned them?——If we sanctioned them, and provided that we paid due attention to our past results. I imagine that, if we came along with a terrific burst of capital expenditure without having shown that we had achieved results in the past, the market might look askance at our request for money.

10765. *Sir Oliver Franks*: Could I come back to one point, to make sure I understood? Am I right in thinking that it is your view, and therefore the experience of your company, that in a period when money is dearish or dear for quite a time, say in 1955 to 1957 when by and large money was dear or dearish all the time, there are perceptible differences in the demand for some of your products, and that you would be inclined to attribute that to the workings of monetary measures? Is that a fair statement, or would you want to qualify it?——I think I would want to qualify it a little bit. I am not a textile expert, and I may be wrong, but I imagine that one of the reasons for the position of the textile business now is that there must have been for various reasons an excess stocking of textiles in the general community at large. That may also have been contributed to by the fact that money was dear and therefore people who would normally have bought so many textiles have not.

10766. I expected you to say, as I think you are saying, that many other causes may and do affect your markets with monetary measures taken; but the positive point I was on was that you do think monetary measures, if at all stringent, do affect some of your markets perceptibly, and you take them to be either causes or important among the various causes of the phenomena which you observe?——Yes; but of course very few of our products are going directly to the consumer market; they are going to raw materials, mainly.

10767. *Professor Sayers*: In discussions as to whether you should go ahead with particular projects or not during the last three or four years, has any participant in such a discussion ever said something like: "Money is being rather persistently dear, and difficult to get; therefore the textile markets will be rather more depressed; therefore we had better go slowly"?——By and large the answer is that is no. We go for the markets and whatever the cost of the market, whatever the size of the market, the decision is based on that.

10768. *Chairman*: Your real test is a constant check of sales realised against forecasts based either on trend curves or upon market research work on projects. Those facts are presented to you currently as you go from year to year. I suppose you are not directly concerned to ask what is the cause of divergences?——We do not quite go in consistently and deeply into the cause. We rather go for the effects.

10769. You must, when considering what to do about a variation between sales and curve forecasts, try to analyse the causes which produce them?——Yes, because if there are reasons to think that the cause is a final cessation then there is no use going on; but if it is a temporary cessation of use, as in my conception is the case in the textile industry now, then trade will go ahead, and we probably carry on.

10770. I think it follows from what you said to Professor Sayers that you do not regard the monetary factor as one of the causes for variations between sales realised and forecasts in recent years?——It has not been one of the major causes that has come into our estimation.

10771. *Professor Sayers*: When the Budget news comes in April each year, does its nature affect the atmosphere in which you take decisions?——If you are asking me as a technologist I say no, but of course I am only part of a large organisation, and there are a great lot of other people who are more used to thinking out, considering and coming to conclusions on those particular things than I am.

10772. Do you think the weight of opinion in your board can be changed by a surprisingly generous or austere Budget?——What do you mean by an austere Budget?

10773. One that puts a sixpence or shilling on the income tax unexpectedly.—*Sir Oliver Franks*: Or makes investment allowances negative: it would be austere if you had to pay to invest.——We have to pay in the end. It would be wrong to say that Budgets are of no interest, but I cannot recall any of them that made any significant change in our approach to what we were thinking of doing.

10774. *Professor Sayers*: Did they ever make for delay in a project before it had got its momentum?——I cannot recall any occasion.

10775. *Chairman*: What you have been saying includes the devices directed straight at you, such as investment allowances which are supposed to affect industry?——These are particular matters on which I personally look for guidance to others rather than plunge ahead on my own responsibility. As I tried to indicate, my financial conceptions are relatively simple, and may be so simple as not to take any of the major factors into account, so I am always looking to being corrected on these matters and being told I have missed out some important point.

10776. I gather these particular devices do not play a part?——They do not. I cannot recall anybody saying: "Now they have given us a good investment allowance; let us get on with it." I cannot remember them having such an effect that it was the difference between "stop" and "go".

10777. *Professor Cairncross*: You told us that you normally ran on a 70 per cent. self finance and 30 per cent. market finance basis. At the same time you put to us that you had a fairly steady programme of capital expenditure ahead, that reflected to quite a large extent progress in technology; new projects and new techniques you wanted to incorporate in your business that would involve capital expenditure at that rate. Is it a matter of accident that a lot of big companies all have roughly the same ratio which they stick to, although at the same

time they have programmes of capital expenditure to finance which may vary from time to time?——If you tell me it is a fact, I accept that. I do not know exactly, when you say "big companies", what you refer to. I do not think that you could say that British Railways do just that. I do not know about the Electricity Council; they conceivably could do it, but I do not think they do. But I have never done any calculations.

10778. I was thinking of manufacturing industry. I will put the question to you more simply. A 70 per cent./30 per cent. ratio really of itself would give you the figure, would it not, knowing the profits, for the amount of capital expenditure? But you do not know it till people come forward. Do you get projects that tot up to that?——Yes. Also remember that I said the *rate* of capital expenditure; I did not say the total of projects in any one year. There is a smoothing out; there was one year that projects came forward whose total value was something of the order of 70 to 80 per cent. of a year's capital expenditure, but of course the capital expenditure on them in that year was not 70 or 80 per cent. Again I come back to the four years it takes to have an effect. I have here some figures: in the first year we spent 8·5 per cent. of the total on a particular project, in the second 36 per cent., in the third 33 per cent., in the fourth 16·5 per cent., and in the fifth 6 per cent. So for a project as a whole 94 per cent. of the total is spent over the first four years.

10779. Suppose that your profits were to fall in directions which did not affect your capital expenditure at all, but none of your new projects was going to be held up because you were running into a difficult year, and you had rather less money coming to you than you had reckoned on; would that by itself dispose you to look at your capital expenditure again and make cuts?——Naturally what we do depends on our financial position. This comes into the questions that you asked me about stocks. We do not trade in stocks. Our business is only to have money in stocks so far as is necessary for the smooth running of the business. If there was this kind of condition that you mention, we would naturally endeavour to run down our stocks so that we had only those stocks at the minimum to carry the smooth running of the business. I sometimes bring together the top men of the divisions, and the finance director will bring together the chief accountants of the divisions, and if we have seen that stocks are diverging from pattern there is a conscious and distinct effort to get them into line with the business that is being conducted.

10780. *Professor Sayers*: Would such a discussion ever be initiated as a result of the finance director coming along and saying: "Somehow or other we have got to get ourselves more liquid"?——Presumably.

10781. Would you trim your stocks a little?——Presumably.

10782. Has it ever happened?——For that particular purpose it certainly has not happened recently. I seem to remember one time in 1937 or 1938 when it did happen, but I am not aware of it in the last three or four years. That has not been a major factor.

10783. *Chairman*: The safeguarding of your liquidity is, I suppose, the concern of your finance director?——Yes. As you know, we are blessed with Paul Chambers, who has a reputation in these matters; he is the Deputy Chairman, so I have the benefit of his advice from day to day. We also have a finance director, Mr. Menzies.

10784. *Professor Sayers*: May I ask one other question of fact? I do not know what is true of your company, but over the company field generally it is pretty clear that plans of capital spending during the last year have fallen to an appreciably lower level than in the previous year. Have you any idea of what has brought about that fall?——I understand that it very largely comes from the relatively smaller companies. That is my impression, but I have no figures to justify my view.

Chairman: I think we have covered all our questions, thank you very much indeed; it has been very helpful to us.

(The witness withdrew.)

(Adjourned until 2.15 p.m.)

SIR THEODORE GREGORY called and examined.

10785. *Chairman*: Sir Theodore, you are the second member of the Macmillan Committee whom we have had here today; Lord Brand was here this morning. We are very grateful to you for your memorandum*. We should like to get you to enlarge on some things. In paragraph 14 you say:—

"... there are two things about the present situation which impress me very much. The first is that changes in the rate of interest do have a much greater influence on the willingness to save and the willingness to borrow than we had been led to suppose by the fashionable thinking of the last two decades."

Could you say a little more about that?——*Sir Theodore Gregory*: I think there has been a great deal of defeatism, especially in English thinking, on the function of interest rates and their significance for the economy as a whole. There has been a tendency to assume that borrowers are indifferent to the rate which is charged them, and a complete neglect of the fact that people are more willing to save when rates of interest go up than when rates of interest are low. Also I have been impressed by the fact that, even in countries with much more disorganised monetary systems than the British one at its worst, changes in rates of interest have had very great significance both in the attitude of borrowers and in the attitude of depositors and savers. Thinking specifically of the case of Greece, I conducted a five-year campaign to try and get the Bank of Greece to alter the whole level of deposit and interest charges, which they were originally quite unwilling to do. They subsequently did so with very surprising results; the level of deposits went up enormously, and the rate of borrowing fell back very significantly. I fancy that is true of a larger number of countries than current thinking appears to warrant.

10786. Do you think that the effects of the manipulation of rates of interest are rapidly observable, or that one must wait over a period to see the results?——Merely to put up the Bank Rate at a time when the banks are very liquid does require a powerful policy to reinforce it. On the other hand, a rise in the rate of interest has immediate effects on such an organisation as the new issue market. One of the most striking phenomena of last September was that it killed the issue market for the time being stone dead. I think also that so long as deposit rates and savings rates follow the Bank Rate there is an immediate effect on willingness to save. As regards commercial borrowers, I would agree that the effect tends to be delayed, but in certain parts of the monetary field I think the effects are much more immediate and the psychological consequences much more marked than current thinking, at any rate as it was until last September, has been prepared to admit.

10787. *Professor Cairncross*: Is there much evidence for this that one can point to specifically, other than a general impression? Take the effect on saving, for instance?——There are so many other concurrent factors. I would not like to commit myself about the position in the United Kingdom because I have not looked at the figures. As regards my personal experience elsewhere I was very much surprised how quickly in fact depositors did respond, in spite of the fact that lack of confidence in the Greek currency was much more marked than it has ever been in the pound sterling here.

10788. In the Greek case did savings also change, or was it a change in the form in which money was held from currency to deposits?——There was both. There was a change in the willingness to save. Conditions are so unlike English ones that one would have to go into

* Memoranda of Evidence Part XIII No. 11.

a long technical explanation; but the fact is that the rise in bank deposit rates in Greece did induce people to hold currency instead of sovereigns. That is very significant; it overcame not a liquidity preference but a gold preference.

10789. *Professor Sayers*: That would tend to indicate that the effect of the rise in interest rates was to restore confidence?——It was partly the mere attraction of the rate. After all, in countries in which there is a gold market in which holders of gold are not very certain of their legal position, they hold sovereigns just because there is nothing else to hold, and the mere fact that they are offered a higher rate of interest is a sufficient inducement to switch from one to the other. I do not think that (in under-developed countries particularly) people have clear ideas about liquidity preference; they simply say: "What is going to happen to our money if things go on like this?"

10790. *Chairman*: What were the instruments of saving in Greece which benefited from this?——There was an enormous increase in time deposits in the banks.

10791. *Professor Sayers*: What was the range of interest rate changes?——The Greek government, like all governments, was bitten by the idea that there must be relatively cheap money. The official rates were in the neighbourhood of between 5 per cent. and 7 per cent. They put up the rates to somewhere between 9 per cent. and 12 per cent. I know these are very high rates, but one has to make allowance for semi-oriental countries, where the average rate is much higher anyway than it is here.

10792. *Professor Cairncross*: If you were looking at conditions in this country, would you think that the impact on the borrower would be primarily through stocks, or would you be thinking of the effect on long-term investment?——Partly on stocks; I also think that if one is contemplating a "real" capital investment in building or anything else, one is rather deterred by the fact that the rates suddenly shot up from the 5 per cent. to the 7 per cent. level: I think one defers expenditure. I would if I were a speculative builder.

10793. Even though the rise was in short-term rates only?——Even if it were only short-term rates, there is always a repercussion on the long-term rate; and in the new issue market particularly (I am not talking of fixed interest bearing securities, but of new issues of equities) I should have thought the facts justified the view that one cannot rely on the current rate of disposal of new securities continuing when the Bank Rate rises very sharply, even though one may suppose that it is only for six or nine months.

10794. *Professor Sayers*: If one is expecting the efficacy of Bank Rate to be partly through the long-term markets, what case is there for the authorities taking action to accentuate that effect by open market operations in the long-term market?——I do not know that I really have any decided view about that. I should not on general grounds be averse to operating in the long market if I thought it was necessary. I think it is entirely a question of fact; in principle, if I could only influence the situation by operating on longs, I would do so.

10795. *Professor Cairncross*: Including selling longs?——Yes, provided of course that the market would let me do so.

10796. *Chairman*: Is that not probably a most material qualification?——I was very much impressed by the evidence which was given by the General Manager of the Union Discount Company before the Parker Tribunal. That company was in fact the market in certain short-dated securities. He thought that we had allowed things to drift last year to the point when operating through the sale of securities might very well have been ineffective and might simply have smashed the market.

10797. You regard it primarily as a practical market question?——Yes, I have no preconceived idea, like that of the Federal Reserve, that a central bank may only operate in bills and shorts; I would not accept that for one moment.

10798. In the earlier part of your memorandum you refer to the moral aspects involved in central banking; this is not one of them?——To my mind not.

10799. *Professor Cairncross*: You would see justification in the Bank of England on occasion cutting the price at which it was prepared to make sales of Government bonds well below the market price, and therefore establishing a new low market price?——Undoubtedly.

10800. Is not this done in South Africa?——There is no open market in South Africa; that is the real truth about it. That is one of the difficulties, although there are now more than promising beginnings. It is not really possible to practise open market policy unless there is a highly developed money market; when there are only four big banks, and when the real open market is in the hands of building societies and so on, things work very differently. But I cannot imagine that a central bank would be inhibited from pursuing any repressive policy if it thought it necessary at any given moment in time.

10801. Your judgment would be based entirely on whether it was effective?——Decidedly; and I would say that one would limit one's rate of loss by acting as soon as possible. If the central bank waits until the market is in such a disorganised condition that it has to suffer very severe losses, I agree that it might find itself in a very difficult position. It would need big reserves in the central bank to stand situations of that kind.

10802. *Chairman*: Putting aside losses that the central bank might inflict upon itself, perhaps you would consider the losses inflicted on those who would be expected to operate in the market year in and year out?——I agree that there is a very difficult problem, if we are thinking of the jobbers in this market; but there again I would say that very heavy losses are only likely to be incurred if the situation is left to drift too long. That was the real tragedy of last year. One might have reached a situation when very heavy losses might have been inflicted on the jobbing market without any considerable effect on the credit situation, because nobody would buy at all at any price.

10803. *Professor Cairncross*: Do you see any difference between that situation and a situation where the Government is a constant seller of bonds because it has large requirements to finance and attempts to press its sales very vigorously? Might this not involve acquiescence in a permanent fall in the price of bonds?——Why permanent?

10804. Are not people's expectations about the future price of bonds governed to some extent by current operations, especially by the Government, in the market, so that if the Government was selling heavily and quoting lower prices, that might force the market down and let it settle down?——It would require a very curious situation in which that could arise. I should imagine that it could only arise if people thought that the monetary system was so completely disorganised that there was no chance of recovery over a period much longer than the average life of a short bond. Then one would have to cut one's losses anyway to get to a saner situation.

10805. Does this mean that you think the price of bonds is geared in some close way to the expected rate of return on short-term investments?——Not the very long ones, because they did not fall very much even last September; but only going up to ten or fifteen years, yes. If people thought that over the next decade the requirements of monetary policy would call for an average level of rates higher than in the last decade, I think that they would be right not to buy bonds except at an appreciable discount on their present price; but that is a different thing from saying the central bank ought not to sell bonds.

10806. Do you feel that the central bank in this country has some freedom of manoeuvre in the handling of short and long rates, and can for instance push up long rates without necessarily pushing up short rates at the same time?——If it were known that the central bank was deliberately selling in order to depress the level in long rates, that would surely have some effect on short rates. It really depends on the view taken by the market as to how long this policy is going to continue. From the standpoint of some investors, let us take insurance companies, which have a quasi-perpetual life, it might be extremely attractive to buy long-dated at what they would call bargain prices if they thought that within the next two or three years there might be a recovery.

10807. But the rise in long rates in your view, if I understand it, would not necessarily provoke a substantial rise in short rates?——Suppose that there was a fall of fifteen points in a thirty-year bond, and I as an institution am indifferent to what I hold from the standpoint of my responsibilities to my investors; I am not at all sure that I would not sell some shorts and buy some

longs. If I were an insurance company, provided I thought that this was really only in order to effect a readjustment of the monetary situation *de facto*, I should buy longs. If I thought that this was an indication of the central bank and the monetary authorities generally that they took a very gloomy view about the long-term prospects, I do not know what I should do; I would probably hold shorts.

10808. An insurance company might have a relatively small interest in shorts in the ordinary sense of the term?——If there was only a very small interest in shorts, and if it were supposed that the operations of the central bank were not intended to effect a permanent change in the monetary situation, then I would be inclined to say that the reaction on shorts might be very small. It depends upon how the market takes it.

10809. *Professor Sayers*: Suppose that instead of this being ascribed to a very gloomy view on the part of the monetary authorities it was ascribed to a very optimistic view; suppose that the authorities believed that there was going to be a persisting demand for capital development and that therefore a relatively high long rate was appropriate, not merely now but for some time ahead, and on that ground they thought it right to push long rates up somewhat by selling long-term Government securities at rather lower prices than had prevailed. That is not a gloomy situation; it is a situation in which the authorities go quite deliberately into higher long-term rates. In that situation what would you expect to happen about short-term rates, and what do you think the authorities should do about short-term rates?——If they really took the view that over the next five or ten years requirements were going to be so large that a higher long-term rate of interest was justified and indeed imperative, then I think they should also operate on the short rate, because I do not like to see too much of a spread between the trend of long rates and the trend of short rates. That is on the assumption which you put that there really is a deliberate intention to force the long rate up.

10810. Ought we to add the assumption that the authorities made their view known? Would that be relevant?——If they made it known I should think that there would be instantaneous reaction on shorts. If people were told that long rates were going to go down by five points, the temptation would be for everyone to switch from shorts to longs, and that would affect the short rate.

10811. *Professor Cairncross*: I would have thought that it was open to the central bank to keep short rates low if it so chose, as it did up to 1951, provided it was prepared to create enough cash, and that although the market pressure might be in the direction of a higher short rate it would be possible to impose and maintain a ceiling on the short rate?——You are assuming that the central bank would be prepared to increase the money supply in order to keep the short rate where it is. Could it do that without affecting the long rate again? Suppose that the central bank pushed out a lot of money by open market policy in the hope of keeping the short rate down; it would do that for two or three months, but if it were known to be doing this in order deliberately to increase the spread between long and short, surely there would be some further reaction on the long market.

10812. What is your comment in the light of what happened until 1951? There was clearly a very rapidly growing spread between short and long rates over that period, but it did not seem to provoke anything untoward?——I would not like to comment on that because I was not here at the time. But I should have thought that the Bank could not operate too much in one market without directly or indirectly affecting the other.

10813. *Chairman*: Is that because you do not regard the money created for the purposes of operating in one market as dedicated and confined to that one market?——Once the money is out it is out.

10814. *Professor Sayers*: You mean that there is such contact between the various parts of the market that money moves readily from one part to another?——It is not as if there was only a supply of Treasury Bills and a supply of thirty year bonds; there are intermediate and short-term stocks and so on. There must be a percolation through, I should have thought. But I am speaking with great diffidence about this; you are asking me questions which are outside my professional experience.

10815. *Chairman*: Why would you not like to see a big spread between short-term rates of interest and long-term?——I would say that it is really, to use a much abused phrase, a little unnatural; I base this on a sort of feeling that it cannot be right.

10816. Does that mean that you think that it would inherently correct itself over a period and that the spread would shorten?——I think it would set loose forces the ultimate effect of which the Government could not control. Deliberately operating in two different directions at the same time in two different markets which are not water-tight at all seems to me a horribly difficult thing to do; I would almost say an impossibility in the long run. In the short run one might have changes in the long-term rate which do not reflect themselves on the short-term rate, and *vice versa*; but I do not think anything like the policy envisaged by Professor Sayers, as a set policy over a number of years, would be possible, if the authorities operated in two different directions.

10817. *Professor Cairncross*: It has sometimes been put to us that, while there are a lot of people who are interested in securities with a maturity of less than five years, and a great many interested in securities with a maturity of more than ten years, there is a certain weakness in the market intervening between these two maturities. Have you ever noticed anything of that kind?——I would not like to say. I have not operated on the London securities market; I would simply take the market view about that. But I should have thought that in a properly organised monetary and banking system there must be some kind of organic, if loose, relationship of the whole complex of rates; I cannot get away from that.

10818. *Chairman*: In paragraph 1 of your paper you are speaking of your "experience of the kind of *moral*, as well as of the *technical* issues which confront those engaged in central banking." What do you regard as the primarily moral issues which central banking faces?——I was thinking of the position of an individual who is possessed of prior information of great pecuniary value to himself and to others; and also of the general responsibility: whether one is doing the right thing or the wrong thing is an ever present preoccupation when one is dealing with these things. For instance, there is the problem, to take a specific British issue, of whether one ought, at a time when unemployment is threatening to increase, deliberately to operate on the market price in order to strengthen sterling. That is also a moral problem, not merely a technical one. It is a problem which, incidentally, countries like Greece and India have had to face several times.

10819. It is the problem of anyone with discretion to act on something which has social connotations and may, as you say, have moral ones. How far do you think the central bank should be independent in its judgment on that kind of issue?——I think that it ought to have a very large measure of independence. I accept (one has to accept) that under democratic conditions, if it comes to a complete ultimate show-down, the Government of the day will have to have the last word. What I am pleading for in this paper and in other papers I have written is that it should not be assumed that what the Chancellor of the Exchequer or the Government of the day thinks at a given moment of time must necessarily be put into operation without a very prolonged period of discussion and investigation.

10820. Accepting that as a principle which I certainly well understand, how would you operate it? Would you allow the nature of the debate to be exposed to the public view, so that contributions could be made to it by the public before the final decision is made, or would you have it all take place within the governmental machine behind the scenes?——I would never accept the view that it has all to be discussed at high level by official with official. I am saying that the central bank is not merely a Government department, and has the right to put its own point of view absolutely independently and quite fearlessly of the consequences. If you mean by public discussion ventilation of these matters by journalists and in the press, and not merely journalists and the press but also heated debates in the House of Commons, it depends of course on the issue. I would deprecate very widespread discussion before decisions are taken, simply because of the kind of situation dealt with by the Parker Tribunal: allegations of people using information for private ends, and all that kind of thing.

10821. *Professor Cairncross*: You say that the Bank must be free to put forward a point of view quite independently; surely a Government department like the Board of Trade can put forward a different point of view from the Treasury; it is quite independent?——I do not accept the analogy. I think it is one thing for the Chancellor of the Exchequer to have a very heated argument with the President of the Board of Trade or the Minister of Labour, but I do not think that that is quite the same thing as an argument between the Chancellor of the Exchequer and the Permanent Secretary to the Treasury. It is a different atmosphere.

10822. *Chairman*: It is inherent in your approach that you regard a permanent head of a department as not free to maintain to the full in discussion with his Minister his independence of view as to the right course of action?——No, not at all. People of the standing of the Permanent Secretary to the Treasury who are persons of great probity and of great intelligence no doubt express themselves with great freedom, and in a sense they are carrying out a public duty by doing so. But I do not think that the atmosphere in which these discussions take place is quite the same as between one Minister and another, or quite the same as that which in my judgment should be maintained between the Governor of the central bank and the Chancellor.

10823. Where does the difference come, when it is a discussion between the Minister and the Governor of a central bank whose constitution requires him to obey the directions of the Minister?——I do not think that he is quite a civil servant in the full sense of the word. I apologise for putting it as crudely as that, but that is the sort of thing I had in mind. I have seen this kind of issue; I have seen it in India between the Reserve Bank and the Treasury, and I have seen it in Greece. In India the problem was solved by the fact that everybody was a civil servant. The Minister of Finance was, after all, an Indian civil servant; the Governor of the Reserve Bank was, or had been, a civil servant, too. They were talking as professional to professional without the atmosphere which is likely to prevail in a country like this, with a fairly vigorous press and a very critical public opinion. In Greece I have seen the thing brought to its logical conclusion, where the Minister discharged the Governor of the central bank almost at five minutes' notice because they could not agree. The independent persons there were the two foreigners, an American and myself, who were members of the Currency Board, and we were perfectly free to talk to him as Minister to Minister. I have been very much impressed by my experience in both these countries. The more public opinion becomes aware of the significance of these monetary policy issues the more important it is in my view to differentiate between the Governor of the central bank and the position of a very high civil servant inside the Treasury.

10824. *Professor Cairncross*: Was it the constitutional position of the Governor of the Bank of Greece or the Governor of the Reserve Bank of India that was really the important factor, or was it personal relations and working relations between those Governors and the Ministry?——The personal relationships were very important; but it was also the constitutional position.

10825. Could you tell us how the constitutional position affected it?——When a man is a little uncertain of his position, as a Governor of a central bank in one of these Balkan countries is apt to be, I do not think that there is quite the same objective attitude towards the solution of problems as there would be if the man was quite certain that whatever he said it would not affect his position.

10826. Does not affect his position in the sense that he will not lose it?——He might in the long run find that the position was intolerable, and resign; but the unpleasant side of it is not so immediately apparent. I know that the Governor of the Bank of England is subject to directives, but the mere fact that a directive has never been issued to my mind shows that that is not a suitable way of dealing with these things.

10827. *Chairman*: You think that this power, which has never been exercised, for the Treasury to issue a direction to the Governor of the Bank is not the best way to deal with the situation?——I am perfectly certain it is the worst possible way. If it is used at all frequently it indicates that things are so bad that one has to change the situation either by changing the persons or changing the policy, or both. I cannot imagine, considering the importance of the Treasury in the money market today and the importance of Bank operations for the Treasury, that these matters can really be settled by a series of directives addressed by the Chancellor to the Governor. The Governor would be forced to resign if it took place frequently.

10828. It is an inappropriate instrument for what you want to do?——Yes. The majority of countries have these directives now, but as far as I know they are not made use of. In Australia, I think, there have been some rather sharp passages in recent years; but I am not seized of that particular point. A power to direct may be useful as a paragraph in a Bank Act, simply in order to satisfy certain elements of public opinion, but I do not think that as a working instrument of policy or of administration it is worth the paper it is written on. I can imagine cases where there might be very real conflicts; but even then, if the Treasury had to use the directive it would surely be better to change your Governor or your Chancellor.

10829. Can you think of a way to express the relationship you want, which is not that of complete independence as I understand it, which does not involve this formal power to issue a direction?——I think that that power would probably have to be retained as the ultimate sanction; but I should have thought that the only way of settling these things is by conventions of the constitution that people behave in a way to make the machine work, including the right of the Governor to press things very hard before he finally agrees to do what he is told.

10830. *Professor Cairncross*: You are not laying stress now on constitutional relationships?——I do not. I do not think that it ought to be part of the normal working operations for the Treasury to say: "You do this; you put the Bank Rate down." I do not think that things would work like that for a week.

10831. *Chairman*: In the Bank the Governor is only the chairman of a group of people, each of whose votes counts for one. Do you think the present set-up adds to the weight with which he can debate policy with the Chancellor before it is decided upon?——Yes. On the whole I think a reasonable balance of power has been reached inside the Court of the Bank. It is no longer composed, as it was at one time, exclusively of merchant bankers. It now includes very considerable elements drawing their inspiration and strength from other circles of society. It may possibly be a matter of discussion whether to change one or other personality or change the composition a little bit, but on balance I should have thought that we have what we want. There is trade union representation, commercial representation and financial representation. If the Governor is really going to act with knowledge I should have thought that this was on the whole a pretty good scheme. If I am asked whether Treasury officials ought to be on the Court, all I can say is that the only case I know where this matter has been seriously discussed was in the United States, I think in 1935, when the Secretary of the Treasury and the Comptroller of the Currency were taken off the Federal Reserve Board because they bullied the rest.

10832. *Professor Cairncross*: Do you think that the strength of the Governor must to some extent rest on public opinion and the extent to which he is able to carry public opinion with him?——Yes. That is one of the points which makes me inclined to think that he ought not to be assimilated to the position of the ordinary very high official, because I do not think that an ordinary high official ought to appeal freely to public opinion.

10833. You think that the position of the Governor in this country must rest at least as much on his standing with the public as it does on any constitutional rights? If he is urging something on the Chancellor, surely the force with which he urges it must depend on his feeling that he could carry the weight of expert opinion with him?——Yes; given of course that these discussions are conducted privately.

10834. *Chairman*: How is he to be in a position to say that public opinion is on his side unless the issue can be ventilated so that public opinion can express itself?

It is a very technical matter; all these issues are very complicated?——There are organs of opinion which represent very important elements of opinion: papers like *The Economist* and the financial columns of *The Times* and the *Manchester Guardian* ventilate issues even before they come to the Bank. I was not here last September except incidentally, but I suppose an approaching crisis like the sterling crisis of last autumn cast its shadows over the financial press.

10835. *Professor Cairncross*: The financial press did not emerge with flying colours?——That I am not prepared to deny.

10836. I want to put to you that the standing of the Governor would depend not on the attitude he assumed in respect of any one issue but on the feeling of trust the people had for him and in his judgment, and that that feeling of trust would require cultivation over a period of time?——He does in fact express his views publicly at bankers' dinners.

10837. After the event?——Yes, but that gives the public an idea of the sort of man he is.

10838. We have heard a good deal of evidence which indicates a certain distrust of the Bank of England. I wondered whether you felt that anything could be done to remedy the existing state of affairs, or whether you felt that banks are always an object of mistrust and that nothing can be done?——I should say that so long as there is a large body of opinion of a collectivist type there is an opening for that kind of criticism of another institution which is part of a system which is not collectivist. My own feeling in these matters is that in considering the position of the Governor of the Bank of England one has not merely to consider the internal position but the reaction in the whole world to any significant changes in his position *vis-à-vis* his powers and the Chancellor's powers. That I do take very seriously.

10839. *Chairman*: Might we shift for the moment from the Governor as a single figure to the Bank itself, because after all it is the Court that is responsible. You say that you cannot consider facts or judge the present situation without relating it to the history of the Bank of England and its standing in the world. Do you think that its status today in world opinion is the same as it was twenty-five years ago, or forty-five years ago?——That is a horribly difficult question to answer. I find my friends in places like Zürich, Frankfurt and New York are still enormously impressed by the historical position of the Bank, and are very worried indeed by any suggestion that the position of the Governor should undergo any significant change. I am quite sure that, if it were assimilated to the position of the Permanent Secretary to the Treasury, that would have a very bad effect indeed abroad. I do not merely consider this to be a matter of prestige but also of very considerable importance to the future of sterling.

10840. *Professor Sayers*: If instead of being assimilated to the Permanent Secretary to the Treasury he was assimilated to the Chairman of the Governors of the Federal Reserve Board, what do you think would be the effect on international banking opinion?——I am not trying to quibble; I should be inclined to say that foreign opinion really considers the President of the Federal Reserve Bank of New York as the operative head of the system, and I do not think they pay much attention to what Washington does.

10841. I was thinking of the way in which the Chairman of the Board of Governors of the Federal Reserve System is constantly defending himself explicitly in various quarters, official and otherwise, and is the head of an organisation which is constantly explaining itself and cultivating the support of expert opinion?——I think that it is going a great deal too far; I do not think it would work in this country.

10842. What is it about this country that makes such a system inappropriate?——Merely the fact that it has never been done. It might work all right. I am certainly not as afraid of that as I would be of the opposite thing, muzzling the Governor altogether and putting him under the Treasury. That I view with the greatest possible apprehension. There is after all the division of powers in the American constitution. I do not know whether it would be possible to assimilate the position of the Governor of the Bank to the position of the Chairman of the Board of Governors of the Federal Reserve System under British political conditions. I think on the whole it would be unwise. We have quite enough centres of dispute already; I do not think that we want to add to them. The Governor has the opportunity through press interviews to explain his point of view; I do not know whether one ought to give him the right to act as the Chairman of the Federal Reserve Board does, because I think far too much time is spent in Washington in washing dirty linen.

10843. May I put it just in this narrow way: would you encourage the Governor to go further in his cultivation of press contacts and so on?——I would. There has been a tendency for the Bank of England, in the past at any rate, to be a little too complacent in assuming that, because the City understands what it is doing, public opinion generally understands. I think that it would be a very good thing if occasionally he did directly cultivate a policy of explanation in popular terms, but I would not like this perpetual press hand-out which is the particular feature of Washington and which I think has done the Board a great deal of harm on balance. I do not say that the Governor of the Bank of England should spend his time interviewing pressmen and giving cocktail parties, explaining what he meant.

10844. *Chairman*: When you say that the Washington system has done a great deal of harm, do you mean that the Federal Reserve Board does not enjoy a status in the public mind in America?——I think that it has done so in recent years largely because it has pursued an independent policy *vis-à-vis* the Treasury. As you know, the money power in the United States is something which is regarded as very sinister and very evil; the whole *einstellung* is different.

10845. You have a singular experience to help us on this. What is the position of the Bank of England with the foreign banker since the war? Does he regard it as a monetary authority which arrives at decisions on monetary policy which are not subject to political control?——I do not think it is any good blinking the fact that there is terrible nervousness abroad about what would happen in certain political contingencies to the Bank of England. By and large the Bank of England being nationalised has not played a very big part; I do not think they regard the Bank of England as merely the slave of the Treasury. The prestige of the Bank of England is still astonishingly high, judging from such conversations as I have had at Basle and elsewhere with central bank governors.

10846. It is regarded, you would say, as a monetary authority which is able to arrive by and large at its own decisions?——I think so. There has been very great nervousness abroad about the trend of English monetary policy, but I do not think that that is specifically associated with any very grave weaknesses in the constitution of the Bank, or in the Governor of the Bank. It is very astonishing, considering the vicissitudes of the last twenty years, how high the prestige of the Bank is. But of course if one talks to bankers like the former Governor of the German central bank all they want is to strengthen the central bank against the government; that is their passion.

10847. *Professor Cairncross*: Would you agree that since the Macmillan Committee reported there has been far closer integration between monetary policy and other aspects of economic policy, notably fiscal policy?——Certainly.

10848. So that monetary policy has become very largely inseparable from the general economic policy of the Government?——Agreed.

10849. This is true whether one takes the aims of Government policy, including full employment, or the mechanisms for affecting demand. Would you agree that this means that the independence of the Bank of England is inevitably limited, to the extent that what is urged by the Bank must form ultimately part of a general policy framed by the Government itself?——Yes, I accept that.

10850. You feel however that it is still possible to maintain a kind of independence in the Bank of England in the formulation of the advice?——Not only in the formulation but also in the implementation. I feel that it is easier for a quasi-independent Governor and Court to go to the Government of the day and say: "In our opinion a rise in Bank Rate is imperative" than it would be even for a very respected and eminent civil servant to do the same thing. Of course anything the Bank does, just as anything the Treasury does, requires discussion with its

opposite number. One cannot work the thing in any other way; consider merely the question of how many Treasury Bills to issue, which must be discussed. The problems which arise from day to day are so numerous and so significant that because they are dealing as between equal and equal that does not mean that either party is in any way in a position to ignore the view and the necessities of the other party.

10851. Who do you think is the opposite number of the Governor in the Treasury?——I do not know; I wish I did know.

10852. Is not this part of the problem? If you take the Greek or Indian case with which you are familiar, was there somebody you could identify in the Treasury who was recognisably the counterpart of the Governor?——No, because the situation was rather different. The central bank in India was then largely concerned with the sterling balances and issues of that kind upon which no internal conflicts were really possible.

10853. The situation I have in mind is one that applies so far as I can judge to most nationalised industries. There is usually in a Government department one person or a group of people who are trying to follow what is going on in the field of policy concerned?——I take it that at the moment somebody like Sir Leslie Rowan would presumably be in charge of relations with the Bank of England. I do not know; that is the sort of question an outsider naturally does not put to his friends.

10854. *Professor Sayers*: What do you think should be the position in the Treasury or in the Cabinet of the person who is the opposite number of the Bank of England Governor?——The only person who can be the opposite number in the Treasury is the Chancellor. If you ask who is the expert who has to deal with the field of problems impinging on the Bank, that is a different matter.

10855. *Professor Cairncross*: If you say that the opposite number of the Governor is the Chancellor, you are according to monetary policy a weight in the formulation of total policy which you do not give to all the rest of it. It means that, if someone has a job in the Treasury seeking to integrate monetary policy into general economic policy in its relation to fiscal policy, for instance, any judgment expressed at the official level will not carry the same weight as the expression of monetary policy alone by the Governor?——I think that you are really rather proving my point. I should have thought that the proper person to be co-ordinating aspects and emphasising the points which are of particular interest to the Treasury is the Chancellor. The Chancellor can and should be advised by persons of the greatest eminence. After all, the Bank of England has its own advisers and experts to whom some one in the Treasury can go and talk before either party puts its final decisions before the two top men. If I were in the happy position of being adviser to the Treasury I would not want to go and talk directly to the Governor of the Bank of England, though I would like to talk to a lot of other people in the Bank. But when it is a question of arriving at final decisions I would put the thing to the Chancellor.

10856. If there is somebody considering hire purchase, somebody else considering public investment, and somebody else looking at the outcome of the Budget, all these people may as officials press their view on the Chancellor but without quite the same status as the Governor. There may also be people who are not trying to press a particular view in relation to an isolated field of policy but trying to see how the different bits of policy fit together. As I understand you, you think that the non-monetary aspects of policy can sufficiently be pressed on the Chancellor by civil servants; they can however meet one another and discuss freely; they have a departmental mechanism by which their views are summed up and digested?——I do not know enough about the day-to-day work of the Treasury to be confident about my reply, but I should have thought that the proper official inside the Treasury who really ought to be called on to do all this co-ordinating and high level thinking is the Chief Economic Adviser to the Government. Whether he does so or not please do not ask me. I should have thought that that is the natural chain of command: the Chancellor, the Chief Economic Adviser, the Chief Economic Adviser's staff and people in charge of the national debt and issues of that kind.

10857. The more commanding you make the Governor or the representative of the Bank of England the more difficult perhaps it may be to reduce monetary policy to its proper field as one element in the total?——You think that the danger is that the Governor dominates the Treasury instead of the Treasury dominating the Governor?

10858. *Chairman*: Do you think this is a possible consequence of the set-up?——There is always a play of personality; we might have a very strong Governor and a very weak Chancellor. But I do not think that that can be avoided under any circumstances, whatever the position legally or constitutionally may be. I always have taken the view that there has been such a neglect of the autonomous nature of monetary policy that I would rather like to see the Governor's position strengthened rather than weakened. There has been far too much tendency to assume that monetary policy is really a subsidiary of something else. I think that this is really frightfully important; not more important in some respects than budgetary policy, but much more important than full employment, cheap money, or any of these fashionable slogans. All my detailed remarks in reply to you really flow from that principle.

10859. *Professor Cairncross*: Do you think that there might be some mechanism, better than anything we have yet had experience of, for bringing the Bank of England into discussion on other aspects?——I do not know how far the advisers to the Governor meet the advisers to the Chancellor. I would very much like to see more intimate, even if you like day-to-day, contacts between people at that level; but when it comes to a showdown on a particular point then I think it ought to be between the Chancellor and the Governor. I do not see how it can be done in any other way, because if it is left even to very high civil servants they can in the moment of crisis be repudiated, the Minister can say: "Why was I not told about this?" That is the danger.

10860. *Sir Oliver Franks*: You said that monetary policy had a certain autonomous nature. Would you mind elaborating that? One of the things we have had put to us is that the opposite is true: that there are certain political and social ends which can be pursued by monetary measures, by budget measures or by quantitative or physical controls, and that there is a choice between these alternative ways of doing things, but that the dominant things are the social and political choices by which the objectives are expressed, and that therefore the problems with which a Chancellor of the Exchequer, or indeed a Governor of the Bank of England if he takes the full field into view, deals are not problems to which the word "autonomous" would naturally apply?——I would not accept that for one moment. I think that that has been the fundamental vice of monetary policy for the last twenty years, and has led us from one disaster to another. Money is central to the whole organisation of economic life; that is really what I mean by "autonomous". Society has twin pillars, the law on the one hand and proper monetary institutions on the other, and I would no more accept the subordination of the judiciary to the executive than I would accept the complete subordination of the monetary authority to the Treasury, simply because I think that the Treasury would always be tempted to subordinate the long-run needs to the immediate interests. I fully understand the pressure for, let us say, full employment, but I do not think that is the fundamental thing; I think that all the difficulties which we have suffered since the first world war, the hyperinflation of the twenties and the difficulties of the thirties, come from the fact that people have not been willing to accept the fact that the proper functioning of the monetary system is central in any kind of decent civilisation. That is why my objective is maintaining confidence in the currency; that is the autonomous end.

10861. Since the 1944 White Paper, with the embellishments which Mr. Butler added in 1951 or 1952, we have had general agreement, whoever was in power in this country, that full employment, a high level of demand and a dynamic and growing economy were prime objectives to which Governments had committed themselves, and to which therefore the various measures which they

might adopt, whether monetary, budgetary or quantitative controls, should be adapted. Are you now saying that Governments of this country, whether Conservative or Socialist, have committed themselves to false gods over the last twelve years so far as monetary matters are concerned, because they have both implicitly and explicitly denied them autonomy by virtue of what they have said?——I accept that except for one qualification: for "false gods" I would say "subordinate gods." It is not false policy to wish to have a dynamic economy or full employment, but I think that it is very dangerous to have one or the other or both if the monetary system is falling to pieces.

10862. It would appear from what you say that you only feel happily able to argue for the position and relative independence of the Governor which you think right, provided that the electorate and the Governments of the day do not make as large claims as they have been making these last twelve years?——You are pushing me to an extreme; but I should accept that. I think that there has been a miseducation of the public, to put it that way; I think that there has not been sufficient emphasis either in academic circles or business circles or administrative circles on the absolute necessity of preserving monetary institutions in a sound condition, and I think that all our difficulties flow from that.

10863. In the evidence which has been put before us we have had three types of view about the stability of the currency. Taking that as one of the objectives which the Macmillan Committee named as objectives of monetary policy, one view is the one you have put forward, that it is an autonomous end, something worth pursuing for its own sake in relation to its social quality. Another view is that there are a certain number of prime objectives of governmental policy, of which stability of the currency is one, and a high level of employment a second, and so on, that these prime objectives may not all be easily reconcilable, and at particular moments not reconcilable at all, and that the job of the government is to make the best attempt it can in the measures that it actually takes to work along with all of them and prejudice none too much. The third view is that the stability of prices is subordinate to the important objectives of Government, which are a certain level of activity in economy, and a certain balance between consumption and investment. Are you deliberately relating your views on the position of the Bank and of the Governor to your views on the autonomous objective of monetary policy?——That is right. I would not for one moment deny that in the day-to-day operations of Government, the balance of political and social forces being what it is, considerable attention has necessarily got to be paid to all these other elements; but I say that in every case of doubt I would plump for the autonomy of the monetary system, because I think in the long run everything else depends on that.

10864. Given the interpretation of events which is current in a large part of this country, and looking at the last thirty years, the electorate has known what it was doing when it elected Governments which held these other views, in the sense that it was trying to avoid something which it believed that it disliked and distrusted in the past; therefore your view, if it was to prevail, would entail fairly complete re-education of most of the people in this country?——I should have said that after the experiences of the last twenty years re-education would not be quite as difficult as one might have imagined it. After all, take the case of Germany, where probably things have swung to the opposite extreme: the fear of inflation is there so great that the authorities cannot do anything that might be hinting at instability of the currency. In this country there has been a very sad neglect of the absolute necessity of inculcating that before anything else. So long as we have a society based on pecuniary relationships those pecuniary relationships should not be subject to arbitrary action. The first thing to do is, I would say, to maintain the stability of the currency, by which I do not mean absolute stability of prices. I think that that has been neglected to an appalling extent.

10865 *Professor Cairncross*: What changes do you think desirable in the present constitution of the Bank of England? Do you think that it would be worth while to have directors of the Bank drawn from different groups, including the clearing banks?——I am not in favour of that. I think that it would be impossible to work the British banking system by selecting one individual to represent the clearing banks on the Court of the Bank of England. As regards the composition of the Court, I do not think that any very fundamental changes are required. It may be necessary to strengthen the non-City elements a little bit; I do not know. I would like to bear the views of other people on that. As regards the general conduct of affairs I think there is a good deal to be said for rather more information being available to experts and a rather closer contact particularly between the Governor and non-banking elements in the community, but I am not prepared to say that I want to see any very fundamental changes.

10866. Do you think it worth while to work towards more directors being appointed from within the Bank of England?——There is the danger of bureaucratising the Bank of England. Perhaps there is a case for two more full-time directors; I do not know.

10867. *Chairman*: Why do you call it "bureaucratising" it? Why are they more bureaucratic there than anywhere else?——I can only refer there to my own personal experience of life. I was twenty years an academic and twenty years a *quasi* civil servant, and the atmosphere of a university and the atmosphere of a Government department are simply not the same. I do not think that the relationship between the chief of an organisation and his staff is the same as the relationship between the chief of an organisation and outside directors who are there to advise him and to participate to some extent in the administration, but not to the full extent. It is a question of atmosphere; one cannot define these things in specific terms. If one goes to the Bank of England and sees the way in which the non-official directors deal with the Governor and the way the official directors do, one is aware of a certain difference of atmosphere, with all the best will in the world to conceal it; it is inevitable.

10868. You think that, if more of the total directorate was appointed from inside the Bank that would tend to give the Governor larger powers in the control of the Bank's policy?——Undoubtedly.

10869. *Sir Oliver Franks*: It might be argued that it would give him both larger and smaller; larger in relation to the determination of the policy, smaller in relation to the amount of purchase he would have in arguing with anyone outside the Bank?——Yes; but inside the Bank it would strengthen his position. I do not say that he would want it to, but it is the inevitable consequence arising from a certain psychological situation.

10870. *Professor Cairncross*: So, just as you want the Governor to be as independent as possible of the Chancellor, you want the members of the Court to be as independent as possible of the Governor?——Yes, I do. I think that free discussion is absolutely essential; I do not think that these things can be settled by a chain of command on army principles.

10871. *Chairman*: You do not think they require also full-time professional attention?——I certainly think they do; I would be prepared to consider strengthening the number of full-time directors. I do not know if there is a very strong case, but I certainly would not object to it. But I would object to the elimination of the independent director; I think that that would be a very bad thing.

10872. *Professor Cairncross*: You will have seen suggestions that it might be preferable not to alter the Bank Rate exclusively on a Thursday. Do you see any merit in that suggestion?——It would add to uncertainty. I do not think that there is any great merit in it. There may be crisis events, of course; but if you are suggesting it should be settled on Friday and announced on Monday, as I believe the Attorney General suggested to the Parker Tribunal, I think that would be very undesirable. There is a great deal to be said for people expecting changes on a certain day if there is going to be a change at all. Everybody has accommodated himself to that position. It might lead to the result that the importance of a change might be exaggerated because it had not happened on a Thursday.

10873. Do you not think that the situation in which a change in Bank Rate was in suspense might be more

frequent than you have taken for granted here, if the Governor was free to make up his own mind?——Changes in Bank Rate might be more frequent, I agree. I think that they ought to be more frequent; we have become too accustomed to the idea that the Bank Rate must not change.

10874. That is not what I was saying. I was asking whether there might not be an argument, given that the Bank of England was a largely independent institution, about whether the Bank Rate should alter, and in consequence of that there might be a long period of doubt whether it was going to be raised or not. The situation of September 1957 might not be quite so unusual as you represent it to be here in your paper?——I have a feeling that in practice the situations in which a change in Bank Rate is indicated one way or the other by and large announce themselves. In September 1957 it was a very unfortunate state of affairs, the discussions on the Bank Rate change dragged on for a week. I do not think that the issue which was considered by the Parker Tribunal would have arisen if they had settled it on the Wednesday and announced it on the Thursday. But by and large I think that people in the City judge by market rates and the position of the exchanges. I take it that the Treasury officials handling these things do the same. I do not think that the points of conflict in practice are so great as one might imagine, simply because there is, after all, an instructed public opinion of experts.

Chairman: Thank you very much, Sir Theodore. We are very grateful to you.

(*Adjourned until Thursday, 23rd October, 1958, at 10.45 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-SIXTH DAY

Thursday, 23rd October, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.

W. E. JONES, ESQ., O.B.E.

PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH

GEORGE WOODCOCK, ESQ., C.B.E.

MR. R. T. ARMSTRONG, *Secretary*

MR. G. PENRICE, *Statistical Adviser*

PROFESSOR J. R. HICKS, F.B.A., Drummond Professor of Political Economy in the University of Oxford, called and examined.

10875. *Chairman*: Thank you very much, Professor Hicks, for the two papers* with which you have supplied us.——*Professor Hicks*: I hope that you will forgive my not having prepared something specially for the Committee. I do not regard myself as a monetary expert, and I did not feel that I had anything to say to which I particularly wanted to draw the Committee's attention. But I find myself writing on more or less this sort of question now and again, and when some of your members took an interest in the paper I read at Manchester I was glad to be able to come and answer questions on it.

10876. We are very grateful to you. Might we take the Manchester Statistical Society paper first? There is one passage I would like you to enlarge upon. At the top of page 14 you write:

"And so we pass to the current situation, for which I have so far done no more than provide a background of history. The rise in the long-term rate since 1946 (as shown on the Chart) has been quite startling; nothing like it has occurred, in peace-time (if we include the aftermaths of the wars with the wars themselves) in all the two hundred years which we have surveyed. There is nothing extraordinary about a 7 per cent. Bank Rate; that has happened before; but in former times it was not implied by a high Bank Rate that the long-term rate would behave in this fashion. Excepting in the aftermaths, when a great weight of long-term Debt has overhung the market, a 7 per cent. Bank Rate has been consistent with a long-term rate which has not passed outside its traditional norm of 3–3½ per cent. It is the 5 per cent. long-term rate which is the extraordinary feature of the present situation."

I am not quite clear how closely you relate the high Bank Rates which have been a feature of recent years with the persistently high long-term rate?——It seems to me that it is one valid way of looking at the thing (I would not claim more than that) that the long-term rate is related to the expectations which people have of the course of interest rates in general in the relevant feature; that if in fact there have been frequent periods of credit stringency in the recent past and the reasons which have led to them have not been dispelled, so that there is reason to expect a recurrence of credit stringency in the sort of future to which people look forward, then people can be expected to be conscious of the danger of capital loss in investing in long-term securities; that that would make them unwilling to purchase long-term securities; and that that would affect the long-term rate.

10877. *Professor Sayers*: Is your argument that, if one says that the high short-term rates have been primarily due to balance of payments struggles, the long-term rate is high because people expect that we shall continue to have balance of payments difficulties and that we shall continue to deal with those situations by short rates?——I agree with that in general, though I am not quite sure that I would fully agree with the last half-sentence. The only qualification I would make to that is that I can conceive of circumstances in which, in spite of the fact that the short-term rate was not overtly raised, there was nevertheless the sort of credit stringency which would react back on the long-term rate in much the same way. I may be wrong about that.

10878. We are thinking of expectations here. You think that expectations are a little broader than the mere expectation of high short rates?——I think so; a little broader. I would not say more than that.

10879. They are expectations of high short rates introduced for other conditions that would make for low prices on long-term bonds?——Yes. I now fully agree with critics of some of the earlier versions of this, that it is expectations of the long-term rate which react back on the present long-term rate; and it seems to me, as I explain in a footnote on page 11 of the paper, that in most cases that is capable of being analysed in terms of behaviour in response to expectations of short rates. But that seems to me to depend to some extent upon the institutional arrangements and so on, and that might not be equally valid in all cases.

10880. *Professor Cairncross*: Does it make any difference whether you take the origin of expectations for this as being continuing inflation and therefore rising prices or as being credit stringency and high short-term rates of interest? There are some passages that you write here where you seem to be emphasising the likelihood of high short-term rates and of consequent high long rates, but later you seem to move to emphasis on expectations of inflation. Do you draw a distinction between these two states?——Not too much, I do not think. I think that it is the expectation of continued inflation which is dealt with in a half-hearted manner which makes for an expectation of high interest rates, as I say on page 15.

10881. *Professor Sayers*: What difference would it make in your argument if you assumed instead that the inflation situation was not being dealt with at all?——Then one would get the kind of situation which one got in the late 1940s, which would be consistent with even lower long-term rates.

* *Note*. The two papers supplied by Professor Hicks were:—

The Future of the Rate of Interest, a paper read before the Manchester Statistical Society on 12th March, 1958, and published by the Society.

A World Inflation?, from *Essays in World Economics* (Oxford University Press, 1959) (see Question 10912).

As these papers are published elsewhere they are not included in the Committee's record of evidence.

10882. But long-term rates were rising?——Admittedly, yes.

10883. *Professor Cairncross*: Do we not get rising long-term rates both ways? If there is inflation and no attempt to control it we get a rising long-term rate; if there is some incipient inflation and credit stringency then we get a rise in the long-term rate?——It is rather hard to say. The distinction appears to be a rather fine one, because we are dealing with expectations. The situation which is being supposed is one in which inflation is taking place and no attempt is being made at present to control it. There may nevertheless be a rational expectation that sooner or later attempts will be made to control it; and that will have the effect in question.

10884. If you contrast the period between 1945 and 1951 and the period between 1951 and 1958, the course of bond prices is not so very different in the two periods, although in the one period short rates were constant and in the other short rates were being pushed up?——I do not question at all that, as is obvious, in the earlier period we were starting from a position where deliberate attempts had been made to depress the long-term rate; as soon as those matters were relaxed, or relaxation could be foreseen, it was quite natural that the long-term rate should rise.

10885. *Professor Sayers*: But it went on rising; it was up to 3½ per cent. by the autumn of 1951, which was appreciably above the wartime level?——Yes.

10886. *Professor Cairncross*: We are interested to know how far it is possible to bring long rates up independently of short, and short rates independently of long. Do you feel that the two sets of rates are very closely connected?——I am sure that there is a great deal of latitude in the short run. Most of the historical experience from which I was generalising here is by and large in a period in which no very deliberate attempts were being made to separate the two rates; there was very much less policy about the whole thing. When there is a great deal of policy it seems to me quite evident from recent experience, perhaps in America even more than here, that in the short run they may be made to move very differently. But I still feel that such movements set up expectations which have effects, so that, once the authorities turn their backs, things will begin to move back into a more or less orthodox form.

10887. *Chairman*: You have used a phrase which rather sticks in my mind: "jabbing at the Bank rate". Is there a hint of criticism in that, as being an undesirable thing?——I think that it is an undesirable thing, in the sense that it would be much nicer if you did not have to do it. I do not mean that it is necessarily undesirable.

10888. You mean to deal with the situation you are facing?——Yes.

10889. The situation I think you are dwelling on there is a shortage of reserves allied with a fixed exchange rate. Do you think that "jabbing" itself, which was forced on the authorities by these conditions, had any material effect on expectations with regard to the long-term rate?——I think that it does so only if it is necessary to do it very frequently.

10890. *Professor Sayers*: In the 19th century they did "jab", but less frequently?——Indeed they did, yes.

10891. We have talked about the effect of the prospect of inflation on expectations. May we look at what lies behind the expectations? At the top of page 3 you say: "There is some presumption that when the Pure Rate goes up, the Representative Rate goes up." You do not look at whether there is any presumption that when the Representative Rate goes up the Pure Rate goes up. Would you argue that there is no such presumption?——I do not know. I feel that economists in the past have very much exaggerated the relation between these things. I find the mechanism for that back effect not very easy to understand. I would not exclude that it can occur, but I do not find it easy to understand.

10892. Could we look, in that context, at what happened in 1946, 1947 and 1951? The effort to beat the long rate down to below the wartime level failed. It not merely failed, but the long rate went appreciably higher than the wartime level. Was it purely expectations of inflation that led to that? Was not there any fear that the pressure for capital development was such that there was going to be a continuing pressure on the capital market, so that a low long-term rate was untenable? Was not this an element that was in press comment throughout those years?——Yes. I certainly would not exclude that as a possibility.

10893. Would this not be a case of the Representative Rate pulling the Pure Rate up?——Yes. I do not disagree that it can happen.

10894. Is not that rather important when we are looking at a future rate of interest? You have rather taken the line in your Manchester paper that, if the long-term rate is persistently outside the 3 to 3½ per cent. range, we are in an unfortunate position, from which we should seek to escape?——I think I have, but that has been largely on a matter of historical experience. In periods of past history, such as the railway age, we did not have to put up with these very high rates of interest on gilt-edged.

10895. But when the break-through down from the 3 per cent. rate occurred, it was at a period when there seem to have been less opportunities for investment at home. Does not that suggest that the Representative Rate has some effect?——I think there is quite possibly something in this; I was only suggesting that on the basis of historical experience it seemed to be rather smaller than one expected at first sight.

10896. If we are looking ahead to rates of interest in the 1960s, would you attach any importance to this point?——There might be something in it, but I would not expect it to be really large if the other difficulties were overcome.

10897. You attach much more importance to expectations of general price movements, for instance?——In so far as that affects the balance of payments, and so on, I would certainly attach more importance to it.

10898. *Professor Cairncross*: Suppose you take the most closely related similar period in the past, between 1906 and 1913: you show there a quite remarkable rise in the long-term rate of interest, and a corresponding fall in the price of Consols. Was that not accompanied by a tremendous amount of pressure on the capital resources of the country, which may have reflected itself in rising short rates but did correspond to a demand for capital that was much larger than it had been in the recent past? Does not that suggest that simple productivity factors may influence the movement of long rates?——I do not question that it was a matter of the increasing opportunities for investment of capital abroad and the pulling up of interest rates in this country to a level which was appropriate to the greater mobility of capital.

10899. Not greater mobility, but greater productivity? Capital had been mobile for a very long time.—*Professor Sayers*: Was it not expectations of great profits from real investment that lay behind this rise in the rate of interest?——I am sure that had something to do with it, but I am not willing to agree with Professor Cairncross, though he knows much more about this matter than I do. It seems to me that factors which I should call mobility must have had a great deal to do with it, but I am sure that there were other things at the same time.

10900. But even if you talk about it in that way, is it not a case of the Representative Rate pulling the Pure Rate up?——Yes, certainly.

10901. *Chairman*: I do not see why, as a general proposition, if we have a future period when there is great pressure of demand for capital resources and a reasonable expectation that that will be productive in the terms of profit arising from the expenditure, one should not expect that the interest rate will be pulled up by that force?——I do not want to deny that this is one of the things that act on the rate of interest. I was rather reacting against what I thought to be the traditional point of view, which would regard it as being almost the only thing acting upon the Pure Rate of Interest. I do not believe that it is anything like that; it is my contention that one can make very good sense of most of the story without paying very much attention to it. I do not want to imply that there is nothing in it, but if that were the only thing at work I would not expect the movement in the long-term to be so very large.

10902. *Professor Sayers*: If you do go so far, then it is a very different position when one comes on the "jabbing" period. The "jabbing" period may then be

explained as a movement in short rates that was forced on the country by a failure of the long rate to rise when opportunities for investment were quite extraordinarily big and looked like continuing to be big?——Yes, that could happen.

10903. *Professor Cairncross*: Would you agree that part of the problem here is that the demand for capital on ordinary terms is itself affected by the course of prices, and that high investment simultaneously tends to make prices rise and makes profits emerge, so that it is easy to find rates of interest climbing for a period of inflation, and then difficult to disentangle how far that results from a real increase in the level of demand, and how far it emerges from expectations about prices?——Yes, indeed.

10904. Nonetheless, I assume that you have in mind in some of your earlier replies that there could be periods in which there was more than usual scope for the use of capital in relation to the movement of prices?——Yes.

10905. And that in this case it would be reasonable, unless there was a change in the employment situation, to expect a rise in the rate of interest that could he attributed exclusively to the pressure and the need for more capital?——It is undoubtedly true that that pressure will raise some sort of equilibrium rate of interest in a theoretical sense, but I do not believe that the forces which keep the actual rate of interest in line with that theoretical rate of interest are so very strong.

10906. *Sir Oliver Franks*: It seems to me that, in the discussion as to whether the Representative Rate affects the Pure Rate or not, one is really distinguishing between the two types of causation: on the view that the Representative Rate does affect the Pure Rate, we are saying that demand for capital affects the price of long-term money, and that this happens when things pass through people's minds and are altered by being reflected through them; whereas on the other view, as I understood it, it is not that the causal properties of demand affect the price; it is rather that what people, as a consequence of repeated movements of the short-term rate, come to think about the future of money rates generally reacts on what they do now, because it affects their view of the riskiness of investing long. Is not your thesis that a very minor movement in the real causalities may be sufficient to take up a great deal of demand for new investment, but that you begin to get conditions in the long-term rate when the psychological causation comes in, and it is to that consideration we are to look when we are going not from 3 to 3½ per cent. but from 3 to 5 per cent.? Is that a true statement?——Yes, I think that is precisely what I meant.

10907. One of the things that we are hearing a lot of argument about is whether, in this connection, the authorities should operate direct on long-term rates or whether it is best for them generally to operate on short-term rates, as they do, and secure by arbitrage the effects they desire at long-term. If they hold that operating on the short-term rate is going to affect the long-term rate, they must be in agreement with you that what I call the real or physical causation is not terribly important: that is, that the amount of demand for long-term capital can be accommodated by very small movement of long-term rates; that what matters is people's expectations about the course of the long-term rate; and that this is what is effected by moving the short rate about. The authorities, on this view, would be agreeing with you in this, that they think that the psychological causation in the sense that men behave as they do because of the thoughts that pass through their minds, is more important than the straight market operation of supply and demand. Would that be your view?——I think that my view could be expressed in those terms, but I would be a little reluctant to have it expressed in those terms, for the reason that I do not think that the sort of expectations I am talking about are quite so easily manipulated as all that. In the very short run they may be, but I think that what people do when they are not having particular pressure brought to bear on them in that sort of way is very largely based on their experience over a long period. One has to be careful whether one is not making permanent changes in the state of mind.

10908. *Professor Cairncross*: You point out on page 15 that, "if prices are confidently expected to rise at 2 per cent. per annum, an interest rate of 5 per cent. is the same as 3 per cent. in real terms." Would you agree that if there is a permanent state of mind in the country that prices are likely to go on increasing at the rate of 2 or 3 per cent. per annum, that is almost certain to be reflected in a permanently higher rate of interest?——If the situation goes on for a very long time, yes. Whether it can go on for a very long time is another matter.

10909. Do you feel that it could go on for a very long time?——That is a different type of question from what we have so far been discussing; it really arises on the other paper. Personally I do not think it could. It seems to me very hard to believe that a rate of price rise per annum which was large enough to be noticeable (I am not quite sure just what that means: obviously our statisticians have been making things noticeable which might not have been noticeable otherwise) can hardly go on for very many years without very many peculiar consequences following, which are likely to mean a rather difficult and complicated economy.

10910. Your emphasis would be on a complicated economy? Are there not countries where prices have risen steadily for nearly a hundred years, such as Chile?——One thinks of Chile, but I did not know it went back as far as that.

10911. *Sir Oliver Franks*: What are the peculiar consequences that you foresee in a complex economy?——I would have thought that people would protect themselves against that rise in prices. If the rise in prices was sufficient to make it worth while for them to protect themselves, they would do it; and by so doing would defeat the economic effects of the forces leading to the inflation. The result of that would he that the inflation would accelerate.

10912. *Chairman*: Should we see whether there are any questions concerning the second paper first, since we have reached the fringe of it?——I would like to explain about this second paper. What happened was that I was asked to give a lecture in Dublin, which I was then asked to print in the Irish Banks' Review. In fact I was only able to print a part of the lecture which I gave in the Review, and I decided to write the whole thing out at a more respectable length. I am hoping to publish this in a book of essays some time next year. However, I thought the Committee might be interested to see it.

10913. *Professor Sayers*: Your thesis is that the rise in prices in this country and in some others in the last six or seven years is very largely to be ascribed to the excessive devaluation of 1949?——Yes.

10914. It is not the fact of devaluation by itself, but the fact that devaluation went so far?——Yes.

10915. You indicate at some point that you think that the rise has acquired a certain momentum, so that although the under-valuation may have been wiped out, the rise may very well continue unless something is done about it?——That was the position from which I started, and it was more or less what I said in Dublin; but when I came to work through the matter again there was an important qualification that I wanted to put into that. If one thinks what one means by under-valuation, one must mean under-valuation with respect to some norm; and I began to feel that there was a very strong reason for supposing that the norm for this purpose has not been by any means constant over recent years; that the natural process of recovery from the war itself, and the adjustment to the new balance of debts and credits situation which was left after the war, was something which would take quite a long time to work itself out; and that as a result of that it is probable that there is a sense in which the equilibrium rate of exchange, or, as one might put it, the equilibrium level of British prices in terms of dollar prices, may well have been rising over the last nine years. So I think that it is very intelligible that we should have been in a situation in which, at each stage, the rise in prices that was taking place in this country was dangerous but that the danger point, as it were, was continually receding for a considerable time, so that in fact we found that the rise was tolerable after all. I think that that may well have gone on for quite a number of years.

10916. When you say "tolerable", you mean tolerable from the point of view of the balance of payments?——I mean from the point of view of the current balance of payments; and from that point of view it seems to me to be quite possible that the view which is often put forward by economists that we ought to have adjusted

ourselves to any under-valuation in 1953 will not be correct. In fact, the original adjustment due to any excessive under-valuation in 1949 was perhaps over by 1953, but the adjustment to this longer process may have taken longer than that.

10917. *Professor Cairncross*: Is this not based, to some extent, on the assumption that the change in parity in 1949 would be expected to affect the balance between aggregate exports and imports rather than the pattern of imports and the pattern of exports? Most of the trade of this country must have been unaffected by the movement of parities, since most of our trading partners devalued at the same time; it is only a fringe of exports and imports that would be affected. Would one not therefore look for results more in the distribution between the markets and sources of supply than in the volume of imports and exports?——I fully agree with you about that, but it does not seem to me to alter the situation. It is quite true that by looking at the balance of payments of the United Kingdom we do not see these things properly. We really want to look not merely at the sterling area but at the whole lot of countries that devalued together. Unfortunately it is very hard to get information about that. But that is what really matters, from the point of view of the analysis; it is fairly obvious that a great deal of the balance of payments of those countries directly reacts back on our own reserves.

10918. You draw a distinction between the movement of prices in the countries where devaluation took place, and the movement of prices in countries where devaluation did not take place, and at one point in your argument I understood you to be saying that until quite recently it was possible for prices to move up here without the kind of resistance that would be met with, say, in the United States?——I am sorry: I did not think I was giving that impression. I do not quite understand how that arises.

10919. I thought that you were implying that the behaviour of prices in this country was conditioned by devaluation and not by other factors which might have conditioned it, and that the behaviour of prices in this country was in this respect being contrasted with the behaviour of prices in the United States?——There has been a larger rise in prices here than in the United States.

10920. You were emphasising this contrast, but you were also putting forward an explanation of it?——Yes, I was; but my explanation of the mechanism ran, as you may remember, in terms of import prices and wages.

10921. But if you take import prices and wages in this country, have they been so very different in their behaviour in the United States?——They are much more important to us than the United States.

10922. But has the rise been greater over the period you are talking about, from 1949 onwards?——I am afraid I cannot answer that immediately, but I would not have thought that the matter was very relevant in a way, whatever the answer was, because it is obvious that import prices do affect the cost of living very directly in this country, whereas in America they only do it in a considerably less direct manner.

10923. Leaving import prices aside for the moment, there is some indication that the movement of wages has been remarkably similar, even comparing the sterling area and the dollar area, and that the real difference has been in terms of productivity. If that was so, would you feel that you could still account for the relative movement in prices in terms of devaluation and its after-effects?——I find it extremely difficult to think of any forces which would have led to the rise of wages in this country being more or less the same as those in the United States. That those figures should have been more or less similar I can only regard as an accident.

10924. I do not think we are any wiser on that. On the export side, I wondered if you had any comments to put to us. I had the impression that the course of events was to some extent in the reverse direction from the one you were talking about a moment ago; that in a sense British exporters had maintained their prices at a remarkably consistent level and there was no great increase in prices, but in spite of that there had been increasing difficulty in maintaining British exports, so that the difficulty of adjustment, so far from becoming easier in this period, had to some extent become more difficult?——Yes. I do not think that that is at all inconsistent with my thesis. Our exports now mainly consist of the kind of goods that are not just thrown on to the market to be sold at what prices they will take; their pricing is a matter of policy, and it is not the prices at which they will be sold but effectively the profitability of the export trade, which is a matter not purely of policy but of the demand for British exports at British costs. That the selling of our exports has become rather more difficult does not seem to me to be in the least surprising. If it were not for what I was saying about the equilibrium rate having moved, the selling experience would not have been merely more difficult; it would have become perfectly dreadful in view of the movement of prices here.

10925. You were putting to us, I think, that there was likely to be a period after the war in which trade conditions were difficult, that in those conditions perhaps a large drop in the equilibrium rate was natural, and that the rate would improve subsequently. I was suggesting to you that it is a little odd that British exporters had almost unchanged export prices in spite of the very large devaluation, and still found it very hard to compete. Does that not seem odd?——One has to consider all these productivity factors and so on, of course. I do not think it seems to be odd, but I am not quite clear as to the complete answer to that question.

10926. *Professor Sayers*: Whether one accepts the view that the rise in prices has had its main origin in devaluation and there is still some momentum remaining from that period, or whether one takes another view about the rise in prices and says that it is connected with the wage situation and links the wage situation to something else, what steps do you think should be taken to restrict the movement of the prices in future? You discussed particularly the importance of maintaining a stable rate of exchange; what else would you regard as appropriate action?——I would be prepared to envisage a very wide range of different ways of tackling it. I do not think that, if one diagnoses the situation as being a wage inflation which started off from intelligible causes and has now outrun them, it is a very difficult thing to stop. I do not think that it can be stopped by any single prescription; it has to be tackled on a great many different fronts.

10927. *Chairman*: But it is one of the inherent duties of the Government to try and cope with it?——Yes.

10928. *Professor Sayers*: But there is no golden rule?——No.

10929. *Professor Cairncross*: If you look beyond the limits of this country and take the prices of the world in general, would you make your diagnosis of the factors making for a rise in world prices in the post-war period the same as your diagnosis in this country? You are dealing with relative rises in this paper rather than a universal movement?——Over a large part of the paper I am: when I come to the section entitled "The Rest of the World", I thought that I was dealing generally with the question. I would entirely agree with the view commonly expressed, that the increased power of trade unions and so on everywhere means that there is a general danger in almost all countries of trouble of this kind. On the other hand, I think, as I have said, that there is a certain breaking point, in that employers generally might be expected to resist more strongly rises in wages which would force them to raise prices than rises in wages which they could swallow without raising prices. At the same time I do not regard that as a very sure line of defence; if they go simply on the basis of agreeing to any rise in wages that they can give without raising prices, wages get terribly out of line in different industries, and there is in the end a general upward pressure, so bringing wages into line.

10930. *Mr. Woodcock*: In Table 3 you confine yourself to wage rates and do not take account of earnings?——I did so quite deliberately for the reason (which I thought I gave in the text) that it seems to me it was the wage rates which wage negotiations were mainly about. I was trying to point out that there was an active cost of living factor at work in wage negotiations over all that time.

10931. Yes, but surely it is a factor at work, and a factor at work against any movement is that the earnings are increasing all the time. It may be that employers are bargaining for labour, or it may be on the basis of piecework systems or overtime?——Yes, I fully agree;

and, as I tried to say here, that does not in the least affect what people are getting or what was happening to the real standard of living of labour; it stemmed simply from the point of view of wage negotiations, and the calculation served to bring home that the cost of living factor was something which could be brought up rather effectively at any of those dates.

10932. But on this table it does not. Do you not make the point that there was a period in which wage rates were level, despite the fact that wage rates were increasing quite rapidly?——Yes, but that always means, when one comes to any particular year, that it could be shown that in fact prices had risen more than wages had over some not altogether implausible period in the past, and that simply on that ground one could claim that there was a case for a cost of living increase. That was all I was trying to say.

10933. *Professor Cairncross*: I thought you were going a little bit further in one part of the paper, and implying that, if the cost of living could be stabilised, the chances of a rise in wage rates would be less?——I would say that that was so.

10934. *Mr. Woodcock*: How much weight would you put on that?——I do not know; but I would have thought that it was one factor, and that if prices could be stabilised it would be much easier to ensure that rises in money wages were at least moderated.

10935. Not if demand was sustained?——I would have thought differently, but I do not know. I would not doubt that it was possible, but I do not quite see how it could happen, that prices could remain stationary and at the same time there was a sudden increase in demand.

10936. *Professor Cairncross*: Suppose that earnings increased at the existing rates of wages, would not that eventually be bound to react on wage rates?——Certainly. I think that the forces which act upon wage rates and upon earnings are quite complex, and that there are a great many different things to take into account. All I was maintaining was that there has been a significant cost of living element over the last ten years, and the purpose of this paper was analysis.

10937. *Mr. Woodcock*: But is there not rather more than that about this historic analysis? Could it not have happened from some other cause, or is that fundamental? ——It could have happened in a country which was normally self-sufficient in food, as a result of a series of bad harvests or something like that. That could have the same effect.

Chairman: Thank you very much, Professor Hicks. We are very much obliged to you.

(*The witness withdrew.*)

PROFESSOR R. F. KAHN, C.B.E., Professor of Economics in the University of Cambridge, called and examined

10938. *Chairman*: Professor Kahn, we have all got your paper* in front of us and have read it carefully, so that our questions are primarily directed to getting you to enlarge on some aspects of it. I wonder if we could start by asking you to enlarge on this point. I think it is inherent in your treatment of the subject that the field in which monetary policy is capable of mattering is the field of investment, and I think you treat it as capable of having a substantial effect upon investment over a period, subject to qualifications as to the effectiveness which you give. Am I right so far on your general treatment of it?——*Professor Kahn*: In general, yes; I would say that it is capable of having effect provided it is sufficiently drastic.

10939. Looking at the tale of recent years, how from observation can you see those effects taking place?——Naturally one thinks of the present and the immediate past first of all. I feel that the fact that investment in the private sector has ceased to grow, and may even be declining, and shows prospects of being lower next year than the peak it has reached, is to be attributed partly to monetary restriction; not only to the effects of high interest rates and limited bank advances, but to the indirect influences which I have emphasised of monetary factors on Stock Exchange prices. Part of the effect is obviously due to the general slackening of demand, which cannot be entirely attributed to monetary factors. Part is due to the restrictions on nationalised industries of a direct kind. But I would say that this rather unsatisfactory state of affairs in which investment in industry is ceasing to grow and is showing signs of declining, connected with the fact that production for the country as a whole is now actually less than it was three years ago, is to be attributed to a considerable extent to the policy, which started in 1955 and has been accentuated since, of monetary restriction. You might say that that was designed in a sense to have this effect, so perhaps there has been some over-shooting of the mark. As I emphasise in my paper, these effects are very difficult to assess, there are very long and incalculable time lags involved, and we are apt to experience the full effects at a date later than we really want them, and perhaps when we do not want them at all.

10940. I see the force of that, but assuming that we have this recession of demand demonstrating itself over a period which we can see today, and that there is a complex of forces which can be said to be responsible for it, is there any test you could apply which would isolate the monetary forces?——It is very difficult to apply a test when there are other factors operating to the direct limitation of investment in certain fields; restrictions of local authority investment and nationalised industry investment have an influence in limiting the growth of demand, and it is very difficult to isolate that effect from any effect one might attribute to monetary policy. My main feeling is that those who believed that it was necessary to use monetary policy as a means of restraining investment were not altogether wrong, though perhaps they got the timing wrong as a matter of expectation.

10941. *Professor Sayers*: This timing is absolutely crucial?——Yes.

10942. When you were talking about the monetary measures that might be beginning to bite in the last year or so, you mentioned the date 1955. Was that purely accidental, or is it that you think that the steps taken before 1955 have had only negligible effects?——No, the only reason I mentioned 1955 was that it was at the beginning of 1955 that the present phase of monetary restriction began.

10943. Were not the signs of a fall in demand first appearing about the middle of 1957, at the very earliest? ——One must not think too much in terms of absolute fall; demand can fail to grow with the increase in potential productive capacity.

10944. And one can put that back a little earlier in 1957?——Yes.

10945. So that if it was measures taken in 1955 that were the ones that really began to bite, on the face of it there is something like a two year time lag?——Yes. I think there is a strong element of a two year time lag. One cannot define it simply in terms of one period of time, but some influences certainly take two years to work out.

10946. You would expect that on the grounds of how industry works?——Yes.

10947. *Chairman*: Do you think that the major element in bringing about this slackening of demand is purely psychological, the general creation of business feeling that demand is in fact going to be less, or is it more a matter of calculated cost?——I would have thought that on the whole it is more calculation. The extraordinary thing at present is that on the whole businessmen are still in a fairly cheerful state of mind; but the predictions from recent inquiries are that, although they are fairly cheerful, they are not intending, as at present guided, to do as much investment in the coming year as they are doing at present.

10948. *Sir Oliver Franks*: Would it be your view that the high or highish interest rates which we have had since 1955, and the restrictions in one form or another of bank advances that we have had since the middle of 1955, are factors which in themselves are partly operative on people's calculations of what it is and it is not worth while to do, and that it is not simply or mainly a matter of whether the heightened interest rates, or for that

* Memoranda of Evidence Part XIII No. 19.

matter the restrictions on bank advances, make them wonder whether a certain type of future is the one that they are going to encounter?——Yes; it is not entirely the influence on the demand for their products, it is partly, given that demand, influence on how much they feel, in the light of that prospective demand, they want to invest.

10949. So that a high or highish interest rate (what that is no doubt depends a bit on the rate of taxation, and so forth) does itself make a difference, in particular cases, to the way in which people calculate it would be worth their while to invest?——Yes, allowing for the concomitant effects on Stock Exchange prices, and allowing for limitations on bank advances.

10950. And while of course those are different effects, they are effects within the same general category; that is to say, they are not effects which can only be derived because of the effects on men's minds of anticipation about things; they are all real effects?——Yes, they can all be summed up under some such general head as monetary restriction.

10951. Given that, could you elaborate a little on one thing that you said? You thought that the nature of the industrial process was such that it might quite easily take two years for some of these causally active factors to work through to their full effect?——One gathers that at any rate the larger and more complicated firms do believe in planning, that they draw up plans for various periods ahead, some more definite and, as they look further into the future, less decisive; but that for, say, the coming year, a firm rather tends to have made its plan, and it would need a good deal to cause it to deviate from it, particularly where it is a matter of calculation of whether the profitability of the project justifies the financing involved. A sudden reduction in demand might lead to a fairly rapid curtailment of plans; but, partly because industry is so complicated nowadays, there is a great deal of obstinacy in the machine.

10952. *Professor Sayers*: We are now talking about the field of private industry; it is fixed investment in private industry that you are seeing these effects in?——Yes; and they are particularly marked where it is a question of new industrial buildings.

10953. Which is what one would expect on theoretical grounds?——Yes.

10954. In the decline in activity in investment, and the failure of that activity to grow, the emphasis is on building?——As far as I know, the building industry has some slack.

10955. *Professor Cairncross*: Do you know of actual cases where firms would agree that it has been the higher cost of financing capital development schemes which has deterred them in the past few years, rather than market considerations?——I have not made any inquiry. It would be a very difficult inquiry to conduct, because with great respect (I do not intend this in any insulting sense) it is extremely difficult for a business man to analyse his motives. He arrives at a decision after consideration of a great set of complicated and inter-related motives; this is one of them, and demand is another. It would be extremely difficult to separate them, particularly at a time when both of them probably are moving in an adverse sense.

10956. But you would agree that there might be some forms of investment that were more readily affected in this way?——Yes. I am impressed by the rather obvious fact, to anybody who takes an interest in such matters, that the ability of even one of the large firms to raise money on the Stock Exchange at any moment of time, without offering shares at unduly low prices, is limited; there is a certain absorptive capacity of the market, and, as I say in my paper, I think that not only the level of Stock Exchange prices but the readiness of the market to absorb the shares of a particular concern have to be linked to monetary policy.

10957. Would the latter factor have come much into operation until the last two or, at the most, three years?——No; in this country Stock Exchange prices in ordinary shares generally reached their peak about the middle of 1955, and they are not yet, speaking quite generally, back to it.

10958. Would you agree that there are other possible hypotheses governing the behaviour of fixed investment in private industry in the last few years, and that there may have been a temporary exhaustion of the more obvious types of investment?——No, I should be rather reluctant to accept that.

10959. *Professor Sayers*: Why do you find that a difficult hypothesis to swallow?——Simply because one knows, without being an expert in the matter, that technical progress, scientific research, all that sort of thing, has been going on if anything at a faster pace than in earlier periods, and one feels that to take full advantage of these technical developments one needs a growing rate of net investment in industry. It is remarkable that where there is a clear outlet, as in the motor industry, the thing does work well.

10960. But if there is a long period in which there are all sorts of obstacles of a non-monetary kind in the way of people who want to go into various capital developments, and then comes a period in which the obstacles are very largely removed, would you not expect a spate of developments followed by some falling off, even though there was an underlying trend for increase in investment?——The productive capacity of our metal-using industries, after subtracting the needs of defence, has been so pitifully limited that the extent to which the backlog could be worked off in recent years was really rather small. It has been a common view that until recently we have been suffering from an overload on the metal-making and metal-using industries. That may be associated with defence requirements, but it emphasises the point that it has not been possible to make a very big encroachment on the accumulated stock of ideas. If it were a fact that the urge to invest was beginning to slacken, that would seem to me to point to a strong relaxation of monetary policy as a compensation for that diminished urge. The justification of dearer money and credit restriction was that businessmen wanted to invest more than the country could afford, but if businessmen do not now want to invest as much as the country needs, the case is one for monetary expansion.

10961. You mean that the case *was* one for monetary expansion a year or two ago?——Yes, but the fact that it has been delayed is no reason for not contemplating it now.

10962. *Professor Cairncross*: The question I was putting to you earlier was directed simply to establishing whether monetary policy was of special importance in regulating the level of fixed investment. Clearly, if it has no effect either way, then it may be inappropriate to make use of monetary policy for the purpose of increasing investment or diminishing it. Your view is that it has a very real effect on capital investment in the private sector?——Yes. I am not saying that it does not have an effect in other sectors, but in the private sector I do say that it has an important effect, but that the changes needed in monetary policy in order to bring about a reasonable effect are large.

10963. If you are thinking in terms of a situation where there are large arrears of technological knowledge to be made use of in industry, ought not that also to be a situation where there are very remunerative investments to be made, and would not these be likely to take priority over other investments which a firm might normally wish to make, but which it could defer if it had something of more special importance up its sleeve?——Yes, I think they would, but the situation we are now in is one in which the power of the country to perform physical investment is not being fully utilised. The question whether some forms of investment are more or less desirable than others is not so important as it is at a time when all available resources are being stretched.

10964. The issue is in part whether the things that are not being done would be particularly productive in relation to the things that are being done?——I do not admit that. I think the issue is whether the things that might be done are not sufficiently important to justify their being done, at the expense perhaps of some deterioration in the balance of payments, and also possibly of slightly less satisfactory real wage rates for the moment, more than compensated by bigger earnings.

10965. That is a different issue, and not the one I was discussing. I am trying to pursue only the influence of interest rates on investment, not on aggregate investment for the moment, but on the types of investment that are conducted. It would, I should have thought, be likely that, if firms could choose between those investments that

yielded a high return and those that yielded only a modest return, they would take the ones yielding high returns, and therefore give effect to new technological knowledge. You feel, however, that there is an aggregate of investment that could employ other knowledge, still unutilised, that would add substantially to productivity? I am not now speaking of the nationalised industries. It has been put by witnesses to us that there is a big margin between the return that firms normally look for and the current rate of interest, and that if the rate of interest were to be increased from, say, 4 to 6 per cent., this would make very little difference to a firm thinking of embarking on investment yielding perhaps 20 per cent. What comment would you make on that?——If you compare the rate of interest on gilt-edged securities with the prospective return on a speculative physical investment, you are not comparing like with like. The return on a gilt-edged security is normally absolutely certain, whereas the return from an industrial investment of a physical kind is subject to a considerable degree of risk. The much bigger return that has to be expected in order to induce the investment is a measure of the risk involved. One comparison which is apt, I think, is between the return that one can expect to get by buying ordinary shares on the market and the return that a businessman would expect to get by physical investment. When I speak of the return on ordinary shares, I am not thinking simply of the dividend yield in the narrow sense, but in a wider sense the earnings yield, which of course is of particular interest to people subject to surtax. Those are two quantities which are comparable in the sense that they both involve risk and are also comparable in order of magnitude.

10966. If you take the latter basis, would you say that a rise in gilt-edged rates would be likely to be accompanied by a more or less proportional increase in the earnings yield expected?——Yes. Ordinary share prices tend to move with gilt-edged prices, apart from other influences which operate, and the general tightening of monetary conditions which accompanies any pushing up of the gilt-edged rate has also a separate influence on the market in shares.

10967. If the gilt-edged rate rose over a period from 4 to 5 per cent., would you expect the earnings yield on industrial investments to rise by 25 per cent.?——I do not want to be tied down to an exact quantitative answer on this, but in general terms I would say that there is a certain relationship between bond yields and share yields which tends to be maintained, subject to differences of expectations about the future course of profits compared with the past.

10968. *Chairman*: I am not quite clear how this ties up with the original question, which I thought related to the business man's possible expenditure on new technological processes, where he was supposed to be expecting a very high rate of return on money he spent, and the question whether his determination to do that or not could be seriously influenced by any change of the order that we have seen hitherto in the rate of interest on the money which he borrowed for the purpose?——In so far as the investment which he has in mind involves highly durable forms of capital (buildings and that sort of thing) then there is an important effect of the long-term rate of interest itself. In so far as it involves equipment which wears out fairly rapidly, the rate of interest itself has a quantitatively much less important effect. But this business man has to consider how the project is to be financed; it may be that he has exhausted his liquid assets, and his opportunities of borrowing on fixed interest account either from the banks or from the market, so that he has to think in terms of ordinary shares. He must ask himself, as one of the factors operating, what sacrifice is involved for the shareholders if they issue shares to outsiders which are expected to yield in the course of years a high earnings return on the market price. He will also be concerned, as I have said, with the capacity of the market to absorb a large issue of ordinary shares without his being obliged to offer terms which would be very unfavourable to the firm. There is also the point, which is becoming increasingly evident, that quite a number of firms nowadays contemplate using their resources not creatively, in making or acquiring physical assets, but in buying up other concerns, usually by acquiring their shares, either on the market or by means of a bid, or by means of some special negotiation. There is a very direct relationship between the yield which they expect some other company's shares to offer them, on the prices at which they may hope to acquire them, and the yield which physical investment might be expected to offer.

10969. *Professor Cairncross*: What proportion of the total investment of the country are we talking about? About one quarter?——You have not asked me about any other sector. I am prepared to argue that the rate of interest is an important influence elsewhere. But if you are asking me about the private industrial sector, and if I may be allowed to talk in terms of net investment, with all the difficulties that that involves, it is something rather over one-third, I should think, excluding private housing.

10970. Do you feel that monetary policy has more effect outside this sector than within?——No; I think it has considerable importance, and in as much as the other sectors are bigger quantitatively, the total effect may even be larger on investment elsewhere than in the private sector; not proportionately, only absolutely. What I am concerned about is the proportional effect in the private sector. The net investment which the private sector absorbs is itself so small that an absolute change which looks scarcely worth talking about may proportionately be of great importance.

10971. Do you see the rate of interest affecting in any way the decisions of public authorities about investment?——Yes.

10972. Would you elaborate that?——First of all take housing, in so far as housing remains the responsibility of public authorities: the rents which they can afford to charge depend on the terms on which they can borrow, subject to such subsidies as may be offered to them; and clearly the extent to which subsidies may be offered is very limited. Indeed, it is claimed by the protagonists of the cheap money policy of the immediate post-war period that the main benefit has been in getting rents of new houses lower than otherwise would have been possible. And it is very widely claimed that the level of rents has an important influence on the demand for house room. In the case of the nationalised industries, we have not quite reached the point at which one would expect an effect, because they have been so held up and have this big backlog—I am not quite sure about the coal industry. But the nationalised industries have to keep a very careful eye on their profit and loss account, which usually balances or just fails to balance on an incredibly narrow margin in relation to their turnover, and I would expect them fairly soon to be very much influenced in deciding how rapidly to invest by the terms on which they can get finance.

10973. *Chairman*: You are stressing that as a development you see ahead, rather than typical of their past experience since they were nationalised?——Yes.

10974. Where do you draw the line? What brings about the change?——Simply the point at which they have succeeded in working off the backlog of unexecuted projects which the Government or physical difficulties of delivery have been holding up.

10975. It rather depends upon a view that they have very largely overtaken that position today?——I would not say that they have very largely done so already. I am looking some way ahead, and assuming that you want to deal with the long view, not just with the immediate prospects.

10976. *Professor Cairncross*: Do you lay any stress on the particular forms which one of the nationalised industries might pursue: for instance, nuclear energy as against thermal power? Do you think that that kind of choice will be affected by rates of interest, or do you think that this is decided by other circumstances?——In so far as capital is cheaper, then a form of power production which involves the use of a lot of capital, perhaps because it is very durable, will to that extent be preferred.

10977. *Mr. Jones*: As I understand it, you are saying that in the nationalised industries planning has made provision for a certain degree of development, and that, having regard to the physical and financial circumstances of the country, it has not been possible to make the progress with those plans at the speed, and with the impetus, that seem to be desirable and necessary?——Yes.

10978. *Professor Sayers*: Do you think the size of the backlog is itself partly due to what the rate of interest is and has been in the last years?——I think that plays a part, certainly.

10979. So that, if the authorities thought that the backlog was very big all round, not in the public sector only but perhaps even in the private sector, and that a raising of the rate of interest was an appropriate way of sifting the projects, the backlog might then become smaller?——Yes. I am not advocating that way of doing it, but that would be the result.

10980. I am just suggesting that the backlog is not something absolute, but is linked to the atmosphere of the rate of interest?——I agree.

10981. *Sir Oliver Franks*: In the opening of your paper you make a distinction between means and ends, and you say that one of the dangers of reflections on monetary policy is to mistake means for ends, and therefore to treat them absolutely. When one comes to the latter part of your paper it emerges that one thing which you think is at best a means tends to be given this absolute quality, and therefore has been a matter of mystique, is the money supply. You therefore say two things about the money supply: (1), that it should pass the test as a means to the ends, the ends being essentially political, social and general economic ends, such as the general level of all economic activity, the balance within that of investment and consumption, and so on; and (2), that the quantity of the money supply is not itself something which should be treated as an object of manœuvre, but is rather a result of the structure of rates of interest, and that it is the structure of rates of interest which should primarily be manipulated or varied by the authorities if they are wishing to exercise policy through monetary measures. Would you mind elaborating these two quite different points about the money supply?——I would apply this idea of the danger of monetary mystique in the context of both questions. I think I am using the word "end" at two different levels. First of all I am thinking of the ultimate end in terms of activity and the pattern of production, the extent to which the production is devoted to making improvements for the sake of the future rather than to current consumption; and then at a lower level I am afraid I was probably using the same word "ends" to mean the influences in the monetary sphere which operate towards reaching what is desirable at this higher level of the word "end": namely, the structure of rates of interest, the ability of the banks to advance more, the state of the Stock Exchange, and so on. I am trying to emphasise in this paper that the quantity of money should be regarded purely as a concomitant; that one should ask oneself first of all what the ultimate ends are in terms of pressure of demand, level of activity, investment in relation to consumption, and then, in so far as one is contemplating monetary rather than other means of securing the right sort of balance, one should think in terms primarily of rates of interest, and of the liberty of bankers to lend, and have an eye to Stock Exchange prices and business men's expectations in the immediate future. Having decided what monetary features are calculated to reach the ultimate ends desired, and having agreed, if agreement can be reached, how those features are represented in terms of rates of interest and all that, then the quantity of money should in my view be left to look after itself; it should be regarded as a pure concomitant. One should recognise that in some circumstances it may need a larger quantity of money, and in other circumstances a smaller quantity of money, to reach the same result in terms of rates of interest and the effects of rates of interest, and that the difference between those two situations, the fact that in one situation the quantity of money is greater than the other, need not be regarded as at all disturbing. It simply means that, for some reason connected with expectations of the future, various people and institutions are a little scared about holding securities, and they prefer to hold money. To meet that extra demand for money, if the authorities do not want the price of securities to be depressed, they must create the extra money, which is very nice for the banks, who will earn bigger profits, and to some extent for the Government in so far as the Bank of England is involved, because the Bank of England will have bigger assets as the concomitant of a larger quantity of money. I am trying to argue that any line of thought which seems to suggest that a particular policy or proposal is undesirable purely by reason of what it involves for the quantity of money should be treated with great suspicion.

10982. And it is there that the element of mystique enters in, if one allows oneself to think that a particular quantity of money has some intrinsic virtue or vice?——Yes.

10983. *Professor Sayers*: I wonder if we might have your comments on another view which has been put to us, for which "mystique" is not perhaps quite the appropriate word: that, though it is through rates of interest and availability of credit and so on that monetary policy works on the level of economic activity, the appropriate way for the monetary authorities to work is not to make up their minds that such and such rates of interest and such and such availabilities of credit are appropriate in particular directions, but to operate in some way on the situation as a whole by increasing the quantity of money when demand needs to be stimulated, and decreasing the quantity of money in other circumstances, leaving it to the market to produce the effects on particular interest rates?——Am I being asked not to apply the word "mystique" to that view?

10984. I think that answers my question!——I think part of the confusion arises because there are different ways of increasing the quantity of money. Very often economists who like to propagate this kind of view will imagine that the quantity of money is increased as a result of the Government embarking on some expenditure not financed by additional taxation which it would not have embarked on otherwise, and financing it by borrowing from the banking system. But the results of that I would attribute primarily to the Government expenditure. The fact that the Government is engrossing labour and physical resources is responsible for the main effect, and that main effect would be experienced equally if the Government issued securities on the market instead of borrowing from the banking system in order to finance this expenditure. The only difference between the two methods of financing a particular line of expenditure lies in the behaviour of the rate of interest. In order to sell these securities on the market without an increase in the quantity of money their price would have to be depressed; the rate of interest would be higher. I do not know whether this is at all helpful, but I think that when one talks about the effect of an increase in the quantity of money one has to ask oneself what is the mechanism by which that increase comes about, and one has to be quite sure that inside the mechanism there is not an influence which would operate independently of an increase in the quantity of money.

10985. I am in some difficulty, because I am putting the views of others; but I think one form in which this doctrine is put forward is that monetary policy should take the form of a regulation of the total supply of bank money, and that that should be allowed to have its effects on the whole series of rates of interest, working through from those most directly affected by changes in the supply of bank money. Would you like to comment on that view?——I should want to hear some argument in favour of such a view before I was asked to comment on it.

10986. *Professor Cairncross*: This view implies action on the cash at the disposal of the banks, and leaves subsequent action to them and to the market?——It is inherent in this view that the rates of interest should look after themselves, and that the quantity of money is what matters. My answer is that it is the rates of interest that matter, interpreted in a wide sense, and not the quantity of money; that the mere fact that some people are induced for the moment to hold part of their wealth in the form of idle cash rather than the form of securities is not going to influence their conduct or anybody else's conduct. One has to ask oneself whose conduct is influenced by reason of the quantity of money being larger rather than smaller, if the rates of interest are *ex hypothesi* the same in both cases. Money is a stock, it is not a flow. The things which influences people's conduct are flows, profits, incomes, that sort of thing: things you measure as rates per unit of time; not a stock which is simply a matter of how at any particular moment people decide to dispose of their personal wealth and companies of their liquid assets.

10987. The view put to you would imply that the monetary authorities took a neutral view in relation to the

structure of interest rates, that they did not deliberately try to set a pattern of interest rates, although they did attach importance to the movement of interest rates in general in a particular direction. The relevant point from our point of view is how far you believe that the monetary authorities, in seeking to establish a pattern of interest rates, can change the relationship between particular rates freely?——I think that it is extremely important that the authorities (I use the word "authorities" because I want to bring in all the departments and authorities who are responsible for managing the national debt, which includes not only the Bank of England and the Exchange Equalisation Account but a whole lot of other departments such as the Post Office Savings Department and the National Debt Commissioners) should be regarded as capable, within very broad limits, of achieving any desired structure of rates of interest. They should be thinking in terms of what structure they want, and if they know what they want they are perfectly capable of getting it, provided they are not worried about the quantity of money. Suppose that the central authority does think in these terms, and wants a bill rate which at the moment should be high, in order to keep sterling balances in this country, but a long term rate which should be low, in order to stimulate investment. (I speak, for the sake of simplicity, in terms simply of those two rates of interest, the bill rate and the bond rate.) Either the situation which exists before they introduce a change is one in which each rate of interest is higher than they think it should be, or it is one in which each rate of interest is lower than they think it should be, or it is a situation in which one is higher and one is lower than the levels they would like to see maintained. If both are too high, then open market operations on the expansive tack will bring both down. If both are too low, open market operations on the restrictive tack will put both up. And then from one direction or the other they will reach the third situation, in which one is too high and one is too low, which they can then remedy by a change in the composition of the national debt as held by the banks and the public. They can either accelerate the process of funding, issue long-term securities and pay off Treasury Bills, or they can hold it up, or they can put it into reverse: the departments can buy long-dated Government securities and pay for them by issuing more Treasury Bills. By altering the proportions of bonds and bills which the banks and the public are asked to hold, they will push up the price of one and push down the price of the other. They may then again reach the situation in which both are too high or both are too low; then they want a little dose of open market operations again to bring them to a situation in which one is too high and the other is too low. I am not suggesting that it would be necessary in practice, though very probably it would, to proceed by this process of trial and error; I am merely putting this forward as a logical line of thought to show that a combination of operating on the total amount of bank credit and bank deposits, with operating on the pattern of the national debt held outside the Government departments can, within broad limits, give any desired combination of bill rates and bond rates.

10988. *Chairman*: Does not the possibility of this being available as a technique when the authorities want it depend on our having a market that will allow itself to be manipulated from time to time in this way? Do you think that conscious and sustained manipulation of this kind might affect the market?——Yes, but how much the authorities have to do depends on the state and responsiveness of the market. If the market likes to help by altering its expectations, because it thinks that this is the way the cat is jumping, then the authorities will not have to do so much. If the market proves very obstinate and does not believe that they are going to succeed in doing what they are trying to do, then they will have to do much more. The responsiveness of the market, the extent to which a given amount of sales or purchases will change the price of a particular kind of security, is a factor which determines the scale on which the operation has to be conducted, but it is very difficult to conceive of a situation in which it would not be possible to arrive at any particular price, provided that, as I did say, one is considering this within reasonable limits.

10989. It has been said that there are times when the authorities could not get rid of any volume of long-term securities even if they wanted to; the market would not take them?——I think that that view is associated with a fear to contemplate any increase in the quantity of money.

10990. *Professor Sayers*: You are saying that the authorities can always move to a different price, if they are prepared to shut their eyes to the quantities?——Yes, that is the point. If we are told that the only way of financing a particular need is to issue Treasury Bills because the market will not absorb long-dated Government securities, the inference is that the authorities do not want to see the price of long-dated securities pushed down, and the rate of interest pushed up. That would point first of all to some monetary expansion which should be undertaken without hesitation if there is a feeling that rates of interest should not go up, and to some change in the pattern of the national debt. If the whole complex of institutions and individuals outside the banking system and the Government are prepared to take more bills at the desired rate of interest but not more bonds at the desired rate of interest, then one should quite happily let them have bills.

10991. *Professor Cairncross*: Would you agree that operations in a market of this kind, where expectations are very important and confidence is equally important, may be made difficult by the need to envisage the undoing of what the authorities are doing, to move into reverse very sharply? They may be operating on the long rate in order to move it violently, and only be able to make it move violently by doing something which prejudices their future action. Is not monetary policy under the disadvantage that it is not easy to reverse quickly?——I would admit that they might have to operate on a larger scale to produce a desired effect than would have been necessary if they had not past history against them; but I do not think that they should worry too much about the scale.

10992. *Professor Sayers*: Is that linked with your view that changes in the rate of interest do have quite important effects, though slowly, on investment?——It is not necessarily linked to that view. Independently of whether that effect is large or small, my view is that it is the various rates of interest that matter.

10993. Because of the part that expectations are playing, might it not be difficult to bring about very big changes in the long rate of interest?——If you are thinking of the difficulty of making money very cheap again in the light of the abandonment of the 2½ per cent. regime, without asking me to express a view as to whether either then or now it would be desirable, I would say that, if it was thought desirable, it could be done; once the market realises that the authorities are serious they will dash in and help the authorities. Some people argue the opposite, that the danger is that speculative forces will lead to the mark being overshot. Obviously we need skilled technicians to operate in these markets; but markets are pretty good in this country. It is not as though we are dealing with certain other countries where the capital market is extremely underdeveloped. One can operate on a very large scale in these markets. Perhaps it is worrying members of the Committee that the authorities may have to operate on what may seem to them too large a scale in order to produce a given effect. But if they really wanted 2½ per cent., not tomorrow, but as something to aim at in the near future, I certainly believe that they could get it, provided that they did not mind how much the quantity of money went up in the process. That brings me to the qualification that I consistently introduced into my paper: it is not only a question of rates of interest. The ability of the banks to make advances has an influence independently of actual rates of interest. A very big and progressive rise in the quantity of money would, unless measures were taken to curb bank advances, carry with it much greater ability for the banks to extend advances. Therefore I would argue that there should be imposed on the banks a restriction on the amount of advances which they can make. In this connection I should like to modify slightly my suggestion in paragraph 71 of my paper. When I wrote the Government ceiling on bank advances was still in force, and I commended that method of restricting advances as a permanent arrangement. It ought to have occurred to me that the obvious course is to have a regulation in the form of a maximum ratio of advances

to deposits, so that the banks would be able to compete with one another; the authorities would effectively be regulating the advances of the banks as a whole, though not necessarily the advances of any particular bank that succeeded in advancing faster than its competitors.

10994. *Professor Cairncross*: A maximum ratio applicable to all banks and not varying between them?——It would be very invidious to introduce variations between one bank and another.

(*Adjourned until* 2.15 *p.m.*)

PROFESSOR R. F. KAHN, C.B.E., further examined.

10995. *Chairman*: In paragraph 13 you talk about the desirability of not trying to turn on and off business men's enthusiasm for investment, on the grounds that it is not really a mechanism that you can treat quite in that way. Later on, when you consider the possible means of regulating the economy combined with a high investment programme, you speak favourably of two methods of control: one is a selective import control and the other is a fairly highly selective form of investment control. Are not those just the kind of things which in our experience tend to depress the business man's initiative most?——*Professor Kahn*: Taking the selective investment control, if you are thinking of those business men who are not in the priority classes (for example, the present discrimination in favour of shipping in our tax arrangements) I cannot see that that has a depressing effect on any particular business interest. It is designed to give a particular incentive in a sector where it is thought a particular incentive is desirable.

10996. The selection of priorities takes place far above the head of any individuals concerned. They have no power to affect it one way or another. They have not very much power of diverting themselves into the preferred avenues; there is a general feeling that the encouragement is either there or not there. They cannot do anything to respond to it?——Those interests that are not picked out for the benefit of discriminatory treatment are bound to object. But I would not, with great respect, agree that the effect is positively depressing; they just feel sorry, and they may be vocal. I quite agree that any form of discrimination comes up against political difficulties and that there will be pressure on the authorities to enlarge the favoured class.

10997. Do you think that there is a distinction between a system under which the preferred avenues are more or less fixed for a long period so that people know what will be the preferred objectives, and one which may shift fairly quickly from time to time?——It is desirable not to chop and change too frequently.

10998. *Professor Cairncross*: Does not this apply also to the use of investment allowances or initial allowances or other techniques of that kind? If they change too often do they not lose some of their force?——I am certainly not in favour of changing them more often than is really necessary. The great trouble is creating expectations. If there is a reasonable expectation that an allowance is going to be granted on a particular form of investment, that form of investment will be held up until the expectation is either realised or frustrated. That is why I suggest that changes in investment allowances or initial allowances should be made at any time and not only on Budget day. The same considerations apply here, perhaps in a rather more important degree, as apply to changes in purchase tax. The expectation of a change, even if it turns out to have been an absolutely correct expectation of a change, will until the change is made have precisely the contrary to the desired effect. That is an argument for keeping these changes fairly infrequent.

10999. *Chairman*: What are the causes which have made so valuable the use of such things as investment allowances?——My own view is that the decision to introduce investment allowances in the place of initial allowances was a right decision, and that it was unfortunate that that should have been abandoned. If it was desired to give less encouragement, or even discouragement, to investment it could perfectly well have been done within the fabric of investment allowances. They could easily be made negative, and become an investment tax. It is unfortunate, and it must be extremely aggravating to accountants, that we chop and change between the two systems. I would advocate having a system entirely of investment allowances, and I think that from the accounting point of view it would not very much matter if the rates of those allowances, whether positive or negative, were altered from time to time provided they took place without changing the fabric of the system.

11000. *Mr. Jones*: The difference between the one and the other would be that in the case of an investment allowance the investment would be dealt with on the basis of reducing the taxation to, say, 80 per cent. of the full liability, whereas on the basis of an initial allowance there would be a longer period over which the taxation allowance would be made?——Yes. On paper the initial allowance is not a subsidy. It is simply a change in the timing of the allowance, and the aggregate amount of the allowance over time is simply the cost of the investment; whereas the investment allowance involves a subsidy from the Exchequer. But if one brings rates of interest on delayed payments into account the difference becomes one of degree not of principle.

11001. *Professor Cairncross*: You do, however, foresee the use of this in conjunction, for instance, with building licences; you are not disposed to lay such stress on the use of investment allowances as would permit you to dispense with other controls over investment. Do you feel that the use of building licences would be a more powerful weapon?——Yes. The advantage of building licences is that the authorities can decide what they want and can get it, whereas with any fiscal form of control it depends on how calculations will work out; there is a high degree of unpredictability. Of course to some people that is a disadvantage because they do not want to make up their minds what they want.

11002. On the other hand in the case of building licensing they would have to have a staff in being to administer the licensing if necessary whereas the staff is already in being to administer the system of investment allowances?——There must be some kind of staff at present in being to administer the system of industrial development certificates. Obviously they would need a bigger staff, and a staff covering a wider field; but I do not feel that the administrative difficulties are overpowering; though it is inherent in what I have said that there will be times when the staff is not fully used and some of them might then be transferred temporarily to other work. There would be some periods when there was an open general licence for everybody and other periods when there was an open general licence for certain kinds of building. During the periods when the building resources of the country were being pressed very tight, then they might make heavy use of the staff.

11003. In the case of building licences it would be necessary to generate sufficient momentum to have applications for licences in excess of what one was prepared to grant, but, in the case of investment allowances the anxiety might be to accelerate the rate of that investment. One is positive and the other tends to be purely negative?——I agree. I am not arguing for one as opposed to the other; I am arguing for a combination. The more successful they were in applying the investment allowance the less use they would have to make of the building licensing system. But it does turn, I think, on the point raised by the Chairman: to what extent is it either expedient or practicable to administer a system of investment allowances on a discriminatory basis? In the case of building it is not only discrimination on classes of building; geographical discrimination is also very important. The building industry is highly localised in its resources.

11004. *Chairman*: I suppose in dealing with this you have to envisage not a complete centralisation of control, but that the central mind would be adequately represented

in numerous centres of control in various parts?——Yes, it would mean regional offices, such as we had until recently. I would put my point in the form of a question. The system of building licensing was abolished at the end of 1954 and the Bank Rate was raised in January 1955. If at the time it had been foreseen what troubles 1955 was going to bring into being, would that system have been abolished?

11005. *Professor Cairncross*: Might not one say that the acceleration of building in 1955 was itself a part or outcome of the relaxation of controls through 1953-54?——It probably was.

11006. *Sir Oliver Franks*. I would like to go back for one moment to what we were talking about before lunch. You made a point of the primacy of the structure of interest rates, the money supply being a concomitant, as opposed to the alternative view that the money supply is dominant, and, that, if that is right, the interest rates falling where they will be about right. There is an element of paradox to the ordinary person in this, because it seems that in most things scarcity does come first and price comes next: if there is a poor harvest prices go up, if there is a good harvest prices go down. You are quite clear that the important thing is the right structure of interest rates for any situation and condition, and that it can he achieved provided that one does not worry about what has to be done in relation to the money supply. What is the reasoning which convinces the person who is not clear about this that it is the structure of interest rates and not the money supply that matters and, therefore, makes him feel comfortable in deserting what he would call the "commonsense of commodities"?——I would accept the analogy of scarcity, but I would say that the prices in question are not the prices of commodities but the prices of securities. Money is a stock, and if one is concerned with the effect of scarcity or abundance of money one must relate that stock to something else which is measured as a stock, namely, the stock of securities, which represents the way in which people hold the country's wealth. Except in the case of things like paintings by old masters where there would be some relevance in this analogy, most commodities have to be thought of as a flow, something which is being produced in a regular way, so much per week or per month. If one is interested in the price of a commodity, one must bring to the comparison on the demand side something which can be measured as a flow: expenditure or something of that kind. I am arguing that, whether it is a matter of consumers' expenditure or whether it is a matter of investment expenditure by business concerns and corporations and so on, that is not determined as a matter of proximate causation by the stock of money.

11007. *Professor Cairncross*: You say in some of your early paragraphs in your paper that there is an asymmetry between the use of monetary policy and budgetary policy, and that it is easy to take advantage of this in order to give concessions in the form of reductions in taxation while continuing a strict monetary policy, and that monetary policy may therefore be too restrictive in the sense of not allowing investment to expand when it would be perfectly possible to have that situation. Does this appear to you to have any bearing on the way in which monetary policy and budgetary policy are co-ordinated with one another and on the constitutional arrangements that should be made for ensuring that they are so co-ordinated? Do you feel that as we stand this is what happens, but that it might not happen so readily if we had a different link between the monetary authorities and the budgetary authorities?——I think a greater degree of co-ordination would be a great help.

11008. Do you feel that this would be so if parliamentary control was exercised simultaneously on the Budget and on monetary policy? Would not the same forces tend to lead to too great a concession through the Budget and more reliance being placed on a restrictive monetary policy?——I think that that bias would still exist. I was not thinking of Parliament as a source of wisdom, I am afraid. A great deal of what I am saying refers to the natural tendency of Ministers to give way to Parliament, whether members of their own party or of the Opposition. If in any sense which means anything Parliament had control of this co-ordination the situation would be a good deal worse.

11009. Do you think that this affects the relationship between the Bank of England and the Treasury, and can you give us your view on any improved relationship there from the point of view of the results which you want to achieve?——I am in no position to claim that I know what the relationship is, except in so far as it has been revealed by the report of the Parker Tribunal. I do not think that that is a matter on which I can properly be expected to know the facts.

11010. It would follow from what you say that you do not think that it is possible to devise a monetary policy in isolation from the policy taking shape in the Budget?——Certainly.

11011. *Chairman*: What is the necessary consequence of that? Everybody might probably agree that it would be desirable to co-ordinate monetary policy, whoever is responsible for it, with economic policy and fiscal policy; does it follow from that that the monetary authorities must he subordinate to the others? If so, ought you not to include the banks too?——I certainly take the view that the Treasury should be the overriding authority in all these matters; but the reasons I give for this asymmetry arise mainly from natural human propensities, and I am not suggesting that they would be entirely overcome by better co-ordination. I think that they would be more successfully overcome if those concerned had their attention drawn to these natural propensities which are apt to cause this bias.

11012. In a sense the argument could be put the other way: that if one could create an authority that is not subject to these human failings one could get a more satisfactory realisation of the possibilities?——That is what I am really saying. I am here drawing attention to natural human failings.

11013. *Sir Reginald Verdon Smith*: Might we take you back to a question that Sir Oliver put just now? I find the argument that the quantity of money is not an important factor very attractive in theory, but I find it prejudiced in practice by a very large number of practical considerations in the way of lags in the system and marginal factors. As I come to think of what you were saying just now in making a distinction between commodities and money, I should have thought that it could equally well be argued that from the point of view of the business man conducting an operation, moving from one position to another, money is essentially a commodity and its volume is possibly of greater importance to him during a great deal of his business activity than the cost of it?——With great respect I should have thought that what matters to a business is its liquid resources. Whether they happen to exist at the moment in the form of bank deposits or in the form of Treasury Bills or in the form of Government securities I should have thought was rather a secondary consideration. What does matter is how liquid the business is and how much fixed investment it can finance without drawing on outside finance.

11014. *Mr. Jones*: You say in paragraph 7 of your paper:

"Restrictive measures are usually called for at times when the country is losing monetary reserves, or having suffered heavy losses is trying to replenish them."

Your paper makes it perfectly plain that in your view credit restriction has reduced the level of activity and that certain productive capacity is latent in consequence of damping down by monetary policy. Has not this been mostly operated not so much in favour of a favourable balance of payments in our external trade as in dealing with the situation of the gold and dollar reserves and of the speculation that takes place from time to time against sterling?——A good deal depends upon the period of time you have in mind. I should have thought that before September 1957 it was mainly the balance of payments that dictated policy, but that in September 1957 it was not so much the balance of payments but the so-called run on sterling. In fact, as we now know, the balance of payments in the latter part of 1957 was not too bad; it was the position of the capital account, the reluctance of people to hold sterling in this country, that was causing the trouble.

11015. To what extent has monetary policy in the last twelve months been responsible for a situation which has given us a much more favourable reserve position?——I think that monetary policy has been effective in two ways: it has not only stopped the withdrawal of sterling

and caused a big reflux of sterling, but precisely because it has damped down the natural expansion of production it has helped the balance of payments. If we were now using our physical resources fully we should have to import considerably more materials for industry than we are importing at present. Quite a considerable part of the favourable balance of payments as revealed by the published figures for the first half of this year can be attributed to the imports which we have saved by not running full out.

11016. What about the expenditure that we saved on the external account, which arose from the fact that the terms of trade moved in our favour to the extent of about 11 per cent. in that period?——That has also been a big factor in causing the improvement.

11017. Is there not another factor that may be taken into account during this same period, which is outside the operation of monetary processes in this country? Has there not been a substantial amount of credit made available to the Commonwealth which would otherwise have resulted in a demand by the Commonwealth countries and by sterling area countries for the withdrawal of sterling balances?——I agree. That has not helped the U.K. balance of payments, but it has helped the reserves.

11018. *Professor Cairncross*: Could I ask one more question on fixed investment? Your view is that we should have struck a different balance between investment and consumption that was more favourable to industrial investment; have you formed any judgment as to the magnitude of the change in industrial investment that would have been proper in, say, 1955. How far short do you feel that came of what it might have been proper to aim at?——You are not asking me to argue against our house building programme or anything of that kind, which I think could have been spread out longer over time?

11019 No. I am asking you how far short the level of industrial investment fell below what you would have regarded as in the interests of the country at that time?——As an order of magnitude I would put it at something like £250 million a year. In 1955 a figure of that kind would have increased net investment in industry by something like 50 per cent.

11020. You are thinking of a change in net industrial investment of 50 per cent.; but the change in the total level of investment would proportionately be a great deal less?——Much less, yes. In relation to total consumption, and that is the source of resources to which one would be looking, it would be a pretty small proportion. Net investment in industry is such a small thing that small differences which may seem scarcely worth talking about represent a great deal to the expansion of industrial efficiency.

11021. In order to bring about that increase you would think, I imagine, first of budgetary changes designed to limit consumption more?——Rather of making budgetary changes which had an effect.

11022. And second of specific measures calculated to channel investment in the direction of industrial investment and permit a substantial increase in that sector?——That is a further point. When I mentioned this figure of £250 million I was thinking of that as coming off consumption in 1955, but I think that one could have got a further contribution from other forms of investment.

11023. The point I was putting to you was that it would not happen automatically and might require specific incentives in industry to cause an absorption of investment resources of that magnitude?——I do not think so in 1955. The whole trouble then was that industry very much wanted to invest, but delivery dates were getting very remote. Their eagerness to invest was limited by physical possibilities. Apart from the immediate desirability then of having more investment, there is also the point that, if business men are feeling buoyant, there is a lot to be said for meeting them and enabling them to give fruitful effect to their feeling of buoyancy.

11024. A continuing higher rate of industrial investment, however, if there had been expansion of capacity for the manufacture of plant and equipment and in building, might have meant special inducements to industry to reach the level which you thought reasonable?——Yes, after a time, certainly, such as investment allowances.

Chairman: Thank you very much, Professor Kahn. We are very grateful to you for coming.

(*The witness withdrew*.)

THOMAS BALOGH, ESQ., Fellow of Balliol College, Oxford, called and examined

11025. *Chairman*: Thank you for coming, Mr. Balogh. May we take the paper* with which you have been kind enough to supply us? We have all had a chance of reading it through, and would like you to develop one or two lines which you dwell on there. I would like to discuss first the things you say about the position of the Bank of England, because they are important to our inquiry. I think that it is inherent in the line you take that in your view, in the post-war years, there has not been satisfactory co-ordination of policy between those conducting the Bank and those responsible for the Treasury. Would that be right?——*Mr. Balogh*: I would not put it quite like that. I would say that both in the Treasury and in the Bank a totally wrong kind of policy was pushed. One might say that in the Treasury there are a great many people who would agree with the Bank's policy, but that the co-ordination between the Treasury and the Bank was not perfect.

11026. At one point you say:—

"The Bank under Mr. Norman and under Mr. Cobbold succeeded in influencing policy in directions in which hardly any Government would have wanted to go, or could go without suffering grave defeat at the polls."

That is a fairly strong statement. What kind of thing had you in mind in regard to that?——The Bank of England after the first World War and again immediately after the second World War wanted to return to convertibility, and convertibility would have meant a policy of such deflation that there would have been serious unemployment. Serious unemployment in a democratic country at the present moment would not be possible for a Government to tolerate for any long time; therefore, there were these hitches in England so far as the policy was followed. Whenever there was a little bit of relief, immediately the relief was used to open up, liberalise and de-control the system. At the next crisis that meant more deflationary policies had to be created. The Bank of England used the favourable periods to open up more than any Government would have consented to, had they been aware of the implications of the policy which they were pursuing. That is quite clear from Sir Winston Churchill's reminiscences as far as Lord Norman is concerned. That is now past history, and therefore the usual discretion of Chancellors of the Exchequer no longer applies. He has been quite explicit about what he thought of the advice tendered to him by the Bank of England and also by some of his Treasury officials. The same frankness has not been forthcoming from his successors, but no doubt when we have reached the fullness of time we shall get the same sort of things.

11027. Do you think that this drive for convertibility which you attribute to the Bank has been achieved since the second World War at the expense of the wishes of the Treasury or of the Chancellor of the Exchequer, or that it has represented a joint policy?——As I say, we do not know very much. One can only go by one's impressions. I should have thought that some of the Chancellors were as much in agreement with the policy followed as Mr. Churchill was in 1925. When Mr. Churchill made his statement in 1925 he was completely in agreement with the policy that was proposed to him by the Treasury officials and the Bank, but it is obvious from what he said afterwards (*a*) that he was unaware of the implications of that policy, and (*b*) that had he been aware of the implications he would not have pursued it. But one cannot say that, at the point of time when he went back to the gold standard, Mr. Churchill was opposed to the Bank of England's policy.

* Memoranda of Evidence Part XIII No. 1.

11028. Do you want to see in the future much more continuous Treasury control of what the Bank does?——I do not believe that merely to change the constitution of the Bank or the legal relationship between the Bank and the Treasury would be sufficient without also changing the long term policy-making organs in the Treasury advising the Chancellor. Chancellors, generally speaking, are not economists. Even if they are economists they may be overwhelmed by the immense duties which rest on their shoulders. I do not believe that they can continuously follow changes in the world economic system. We have not got any sort of organ which would think out long term policies.

11029. The gist of your thinking in these pages is that what really matters is the kind of people that are appointed to the directorate of the Bank?——Yes, the kind of people and the positions in which they are placed.

11030. You stress in one part of your paper that the Bank of England has a history and international prestige, and that we must be careful for the sake of its status not to bring it avowedly under political control; is that right?——I do not think I said that there should be no political control. In a way there is political control now over the Bank of England, if we take the Bank of England Act seriously.

11031. You say:

"The most straightforward way to accomplish the aim of subjecting the Bank to orderly parliamentary control would be to make the Bank a department of the Treasury. The objections to this course, however, are overwhelming. It would mean a complete break with age-old tradition, unnecessarily arouse suspicions and antagonism and complicate the relations of Britain with foreign countries."

Can you avoid that danger if you follow out your suggested new scheme of making the Permanent Secretary to the Treasury the head of the Bank?——I should have thought so. If institutions are kept in being, the bottle is the same; it is only the wine which will be different. It seems to me that from that point of view it is the bottle which is so important, because people get accustomed to it. After all, the Banque de France since 1936 has been under complete governmental control, but everybody thinks of the Banque de France as very much unchanged. The Bundeshank has been completely changed, and the relationship between the Bundesbank and the German Treasury has been completely changed. The relationship between the Australian Treasury and the Commonwealth Bank of Australia changed about four times during the time that I was consultant of that bank; nevertheless there has been no change in the sort of corporate entity of the bank. There is a great deal to be said for maintaining the Bank of England as it is but introducing the necessary changes. The fact that Montagu Norman was Governor of the Bank for twenty-four years completely changed the character of the Bank, and the relationship between the Bank and the Committee of Treasury. As Sir Henry Clay has pointed out, Norman had the utmost contempt for the Committee of Treasury. No reflections as to the present situation are intended, but he certainly had complete contempt for the Committee of Treasury as constituted, say, in 1917 and 1918. He introduced working full-time directors and he introduced advisers. He completely changed the Bank from the late 18th or early 19th Century Bank that it was; nevertheless the Bank of England remained the same. One can change the character of an institution, if one maintains the outward appearance, without any great consequence on its relations with countries abroad. I think that this country is especially capable of maintaining the outward signs of an ancient tradition and refurbishing the inside as it has to be refurbished to deal with the matters in hand.

11032. If you send the Permanent Secretary to the Treasury and one or two other Treasury representatives down to the Bank, in what capacity do they go? He is responsible to the Chancellor and, therefore, the House of Commons for the policies which they vote for. Would that mean that the Chancellor would be liable to answer in the House of Commons for the decisions which they would advocate?——As I understand the matter now, he already is. One cannot say that Bank Rate changes have not been subject to Parliamentary questions or debates. The trouble is that he now answers to a large extent without having the effective power of so managing matters that a situation is not created in which his hand is forced.

11033. Would those who are responsible to him be in a majority in your scheme for the Bank?——I do not think that that is necessary.

11034. Suppose that the policies which on his instructions they advocated were not accepted by the outside members?——I do not envisage outside members coming in on main policy issues. I would like to restrict that to a reconstituted Committee of Treasury on which the full-time Treasury officials and certain other independent experts would be in the majority.

11035. Those who are responsible to the Chancellor, and for whom he will be responsible to the House, are envisaged as having the controlling voice on matters of important policy?——Yes. That would not change the present *de jure* situation at all, because *de jure* the Chancellor can always issue directions under the Act, though he has not done so. The *de facto* situation might change, but only under very exceptional circumstances; and I think that, if those exceptional circumstances were to arise, it would be much better that open conflict should be avoided. What I propose would make any open conflict impossible. The same situation in a different way happens in various other central banks, where there is a power of veto and where Treasury officials are on the board of the Bank though not in the majority.

11036. Would there be any real difference in the eyes of the world between a situation in which the central bank was a department of the Treasury and a situation in which all important matters of policy are decided for it by a group of civil servants responsible to the Chancellor of the Exchequer?——This is said to be the position now, so that I do not see the difference. The difference is that in my scheme the direction begins before a situation can be created in which certain policy decisions are inevitable. For instance, take the Kuwait gap: it was quite obvious that we were losing a very large amount of money; we lost £100 mn. or £200 mn. That meant that confidence was weakened in the pound; it therefore made a subsequent attack almost inevitable. When the subsequent attack followed, our reserves had already been weakened to the tune of £100 mn. or £200 mn., and certain other gaps had not been stopped up. If I had been Chancellor I do not know that I could have made any other decision than the one which was made by the then Chancellor, to raise the Bank Rate to 7 per cent., because the sort of counter measures which ought to have been taken ought to have been employed several months before that in order to be effective without the 7 per cent. Bank Rate. Both last year's crisis and to a certain extent the 1953-54 crisis (which was essentially on the same lines) could have been avoided without deleterious impact on confidence and on investment if the measures had been taken early enough; but as the measures were not taken early enough I do not see what else the Chancellor could have done.

All this presupposes that the Treasury direction is in the hands of people who have economic knowledge. That means two things: first, that there has to be a certain amount of economic knowledge which is irrespective of political viewpoint. Even on that score there have been mistakes made. Though Professor Robbins and I do not agree on most economic matters there are certain matters on Bank of England and Treasury policy on which we would both agree that they were not frightfully well done. Secondly, there is a very large field where the Treasury has to take into account the position of the Government in power and fill their economic model for policy purposes with the sort of assumptions which the Government has and then give advice on those presuppositions. On that score one might be very dubious about the policies in the last seven years. The Economic Section has not been really used in this period.

11037. *Professor Cairncross*: You are laying stress on the Treasury itself working out what would be a proper policy and seeing that through the Court to make its view prevail. On this hypothesis what is there left for the Bank to do?——There is an immense amount for it to do. The Treasury will not handle the day-to-day details of exchange control; the Treasury will surely not follow the whole monetary field. It has not the contacts which the Bank of England has. The Bank might bring in valuable additions.

11038. You are saying that operations will be left to the Bank of England. Is it very easy to conduct the control of a nationalised undertaking, on the basis that operations are determined in one place and the policy governing those operations in another? Is it not almost inevitable that some power gravitates to the people who are conducting the operations because they have technical familiarity with the possibilities?——I should have thought that this view would confound the essence of central banking. Central banking is not about banking: it is about economic policy. The banking aspect of economic policy is an important factor in determining the total of economic policy; therefore experts in banking ought to be consulted. But they ought not to formulate economic policy. Central banking is not about giving loans (that is joint stock banking) or seeing that the issues which are made in the London market will not be defaulted on. Whether the issues should be made is a matter for the central bank; it is in touch with the money market, with the capital market, and it has intelligence on the market situation and can therefore give the Treasury valuable clues. In many countries, as in a way in America, the direction of policy and the execution of policy are in two separate units. It has not worked terribly badly, not noticeably worse than in England. The Federal Reserve Board is essentially different from the Federal Reserve Bank of New York; indeed, there are occasions when there is very sharp disagreement between the two. Nevertheless, ultimately the Board can impose the policy on the Bank. That would be the sort of thing which I envisage for the relations between the Treasury and the Bank of England. When the Federal Reserve System was last reconstituted it was thought that the people on the Federal Reserve Board would be political appointees, as the American system works by political appointees; so the Federal Reserve does not seem to be at all different in essence. Of course Mr. Truman and also Mr. Eisenhower have appointed people to the U.S. Treasury who have a certain economic and political bias very similar to that of the Bank of England here, and their views prevailed; but that was not the case in 1933 when Roosevelt appointed very different people to the Federal Reserve Board; they were political appointees and they pursued a political policy, but nothing dramatic happened.

11039. *Chairman*: But does not the Federal Reserve Board consist of people who are wholly dedicated to the study and control of a central bank?——There are some people who are called on and some who dedicate themselves, but some of the dedicated people are not called on.

11040. I can see that persons in that position, although they are not concerned with the operational side, can take on the people who are ultimately responsible for actual operations; but that is not the situation that you envisage as between the Treasury and the Bank of England here?——I studied in the Federal Reserve Board in 1929 and again a little in 1936. I have known it under Hoover, I have known it under Roosevelt, and I have given lectures there under Truman and Eisenhower. I do not think that the members of the Federal Reserve Board, save in exceptional cases, knew much about these things. They were political appointees in the American sense of "political", not in the British sense of "political"; that is, they were appointed because they had contributed to party funds and such like. They had a large and extremely intelligent staff of economic intelligence officers on the basis of whose advice policy was formulated. I did not agree with that policy. Nor do I think that it is a good thing that the Federal Reserve should be completely divorced from the Treasury. Conflicts have arisen, and great difficulties have arisen in the American money market and capital markets as a result of those conflicts; nevertheless, there is no doubt that the Federal Reserve pursued the political policy for which it was appointed and pursued it on the basis of the best economic advice they could possibly get. I do not see any reason why our own Treasury should not do the same, provided that the Treasury policy-making organs and their influence are strengthened. The Federal Reserve Division of Research and Statistics is bigger than all the economic research departments of the British Government put together.

11041. *Professor Cairncross*: Are you telling us that the Bank of England is beyond all redemption when it comes to policy-making?——The whole of my paper is intended to put forward a scheme by which it could be redeemed; so I should certainly not say that it is beyond redemption. If I had thought that, I should have said that it should be made into a department of the Treasury. I feel that it makes a great deal of difference to have a central bank which is essentially a central bank, concerning itself with the money market, the capital market and certain payments aspects of economic policy, provided that those aspects of policy are not imposed upon the rest of the economic considerations and those parts of policy are not pursued to the exclusion of anything else, so that situations are created in which the whole of the rest of the field has to be sacrificed in order that that policy should be maintained.

11042. How large a staff would the Treasury require if it assumed the functions you have in mind for it?——That would depend entirely on who was chosen to do the work in the Treasury. Some people are capable of doing much work, some less.

11043. If you were the Chancellor, how many would you think it necessary to recruit for the purpose?——That would depend on who would consent to come to help me. I have never considered this question because it is not probable that I shall become Chancellor, but I should have thought that, if I could get really good people, I should not need frightfully many. On the other hand, there would have to be a great many clerks.

11044. I am thinking of the kind of problem that arises in administering exchange control, where the operations are inevitably in the hands of the Bank of England, and the policy takes shape in the Treasury. Do you believe that you could devise a suitable policy, particularly if you distrusted the advice of the people in charge of the operations, with a very small number of people, or that you would require a considerable staff to formulate policy?——I should have thought that the formulation of policy has always been by a very few people. Do you think that many people would devise a better policy?

11045. Is it not very hard to separate policy from execution, particularly if you are not really convinced that the people in charge of the operations will give you the kind of advice that you want?——I would change the people in charge of operations if I distrusted them.

11046. If you did that, would you not find that the Bank of England might be putting forward proposals for action of the kind you think it should not put forward?——I assume that these very few people would see through it. I do not see any correlation between the magnitude of the staff and the intelligence of the policy. Sir John Anderson had a very small economic advisory committee, consisting of Keynes, Henderson and Catto. If one could get men like that I should have thought that that was perfectly sufficient, provided that there were a lot of clerks, so that if one wanted some factual information one could get it. I do not see any difficulties at all.

As far as advice about policy is concerned, all these difficulties about the Bank of England and the Treasury have not arisen just recently. This is a very long story, going back to the 1790's. If you look at Viner's book there are some extraordinarily interesting parallels to the crises of 1955 and 1957, or any of the other crises. This is not a very new thing. One of the most interesting instances of which we know a great deal, especially from American sources, is the extraordinary instance of the so-called "free" sterling at the beginning of the war, when full exchange control was not imposed immediately but a large part of foreign balances was left unblocked and allowed to depreciate, as a result of which our price level rose far faster than it ought to have. A great deal of gold was lost which might have made all the difference had Roosevelt not come in with Lease-Lend. It might have made all the difference as to whether we had to surrender or not in 1940. One might argue that Roosevelt would have come in in any case, but this is not an argument which I should like to accept. I was agitating in those years with Lord Keynes for a closer exchange control. A scheme which we elaborated as early as October 1939 was in its entirety accepted and put through in June 1940. Up to that moment the Bank of England protested that it was absolutely impracticable to impose; they said that it could not be operated and they would not be responsible for operating it. They put this forward in the Anglo-French Commission and

elsewhere. Yet when the Churchill Government was formed and Keynes joined the Treasury in June 1940 it was put through, but it was put into effect in such a half-hearted way that, although we reaped all the disagreeable consequences on confidence, half the advantages which we should have gained were lost; but still the policy was put through. So I am very suspicious when somebody tells me that something cannot be done on mysterious technical grounds, because there have been so many occasions in which policy is suddenly reversed, and the sort of thing which one was told was completely theoretical, academic and naive, is put into effect. If the Bank of England could give me some technical account why it would not want to do something, or would give me an alternative in the case of, say, an exchange crisis, I should listen most carefully to it; I hope that there would be some people who would be able to give me advice on those banking matters with the sort of practical and political presuppositions which I share, so that I could accept their advice with confidence. But I do not think that the argument that the execution is different from the origination of policy ought to carry much weight with you.

11047. *Chairman*: You make a point which interests me about the position of the Bank of England as lender of last resort. You say that there has grown up quite recently a defect in its understanding of that obligation, in the sense that it does not just provide lendings to deal with panic or shortage of liquidity, it just supplies anything more or less on a permanent renewal basis, as I understand it?——Yes.

11048. Has there not always been a condition that it should watch against over-trading in the discount market, which is what this is a symptom of?——I do not think that. There was an incident in the twenties when Mr. McKenna disagreed with Montagu Norman about the policy to be pursued, and bought gold abroad, although the exchange rate was against the gold imports, at a slight loss in order to create banking funds so as to impose expansion on the Bank of England. The Bank of England promptly sold Government securities and the import of gold was neutralised. Nobody then really thought that the banking system would just call money from the money market and force the money market into a permanent debtor position to the Bank and pursue an economic policy contrary to Bank of England policy. But lately there has grown up a feeling that there is no possibility of limiting the banking system's cash reserves by open market operations, because the banking system could force the discount market into the bank and thereby neutralise banking policy; therefore the argument is that there should be a funding of all short-term debt to make it impossible for the banking system to expand according to the natural laws of banking, or something like that. It is supposed that the banking system at a certain point, if it had not sufficient liquid reserves, would cease expanding, so that, if the authorities destroyed a sufficient amount of liquid assets so as to make liquid assets very scarce, the banking system would not expand. This would be a very drastic operation; there are various objections to it. The first objection is that everybody would know that the Government would have to fund a large part of the debt; that is to say, the funding operation would have to be done against an anticipation of that funding operation. It would therefore have to be done on a very bearish market and it would be extremely expensive. The second difficulty is that there is nothing to prevent a bank from going to one of its big clients and instead of giving it an overdraft asking it to cover its liability by a trade bill. A trade bill can be discounted at the Bank, because as soon as the bank underwrites it it is a bankable bill. On the basis of the hypothesis that one cannot prohibit the discount market from going into the Bank, instead of Treasury Bills there would be forthcoming a torrent of trade bills into the Bank of England; so that on this hypothesis there would be no way of controlling the banking situation.

I do not believe that the banking system would operate like that, if the Bank put a sufficient amount of pressure on the discount houses. I may be mistaken in this; my connection with the City ceased some time ago and I would not like to be dogmatic. It is possible that the relationship between the Bank and the banking system is now such that we cannot count on the banking system respecting open market operations by the Bank of England. If that is so, there is a remedy: to have a liquidity ratio which comprises all liquid assets. It is extraordinarily easy, and has been adopted *de facto* in Australia. It is not working terribly well actually, but it is working. But it is the *de jure* Australian system of special deposits that, funnily enough, has now been adopted in England. That worked well in Australia only during the war, not since. I think that it is a rather imperfect system as it is conceived, because, if a bank has a large special deposit at the central bank, it would know that in case of need that deposit would have to be released, so that its banking policy would not be much influenced by the withdrawal of that amount of money unless other measures were taken. This new view on the unlimited obligation to lend is a curiosity which I put into my memorandum because it has been put forward by such eminent authorities that one cannot disregard it; but I feel one ought to sidestep it.

11049. *Professor Cairncross*: You argue in part of your paper for a large Budget surplus. Can you give us some idea of the scale of surplus you had in mind? At one point you speak as if the Budget surplus should be of such a magnitude that the whole of public investment would be financed from it, so that there might be something approaching liquidation of the national debt?——Yes, I said this in 1956. In present British conditions I should estimate the overall surplus needed, including the nationalised industries, as £300 million, which means a conventional surplus of over £1,000 million.

11050. This is intended to include the whole of the capital requirements of the nationalised industries and leave £300 million over, which would go in part to repayment of debt and in part to purchase of equities, which you refer to later?——Yes.

11051. And in consequence of that you foresee, in the absence of a confidence crisis, a continuing fall in the long-term rates of interest?——I should have thought so. That depends how precisely net savings would be affected; but I should have thought that, provided the taxation measures taken were such that the base of taxation was spread, and therefore marginal taxation was not too much increased, there would be a very large increase in net savings. I should have thought that it is not beyond human ingenuity to devise a system by which the Government take in a great many taxes and therefore do not have to rely on very high taxes in certain specific directions. That would perhaps stop the undermining and *amorcement* of the tax base which has taken place.

11052. It was the bull market in gilt-edged which was a surprise to me; it is a long time since we have had a bull market of this kind?——A very long time.

11053. You are assuming that this money that is furnished to the market through the purchase of debt or equities would be absorbed by the private sector, and absorbed largely under the impulse of investment allowances or something of that kind?——Yes.

11054. It would represent quite a substantial increase in the level of investment in the private sector if all this were taken up?——Certainly; the private sector until recently has consistently been a lender and not a borrower. The public sector in this country has been consistently a borrower. Even in public companies the position of financial assets, according to the Blue Book, has always been positive in the post-war era; that is to say, they did not use their full savings to finance their new investments.

11055. Apart from that, have you envisaged the magnitude of the incentives that would have to be held out to lead to this increase of investment in the private sector? What kind of scale of investment allowances are you thinking of?——That would depend what Government was in power, I should have thought, and what other taxation measures are. A surplus can be gained by direct taxation, by indirect taxation, by proportionate taxation, by progressive taxation, by regressive taxation. The amount of incentives that have to be given for investment depends partly on taxation, partly on the expectations of the entrepreneurs about their profit possibilities, and so on. I cannot give you a categoric answer as to how much this has to be, unless you specify to me the conditions which are envisaged. But I should have thought that one could always have a sufficient amount of private investment,

11056. I can imagine that in certain circumstances the profit on investment might appear to be comparatively easy?——I am taking the present public and private sectors as given. I do not want to have too much investment in the public sector which is, after all, only the substructure of productive investment. What is nationalised in this country is mainly infrastructure, and I should not like too much of our investment to be on infrastructure. I should have hoped that it would be in manufacturing investment.

11057. Do you feel that there is such an enormous scope, not just for £300 million, but substantially more than £300 million? Manufacturing industry only accounts for from 25 to 30 per cent. of the total employment of the country?——It would depend how much the net increase in savings was, but I should have thought that £300 million per annum would represent the increase in the gross capital formation, over a half of it in manufacturing industry.

11058. It would be much more than that. Half the gross would represent depreciation?——I am not absolutely certain. I have not looked up those figures. It might be like that. The British investment in manufacturing is, in terms of national income, about 35 per cent. below the German.

11059. There is no need in this country to expand vastly; the population engaged in manufacturing has not been expanding, and is not likely to expand?——The German difference is not all accounted for by increase of population alone. Capital intensity and modernisation is far greater in Germany, and they have been switching over to the "hard" sector at a far faster rate than we have. German investment in the engineering industry and the expanding industries (what I call the "hard" sector) was about 56 per cent., and ours only 42 per cent. An increase in our investment is terribly badly needed.

11060. I am not sure that the German experience is conclusive evidence here. Are you putting these recommendations to us because you believe that there are innovations that could be made use of in industry and are not being made use of currently?——I think so; I do not know. I have not studied many industries in this country very accurately, but in those of which I have some knowledge the difference between the lowest productivity and the highest productivity is much larger than the difference between us and the Americans.*

11061. Is the difference between the lowest and highest as great here or greater than in America?——I should say much higher; much more of the smaller firms have been eliminated there in most of the "hard" sector.

11062. Is not the small firm there a big firm by our standards?——But they have a productivity about three times ours.

11063. Is it your feeling that investment allowances would make these firms respond by investing more capital?——This is a question which almost answers itself. Up to now we never had more than about seven months in 1950 and about six months after the 1954 budget in which investment was not frightfully restricted, either directly restricted or in which investment allowances or initial allowances were not abolished, or considerable pressure was put on everybody not to invest. I do not see any reason why, if the British entrepreneur is not frightened out of his wits every two years, he should not want to invest. It is very interesting that fixed investment has not gone down, even after the 1957 crisis. I do not understand it. I would like to know how it is possible that it has not; but apparently, according to the National Institute's latest review of economic conditions, neither fixed investment nor stock building has been really affected during the period of dear money. I should have thought they would, but they have not.

11064. I am very interested to hear you say you thought they would, because I thought from your paper you did not think that monetary policy would in fact have been effective.—*Chairman*: Was not one of your objections to monetary policy that it would not be effective in influencing economic decisions through altering the cost of capital? That is based on your observations over recent years, I take it?——Yes, but the 1957 measures were not monetary policy in the sense of acting on supply and demand by raising the price in the hope that by raising the price they would make demand ebb away. There was a very fierce direct rationing. Nevertheless, neither stocks nor fixed capital investment have apparently gone down at all. One may argue that without monetary policy both fixed investment and circulating capital would have immensely expanded; but I do not think that one can argue that in this country the horse has been taken to the trough but has not drunk, because whenever be even approached the trough a terrific smack was administered to his nose: nevertheless he sort of nuzzled himself into the trough to drink, even with all those handicaps. So the argument that, if one created a situation in which we could have higher investment without inflation, without a confidence crisis, without a gilt-edged collapse, the horse would not seize that opportunity, is at least something which ought to be substantiated, and cannot be substantiated from our post-war experience.

11065. *Professor Cairncross*: The horse in the Clyde does not show much sign of drinking, although it is in the trough up to the neck; it is hard to say that it has not got plenty of incentive?——Investment in shipbuilding, you mean; I do not know. Perhaps they were so badly burned before that they are not among those who are attempting to expand. In steel there is also this reluctance. We are not here to argue whether one ought to increase the nationalised sector because the private sector is not able to expand. That would be a line of argument one might pursue. I do not want to pursue that, because I feel that if one gives sufficient incentives one will get expansion. I do not believe that one can say that, provided incentives are given for writing off capital quickly under certain conditions, and perhaps reaping a tax profit, investment would not be forthcoming.

11066. *Mr. Woodcock*: I wonder if you could explain something to me, because I seem to see a contradiction running through the document as a whole. On the one hand you say that monetary policy is ineffective and should not be used to regulate the economy; then you go on at quite considerable length to advocate such things as variable liquidity ratios, control of bank advances, control of non-banking financial institutions, and things of that kind, to make monetary policy bite. What role do you see monetary policy playing?——I should not at all like to say that monetary policy is ineffective. I would say that it can be effective only at a disproportionate cost if it is pursued in isolation. If all other controls are abandoned and the whole management of the economy is entrusted to monetary policy alone, I feel that it either will not bite or, if it bites, it bites at the cost of unemployment, destruction of confidence and such like, which would be a disproportionate cost, and which I would not advocate at all. On the other hand, I think that there is a great deal to be said for monetary policy as an adjunct of general economic policy in conjunction with other controlling apparatus. That is one of the reasons why I advocate the reform of the Bank of England, rather than the elimination of the Bank of England or its amalgamation with the Treasury, because I feel that the Bank of England, if properly managed and properly staffed, can contribute an essential and very important role to the working of other controls. I feel, for instance (I know this is being wise after the event), that in the immediate post-war period much more could have been done had the profit motive been put to work for controls rather than against controls; that is to say, if one had used discriminatory tax concessions together with direct controls and with monetary policy. I think that the three biting together in the same direction might well have been effective, whilst each individually would not have been sufficiently effective, or would have produced bad results (in the case of controls evasion and the possibility of black markets) which, if they had been handled together in unison, would have been avoided.

Nor would I like to say that monetary policy cannot under any circumstances be effective by itself, because obviously one can destroy confidence in profitability by violent monetary shocks. The most interesting example of monetary policy alone being effective is furnished by Soviet Hungary. In Soviet Hungary, where I was after the war as deputy chief of the U.N.R.R.A. Mission, we

* *Note by witness*: In connection with this answer and the subsequent discussion I should like to call the Committee's attention to *The Competitive Process* by J. Downie (published by Gerald Duckworth and Co. Ltd.), especially chapters 14, 15 and 16.

witnessed an inflation the like of which could never have been experienced before; it went into quadrillions or quintillions, much more than the German inflation after the first world war. They succeeded in inflating an index money, which is quite an achievement. In the end the whole thing was stopped by raising the re-discount rate to some 50 per cent. and imposing credit rationing. A great many people went bankrupt and very large unemployment ensued, but the pressure was sufficient to bring out hoards of goods which had been accumulated during the inflation, and after a time "normal" times returned. With enormous suffering, which they could bring about because they had repressive police machinery, they could make monetary policy work effectively.

I do not think that the example is particularly one which one wants to follow, but one cannot argue that it is not effective. On the other hand, if one wants to lower the rate of interest at the point when demand for capital is rising, as we did immediately after the war, obviously it can be done. The cheap money policy could have been carried through if direct controls had been very much better. But it made direct controls slightly more difficult; so when Sir Stafford Cripps abandoned it I think he was quite justified, because the increase in the cost of money did make some difference to the control of the economy, although not a sufficient difference. There was a period between 1948 and 1950 when with more controls and more monetary policy the ensuing troubles could have been avoided. As it was, the liberalisation immediately after 1948 led to the devaluation in 1949 which again caused the next crisis because of the ensuing worsening of our position. Post-war policy, I think, was far too concentrated on direct controls without the pricing mechanism. At present we have gone to the other extreme of relying far too exclusively on the pricing mechanism without having direct controls. I advocate that monetary control should be used as one important weapon in the armoury, but certainly not be relied on as a sole weapon, because I think that in that case it is either ineffective or costly.

Chairman: Thank you very much, Mr. Balogh; we are very grateful for your attendance.

(*Adjourned until Friday, 24th October*, 1958 *at* 10.45 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-SEVENTH DAY

Friday, 24th October, 1958

PRESENT:

The RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.

W. E. JONES, ESQ., O.B.E.

PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH

GEORGE WOODCOCK, ESQ., C.B.E.

MR. R. T. ARMSTRONG, *Secretary*

MR. G. PENRICE, *Statistical Adviser*

The following witnesses, representing the Electricity Council, called and examined:

SIR HENRY SELF, K.C.B., K.C.M.G., K.B.E., Chairman

SIR JOSIAH ECCLES, C.B.E., M.M., Deputy Chairman

R. S. EDWARDS, ESQ., Deputy Chairman

A. M. SCOTT, ESQ., Financial Adviser

11067. *Chairman*: Good morning, Sir Henry; we are grateful to you and your colleagues for coming along. May we take the paper* you have been good enough to send us? The general picture seems to be that you have been facing a backlog of work which has not yet been overtaken?——*Sir Henry Self*: It would be more correct to say that it has been overtaken, and that today we are able to meet the load without serious risk of power cuts. There might be a measure of voltage reduction but no actual load shedding except in a really acute arctic spell which might last for the odd day or so. It is a question how far the economy of this country can budget against short arctic spells. That is a basic problem with us; we have endeavoured to estimate the risk factor in terms of how many such spells are likely to occur in a hundred years and to say what is the measure of risk which should be accepted. There are various schools of opinion on a matter of that sort, but we have in mind as conditions develop to accept an increased measure of risk. There is another slant to the whole of this problem: our plant is not always available in full. We run on average on 88 per cent. of the plant available for peak load in the winter. We think that we should take the first risk on that, so we are going to work to a 90 per cent. availability, which is the first step towards reducing our forward programme requirements. The extent to which we can develop that into acceptance of a greater measure of risk for really cold spells should be the next step to be looked at.

11068. The backlog, in the sense of being able to provide for current demand, is pretty well overcome?——It has been met by the programmes already achieved and in the immediate future on the generating side. It has not been met on the distribution side. We have made representation after representation that we cannot go on like this. We are using obsolete and potentially unsafe equipment, and we cannot go on in a condition where this equipment is so obsolete and likely to become dangerous very much longer. We are certainly highly embarrassed, as probably those of you who are electricity consumers have realised in your individual areas, in not being able to maintain voltage during peak periods because of local inequalities in the distribution system. In some localities the supply is there from the bulk mains but the local system cannot deal with it. The inrush of new consumers has been so great that we have been recently in considerable perplexity how to meet the demands of new consumers with the existing distribution systems. So we have continually urged that we should be allowed to have increased capital allocations to bring the distribution system into line with the generation and the bulk transmission.

11069. *Professor Cairncross*: Would it be fair to say that in the postwar period your investment in generating capacity has rather more than kept pace with the consumption of electricity?——*Sir Henry Self*: It has not kept pace. We have had periods in which we were woefully under capacity, but today we think we have enough capacity except for really arctic spells. That is a recent development; it dates from not more than twelve months ago.—*Sir Josiah Eccles*: We had a backlog of about 2m. KW at the end of the war that had to be made good; in addition to making that good we are now on top of the job. With regard to current growth it can be said that over the years we have done more than keep pace with the load.—*Sir Henry Self*: We have a very large amount of obsolete plant in commission which we have to keep in service against peak demand, which economic practice would get rid of at once and replace by modern plant.

11070. In economic terms you still have considerable arrears to make up?——Yes. If we keep obsolete plant in commission and supply at a loss on our current tariff prices in order to meet a peak load, that may mean having plant to stand by for a long time. Take Bankside "A" station, the hideous place with eight chimneys sticking up side by side with our splendid new Bankside "B" station: Bankside "A" has hardly been in commission at all over the last couple of years; it is only in commission for short spells in the winter, and is standing by during the rest of the year. Bankside A" is going to be put out of commission this year, as one of the stations we want to get rid of urgently.

11071. *Professor Sayers*: In deciding whether old plant has ceased to be economical, you must be using a rate of interest. What rate of interest do you use?——This is one of those vexed questions that the accountants will not agree on. About 1950 our central auditors complained that we were not including in our assessment of the cost of working such plant a charge for assets, and they could not accept the thesis that, having been written off, no charge was due. If we do not charge a capital element we do not charge an interest element. At the present time our thought is that we should make a charge for assets; if we do it will of course include a capital as well as an interest charge.

11072. But when you are deciding when old plant is uneconomic it is interest on new plant that is relevant, not interest on old. How do you determine that?——*Sir Josiah Eccles*: That is taken as the current rate of interest which we are paying for current loans.

11073. *Professor Cairncross*: You have indicated that you still have a substantial backlog, particularly on the distribution side. Do you see anything in the future that

* Memoranda of Evidence Part X No. 2.

is likely to imply a slower rate of climb in demand than in the past?——Each of the twelve area boards prepares an estimate from its local knowledge and experience of what is in the offing known and believed to be coming for five years ahead. We have a central statistical unit which estimates according to national characteristics and forward thinking on productivity, and all the information that is available from those two estimates is compared and adjusted to a common forward estimate; so we have as firm an estimate as one can have in a situation such as this of growth for five years ahead.

1074. *Mr. Woodcock*: Of demand?——Of demand and of units too: the units likely to be needed by industry are a measure of the capital investment likely to be required.

1075. *Professor Cairncross*: In the postwar period electricity was remarkably cheap in relation to prewar. This must depend on the rate of interest. Are you assuming that electricity will progressively become relatively cheaper than other forms of fuel and power?——All our estimates are based on the current competitive position of electricity *vis-à-vis* other fuels. It is a bit in the realms of speculation to assume that we shall have even more competition in the future than we had in the past; but we take into account physical phenomena such as the determination of the railways to change over to electric power as against steam, and what we know of what private industry is doing in liquidating steam plants and introducing electricity as a matter of economics or convenience. Fortunately for us we only really need to know firmly for five years ahead, because that is the period that is required to order and commission new generating capacity in particular. Percentagewise the increase in demand is falling; in five years' time the annual rate of the increase in demand will probably be 5½ per cent. whereas it is running now at 7, 8 or 9 per cent. That is a little misleading physically, because it is a percentage on a bigger total, so that arithmetically there is a steady rate of growth over the relevant years ahead; there does not seem much letting up.

1076. *Mr. Woodcock*: What about the cost of providing the new equipment you need to meet this estimated demand?——Because of the technical developments that have taken place in conditions and size of equipment and consequently more economical use of space in a power station, the present cost per kilowatt is no more than it was in 1948 despite the 70 per cent. increase in wages and material costs over the ten years.

1077. What about the rate of interest? How do you reckon that?——*Sir Henry Self*: The rate of interest is the best forecast we can give of what the rate of interest is likely to be over the period of the plant's actual use. Nobody is in a position to give other than a working forecast as a guide; but the interest charge is brought into the estimates of the cost of producing electricity from that plant and the plant has to bear the full capital charges.

1078. What is the interest charge?——If I may, I will let you have a statement of the actual figures we have been working to and the way those figures have been adjusted from time to time over the various years*. In working out the estimates our position is complicated today by the fact that Exchequer advances are the main source of borrowing, and the rate of interest on those is determined by the Government and not by us. I am not able to read into the minds of the Government their intentions as to the future rate of interest on Exchequer advances. They also prescribe that we shall repay our advances over twenty-five years; so as we take them we know what interest rates we have to pay on them.

1079. Do you suppose that the Government should let you know their intentions as to interest rates?——I think that they most definitely ought to; we should not be exposed to an uncertain position in forward interest charges. The rate of interest may at the moment be high relative to what we think it should be if we could get the money in the open market, and it is a very important factor in our forward assessment of the economic working of plant.

1080. *Mr. Jones*: During the period of high interest rates from September last year to May of this year, the nationalised industries would have been borrowing money from the Government at something like 6 per cent. Do you continue to pay 6 per cent. for the lifetime of the money they lent you at that particular time, or will that rate of interest vary according to the rate of interest prevailing from time to time?——The Government have insisted that we should commit ourselves to pay them the current rate of interest as determined by them for the full period of the loan.

1081. And that would be 6 per cent.?——It has been of that order; it is now 5¾ per cent.

1082. *Professor Sayers*: In deciding whether a new construction is economical or not, do you use that rate of interest?——No. We would have our own judgment as to what is likely to be the trend of interest rates, and if there is reason to assume that there may be a fall in interest rates generally, we have to assume that the borrowings over the forward years will be subject to some fall in the rate of interest.

1083. But it is the rate this year that is relevant?——That plant will not come into commission for five years.

1084. But that is not relevant. The rate of interest in five years' time is not relevant to the construction that is economical this year, except in so far as expectations of the future trend of rates have already affected the market rate today?——In so far as we order plant, a liability has been incurred. If it is paid for out of money borrowed at 6 per cent., 6 per cent. would be the rate included in the working economics of that plant. But this is really wrapped into the whole complete picture. We have to get the best competitive plant we can. The forward development on competitive plant is such that the interest element does not loom all that big in the picture. The plant is going to show economies; as Sir Josiah said, the cost per kilowatt was £45 in 1948, went up to £67 in the middle of the peak, and has fallen back to £45 a kilowatt today. The forward development of plant is producing so much by way of economies that that overrides the interest factor. The interest factor is an important one, but it is not by any means critical. We have to plan on the assumption that our forward development is always producing plant which is overall more efficient than anything we have, even allowing for the worst conceivable incidence of capital charges. With the nuclear programme a different problem is emerging; the capital costs of that plant are two and a half times the costs of conventional plant, the interest charge becomes a really critical problem.

1085. *Chairman*: In looking five years ahead and making your calculations as to what the economic result will be of particular forms of capital expenditure, you bring in, as you say you must, your own forecast as to what the rate of interest will be. When the time comes for you to take up the money from the Government which is needed for that expenditure, it may turn out that owing to changed circumstances in the meantime you are getting money at a different rate than that which you took when making your estimates of the practical results that would come from that plant. If the rate was higher than you expected would you recalculate the worthwhileness of the expenditure?——There is no question of trying to pull back a major project once started, but the forward development of the nuclear programme would have to be seriously considered if the trend of interest charges rose. But very critical issues arise here. Government fuel policy turns heavily on the question of the availability of coal, oil and nuclear energy. Pending working experience the economics of nuclear power cannot be defined with any precision at the present time; the experts disagree to quite a considerable extent. That being so we are back on the basic issue, that Government policy prescribes the need for the nuclear programme because of the energy position of this country. I cannot help feeling that our anxieties on the interest rate would not be allowed to prevail against a Government forward policy for the development of nuclear energy as a matter of national policy. Personally, I think that nuclear power will hold its own after a considerable teething period, which we have to get through. It is a matter of economic judgment to weigh that against the inevitable necessity of going forward with a national policy because of our fuel situation.

* See Appendix to Minutes of Evidence.

11086. *Professor Cairncross*: You are saying that interest rates are not to determine the position between nuclear energy and other forms of power, since it is a matter of Government policy to go forward with nuclear energy stations. But the necessity to go on was forced on you by the Government's decision in favour of a standstill in capital investment in nationalised industries. Did not that decision itself arise out of the kind of shortage of capital which might otherwise express itself in a high rate of interest?——*Sir Henry Self*: If we were dependent on getting money in the open market we should have to pay for it, but in our judgment we could get our money on the open market and pay the appropriate rate, and still justify going forward with our plant programmes as fully economic in view of the great improvement in efficiency. The manpower used on plant has dropped in the most remarkable way over the last ten years.—*Sir Josiah Eccles*: Take for proof the technical performance of the plant for the year ended March, 1958, as against the year ended March, 1957: if we had been running at the same efficiency in 1958 as in 1957 we should have required one million tons more coal. That is one measure of the improved thermal performance for the same output of electricity. Over the period of ten years the total saving measured in that way has been 41 million tons of coal, which in terms of money would be roughly four times that amount in sterling. Then manpower in the power stations is down by about 33 per cent. as compared with 1948 mainly because less people are required to operate, control and maintain.—*Sir Henry Self*: Money is one of the factors on which to seek economy, but coal is a basic material and manpower is another basic requirement. The economies in those important fields are, I should have thought, more important than the capital charges.

11087. We are trying to see in what way the rate of interest charged by the Government would affect your policy in the future. You could develop pumped storage; you could go for nuclear power or thermal stations; you could have alternative tariff arrangements. In making all these decisions, do you work on the basis of the current rate of interest as charged by the Government or do you work on some other rate of interest?——We have two Acts which prescribe the charter and the conditions of the work of the industry. The Acts have prescribed specific duties and responsibilities; one of them is the development of rural electrification. Left to ourselves we should not go in so fully for rural development; generally speaking it is not economic. Much of it has to be undertaken at a loss during long initial developing periods. But we have to have regard to the stipulations in the Acts as to how we shall run our affairs. We are called upon to balance our working, taking one year with another, but including in the charges all relevant factors such as depreciation and interest. The redemption of capital is a specific charge upon us. We are only called upon to provide for a working surplus which will cover contingencies and serve as a cushion through difficult periods. Therefore we are obliged to consider our global position. Our global position is a question of the total interest charge that will emerge in any given year from the total outstanding capital obligations of the industry. It is necessary when deciding between projects to weigh the economic virtues of each project, but taking the industry as an industry the interest charges come in as a global obligation to be met over a period running for forty or fifty years ahead. We work to an estimate of our outgoings including those global standards. If we start trying to adjust the rate of interest to particular projects, we have to discard a lot of the work we do today.

11088. *Mr. Woodcock*: I understand from your reply on nuclear energy that the decision will be not yours but the Government's about the desirability or need to get ahead in the exploitation of new sources of energy, and that it would not be your function to object. You might comment that you did not like it or that you thought it could not be done economically on the present rate of interest, but it would be a Government decision whether or not to go ahead?——That is so. I would not like my answer to be construed as being that we would not have gone on with the programme. We in fact support the nuclear programme as announced in the White Paper as a form of development for the industry; but in the last resort it would be a Government decision on national policy, and it would be our duty to carry forward that decision.

11089. *Mr. Jones*: In other words, you do not work on strict commercial interests at all; you seek to develop a service which gives a full and sufficient supply of electric power on the basis of securing a return, where the good years will make provision for the bad and the bad years be rehabilitated by the good?——Not entirely. We regard it as our duty not to construe our forward obligations on the strict assessment of historic cost but to make additional provision in the field of depreciation. In our recent accounts we have included £10 million each year as a special provision for depreciation of generating plant, because we feel that the depreciation rates provided, although fully justified in themselves, require a measure of supplementation, especially in view of our heavy forward development capital programme. It is prudent for us to make additional provision for the replacement of existing assets and for carrying our system forward, realising that by doing that we increase our internal provision, so helping towards capital development. But we should not feel it, on our present assessment of our responsibilities, as our duty to place a specific charge on consumers for the provision of forward capital to finance a forward capital programme and the growth of assets, except on a clear indication of Government policy that that was the right thing to do. It is not enjoined by the Acts. It is within the power of the Government to give a direction to this industry that in view of our heavy capital forward programmes our internal provisions should be supplemented by a special addition to revenue to increase our self-financing; but in my submission that must come as a Government direction, and must be reflected into the minds of consumers as Government policy.

11090. Do you anticipate that you will pay the prevailing rate of interest, not upon the cost of a plant undertaken in a given year, but upon borrowing you make as you require money to go forward with your capital projects?——Yes; that is precisely the position I was trying to put over in another way just now.

11091. *Chairman*: In your planning as between one form of capital expenditure and another, how far do interest rates come in to affect a choice? And when the rates of interest on your borrowing from the Government change, does that lead you to do something you would not otherwise have done according to your plan, or not to do something you would have done?——In deciding on the economic virtues of competitive propositions we take a rate of interest appropriate in our judgment to the period during which that plant will be in commission. At the moment we are working on the assumption that the present rate is high, and that we shall see a modest fall in that rate. Of course we also have to consider the manpower requirements and the consumption of coal or other fuel in assessing the merits of competitive projects; but we always make a judgment as to what would be the interest charged on the money committed to a project over the period of its life. Our judgment might be wrong, but we have always endeavoured to make a forward estimate. We worked on 3½ per cent. in our early phases; that is now shown to have been optimistic, and at the moment we are working broadly on 5 per cent. Whether that is too high is a matter for judgment: I do not know. These things can only be worked out as an experience. When they come into our global treatment, 3½ per cent. and 5 per cent. merge into a common interest pool charge.

11092. *Professor Cairncross*: You know the rate being charged by the Treasury, and the element of judgment, I take it, is a judgment as to what that rate will be when you come to spend capital on the schemes that you are considering. It is not judgment over the long period but over the short period. I wonder what that period is?——Five years; the period before the plant comes into commission.

11093. *Mr. Woodcock*: You say in one of your paragraphs that the level of the industry's capital programme is controlled by Parliament globally. Would I be right in thinking that whether you should embark on a programme that involved £2 million or £5 million would be decided by the Government and not by the rate of interest?——The practice is changing somewhat at the present time. Hitherto the Government have tried to control not only

our actual expenditure on capital investment during the immediate year ahead and by the global total of the programme for three or four years ahead, but even by individual projects. The present thinking is shaping more or less clearly to a view that the Government will give us a global overall picture, and it will be for the industry to work out its economic treatment. We shall be relied on, as I understand the position, to determine the amount of capital investment expenditure which should accrue in the year immediately ahead and the year following as a forward indication, and the forward position three to five years ahead on a global content will be subject to a fuel policy which is determined by the Government.

11094. Subject to more than a fuel policy; subject to a decision by the Government that is not just economic but is relevant to broader circumstances: the general economic situation, the difficulty of raising capital and so on?——Economic policy is reflected in the global authority to plan a programme forward of a certain overall size. The individual projects within that global total have to be determined by the industry, but in determining them they must have regard to the Government's fuel policy as such.

11095. Surely more than the Government's fuel policy: the Government's policy without the "fuel" qualification?——*Sir Josiah Eccles*: The future economic policy of the country determines the requirements of this industry in the first case, and therefore the amount of money that the Government is prepared to put into electricity year after year. Having decided that, then there is a second round assessment as to how this money should be spent, say on generation, which is the major capital requirement at the moment. How that money should be spent, how it is carved up, what proportion of it shall be in one thing and what proportion in another is determined by the Government's fuel policy. The overall amount which is available for electricity purposes depends on the requirements of the industry, and that is determined by the estimate of the forward economic progress of this country.

11096. Equally, the Government can require you to postpone a particular project?——We have a statutory duty, which is written into the Act. In simple words it means to provide all the electricity that is required. If we are to discharge that duty, we have a certain minimum forward development that must take place. That minimum is determined by the economic prosperity of the country as foreshadowed over the next five years. If the Government wished us not to discharge our statutory obligation, then we could go back below that minimum, but it would be difficult for them to do that.

11097. But they could do it?——*Sir Josiah Eccles*: They could do it.—*Sir Henry Self*: Suppose that they give us authority to commission $2\frac{1}{2}$ mn. kW of plant, say, in 1962; they reach that determination in the knowledge of the overall economic situation of the country; and they say also that for fuel policy reasons so much should be nuclear power, so much should be thermal plants. They give us a broad indication, and tell us to map out our programme. There was a time in the past when, having got that far, we had to look for some clearance of major projects as such, but present thinking is, as I say, to see how the industry can work out its own allocation of the available funds within the global total and yet conform to the fuel policy of the country.

11098. *Sir Reginald Verdon Smith*: Am I right in understanding that you have for a variety of reasons never yet had, and for some time ahead are unlikely to have, any reason to regard the rate of interest as a determining factor as between one project and another?——I am sorry if I gave that impression. The rate of interest enters into the determination of projects as between themselves, but the forward development of the industry as a whole in global terms must go forward as an act of Government policy. That is reflected in the Government's treatment of our provision of capital; they tie us to gilt-edged terms. They bold us to a timetable which is clearly related to the whole Government financing programme, so that we are in effect part and parcel of the Government financing of the country. It is not a system we like, but there it is. One has to recognise the effect on our overall national economy. We would prefer to go on the market and raise our own money and justify our forward programmes on straight economic grounds. But within our own assessment of projects we definitely relate the capital charges on one project against the other, and interest looms very large in the assesment.

11099. *Professor Cairncross*: When you say that you would like to go on the market, do you mean with a Government guarantee?——So long as we have a forward programme of the size we have got, I should have thought that the heavy total that we require would necessitate the Governent taking a hand in timing it, and we should have to come back to reliance upon the Government guarantee to get the money taken up. Past experience has proved that. But it has also operated heavily against our going on the open market; at one stage our bank overdraft rose as high as £182 million, a picture completely dismal to us, but we were stopped from going on the market because of current national difficulties, and we bad to build up this heavy overdraft.

11100. *Mr. Jones*: Is it not more economic to have Exchequer loans than to raise money on the money market? Do you not get money then just as you want it?——That is a matter of opinion. At the moment we are pinned down to $5\frac{1}{2}$ per cent. on our borrowing, and have to pay that for 25 years. Personally I think that that is a high rate for that period and I do not think that we are getting real advantages from Treasury borrowing. I do not like, and I do not think my colleagues like, Treasury borrowings. Our industry has always earned a working surplus. We have accumulated £100 million of surpluses over the last ten years. We are convinced that we are a thoroughly economic business which could stand on its own feet in the national setting, but because of the national needs we have to face a capital forward programme rising to £400 million a year. That is a problem which obviously has to be thought over very seriously.

11101. Why do you have to pay $5\frac{1}{2}$ per cent. to the Treasury at this particular stage? The Bank Rate is now $4\frac{1}{2}$ per cent., and the Treasury Bill rate is about $3\frac{1}{2}$ per cent.?——*Mr. Scott*: It is a question of the difference between short term and long term.—*Sir Henry Self*: We have been hoping to have an indication of a reduction in the rate.—*Mr. Scott*: There is no sign of it coming yet.

11102. *Professor Sayers*: You would not seriously contend that you could raise twenty-five-year money on the market?——*Sir Henry Self*: At the present time, no, but there is the question of temporary borrowing. We do not need to be tied to a period of twenty-five years, but the rate and the period of Exchequer loans are determined by the Treasury. It is not a free negotiation.

11103. You mean that you would like a chance to speculate on interest rates?——No. I have always held a very strong view against that. We have superannuation funds which are building up to very large totals indeed, and as chairman of the committee of trustees I have always enjoined them not to indulge in day-to-day variations of their investments, because it is their duty to be a stabilising factor, not upsetting the economy.

11104. *Sir Oliver Franks*: The picture in very general terms seems to be that the authority which you represent has its constitutional being laid down in the statutes which prescribe its duties and obligations, and that this is rather like the law in the Constitution of the United States: it both binds you and gives you independence. As long as you operate within the binding clauses you can go quite a long way in asserting that independence against anyone else, including the Government of the day. You on the whole want to see yourselves as free from intervention or interference by the Government of the day as may be. Clearly certain things have to be determined by the Government of the day: for example, the broad balance between nuclear power and thermal power and so on as you have described, and the amount, over a three or five year period, of the real resources of the country which can be put into the development of electrical programmes; but subject to that you feel that you should use the status of your constitution to fend off outside intervention from whatever quarters it may come. Is that a broadly fair statement?——Yes.

11105. *Professor Cairncross*: Do you think that the demand for electricity is affected in any way by the price you charge?——*Sir Josiah Eccles*: It is extremely difficult to say. Following the war there was control of alternative fuels in the domestic sphere until a month or two ago. Where there is only a restricted amount of alternative fuel people are forced to use the un-restricted fuel. Probably that factor more than any other has moved domestic consumers to go over to electricity. It is extremely difficult to say how the price factor has affected it, if at all.

11106. Would it not be surprising if the price factor was not of some interest to some consumers? You suggest that on the domestic front the price factor has been one of the factors. What proportion of that price is represented by capital charges, taking a new plant put up today?——Interest and depreciation charges account for about 25 per cent. of our annual bill of expenditure.

11107. Taking a nuclear station completed five years from now would not the proportion be rather higher?——For a nuclear station the proportion of capital charges will be about 50 per cent. of the total generating cost. That is not quite the whole of the story, because the 25 per cent. I gave you was on the overall cost of generation, transmission and distribution, the whole product of the industry; expenditure on nuclear generation would have to be amalgamated with the secondary capital expenditure in others fields to sell the electricity; but I think I am right in saying broadly that the capital charges on the nuclear station *per se* would be about half the total cost of running that station.

11108. I think it would be helpful to separate the generating capacity from the distributing capacity and confine it to new construction. The issue is not one which relates to existing capacity. What happens in the longer run if you have to work with a rate of interest of 6 per cent. instead of 3 per cent.? What happens to the tariff you have to charge?——The capital charges expressed as a proportion of the running costs are bound to go up with the nuclear programme. But the fuel cost will go down, and if nuclear generation is as economical as we hope it will be (I underline that, because we are in the realm of some speculation here) the gain on the running costs will offset the increase in the capital charges with a margin of about 10 per cent. overall; the capital charges will go up, running charges will go down, and the cost of generation may be about 10 per cent. higher than with the best of our present coal-fired stations.

11109. *Professor Sayers*: On what rate of interest is that 10 per cent. calculated?——5 per cent.

11110. What would you put in place of 10 per cent. if you took an interest rate of 3 per cent.?——Much less, because annual capital charges would go down, and the running charges would be unaffected substantially; so the economics of nuclear generation would be better.

11111. How much better?——*Sir Josiah Eccles*: We are depreciating these stations on a twenty year life, which is the safest estimate that we can make of what may happen; so the interest charges are not quite so heavy as depreciation. If depreciation and interest were equal then the total annual cost would be 10 per cent. of the capital cost, 5 per cent. for interest, 5 per cent. for depreciation. If the interest fell to 3 per cent., that figure of 10 per cent. would drop to 8 per cent.——*Sir Henry Self*: If you would like this point pursued we should be very glad to give you some figures for it; in working out forward development of nuclear stations interest looms very large in the picture. If there is an improvement in interest rates it will be greatly to the benefit of the nuclear programme.—*Professor Sayers*: We should be grateful if you would give us some figures‡.

11112. *Sir Reginald Verdon Smith*: From the financing point of view would you regard it as practicable that the area boards should develop or be changed into authorities of their own, similar in position to our municipal and county local authorities, with their own access to the market?——I can only give you a personal judgment on that, because the Act requires the Electricity Council to judge the merits of a case put forward by a board before any action is proposed in that way; therefore I should not say anything which shows a prejudiced mind. But as a personal judgment in present circumstances I should say that it is most undesirable that individual boards should go out with stock issues of their own because of the overall position of our capital programme and our very heavy requirements. We might have some prejudice; certain boards might possibly get preferential raisings of stocks as against the provision for the industry as a whole. We are working as an industry to a common pooling of all our achievements. It has been established over a period of twelve years and all boards are convinced of its virtues. Nobody has suggested the possibility of going out individually, and I think all would share my present view that it would be most unwise to prejudice our programme as one general standard.

11113. Is the expenditure of the Central Electricity Generating Board on capital account vastly the majority of your annual capital expenditure?——About two-thirds; but the area boards' provision of internal resources towards future capital requirements is quite considerable, some running as high as 80 per cent. of their forward capital grants available from turnover. The Generating Board, because it has had this heavy plant programme since 1945, is not up to 40 per cent. With the advent of the nuclear programme the position is going to be worse, because of the heavy charges, and not better as the years go on. Therefore I do not think that it could be right to have the position of the Generating Board prejudiced because of its national obligations, as contrasted with individual boards in a relatively strong internal position each going out for small contracts one by one.

Chairman: Thank you very much, Sir Henry; we are very grateful to you and your colleagues for your help.

(*The witnesses withdrew.*)

The following witnesses, representing the Association of British Chambers of Commerce, called and examined:

FRANK BOWER, ESQ., C.B.E., President, A.B.C.C.; a manager of Unilever Ltd.

E. T. SARA, ESQ., Chairman, "Radcliffe Committee" Panel, A.B.C.C.; Commercial and Economic Adviser to United Steel Companies Ltd.

C. H. MARSH, ESQ., Member, "Radcliffe Committee" Panel, A.B.C.C.; Finance Director of Henry Simon (Holdings) Ltd.

E. TONKINSON, ESQ., Secretary, "Radcliffe Committee" Panel, A.B.C.C.

11114. *Chairman*: We are very grateful to you and to your colleagues, Mr. Bower, for all the trouble you have taken on our behalf in promoting and securing this questionnaire* on the state of affairs after the 7 per cent. Bank Rate. It bears very directly on our problems. Now we have the chance of seeing you we must regard you primarily as interpreters of the questionnaire, I take it, but before you had a chance of sending that out you had collected views for us in your earlier memorandum† which I should like to have before us too. There are one or two questions which may enlarge the significance of the answers to the questionnaire.—*Professor Sayers*: In the "Grand Total" of replies you show that 11 per cent. of those who reported reductions of turnover, investment or stocks gave as the principal consideration leading to a reduction or postponement tightness of money among their customers, and 5 per cent. gave difficulties of finance. In some of these cases would not tightness of money or difficulty of financing have been encountered at any time?——*Mr. Bower*: You mean because they were not creditworthy?

* Memoranda of Evidence Part VII No. 1B.
† Memoranda of Evidence Part VII No. 1A.
‡ See Appendix to Minutes of Evidence.

11115. *Because bankers and other finance bodies are always apt to object to possible borrowers on credit-worthiness?*——Yes, I follow that.

11116. *Have you any judgment at all on what proportion of these could be considered as projects that would have been dropped anyway because of financial difficulties? How seriously are we to relate this 16 per cent. to the financial measures of September 1957?*——I can only answer that by pointing to the analysis by size of firm. The greater difficulty arose in the small firms, which corresponds with credit-worthiness.

11117. *That is something which would have happened anyway, in your judgment?*——Yes.

11118. *You have no other impression from a detailed study of the replies?*——*Mr. Sara*: We have not any answer to that. We put here the questionnaire we sent out, and we have analysed the answers, and that is the result. Anybody can have his own opinion as to why people put their answers in this or that block; I would not like to give an interpretation of it myself.

11119. *Professor Cairncross*: *Would it be proper to take the higher cost of borrowing (column 4) and difficulty of financing (column 5) together, and assume that a substantial proportion of 4 and 5 represents a reaction to the higher cost of borrowing?*——*Mr. Sara*: As to columns (1) and (2) one has to form one's own judgment as to why customers were short of money or why business was slack; the direct effect of the Bank Rate is, I agree, to be gauged by the response in columns 4 and 5 rather than columns 2 and 5*.—*Mr. Tonkinson*: In the remarks that we allowed the people responding to the questionnaire to make at the end there were frequent remarks that small firms found it difficult to obtain bank finance. Whether that was special pleading or whether it was a mere statement of fact we do not know.

11120. *Chairman*: *From your own knowledge of this field (I am not speaking for the moment of the results of questionnaires) would you have any doubt that the smaller firm has fewer alternative sources of finance than the larger one?*——*Mr. Bower*: It has not got the security to offer which a banker naturally looks for.

11121. *Its own position places it in a weaker position, quite apart from the power to look around and tap a variety of sources?*——*Mr. Marsh*: It is also far less sophisticated than the large firm in these matters.

11122. *In your main memorandum you have made some comments on the I.C.F.C. If I follow them, your view would be that it is not the organisation of the I.C.F.C. that is amiss, but that it just has not got enough money available to do the work which is open to it to do?*——*Mr. Sara*: We quote it in support of one of the comments which came from the Chambers to us, and it seemed to us that they were saying exactly what the Chairman of the I.C.F.C. was saying; we put the two together.

11123. *Sir Oliver Franks*: *Do you think that all that is wanted is more money at the disposal of I.C.F.C. and that then the greater amount of business waiting there to be done would be done, or do you think that it is not simply a matter of a greater amount of money being available but a willingness to embark into business which will involve a slightly different assessment of risks?*——*Mr. Sara*: My view is the second. I think that it is a reasonable interpretation of the data that came up from the Chambers that they were thinking not only that the money ought to be available in greater quantities, but somebody or other, I.C.F.C. or the banks or somebody, should be prepared to take a greater risk in this sort of field. That applies particularly where we talk about export credit finance, on which we were rather anxious to make a little special pleading which Mr. Marsh has come prepared to do.—*Mr. Bower*: Before you get on to that, there is a third factor which is of importance, as I see it: I.C.F.C. is not sufficiently known among these smaller traders. Although they may have been sent documents, it is much more natural for them to go to their bank manager with whom they have done business for years, whom they know and trust. They are timid. A lot of small businesses shrink away from coming to a finance house in London, if they can borrow from their own bank.

11124. *Chairman*: *Does that suggest that greater regional representation of I.C.F.C. would be a help?*——They try very hard to publicise their work, but it has not been achieved yet. If they could use the banks as their selling agents that would provide a useful shop window.

11125. *Professor Cairncross*: *You are talking now of medium and long-term finance, not short-term?*——Yes.

11126. *Do you think that, if the banks made their own arrangements, through subsidiaries if necessary, that might be one way of meeting the position?*——I do not know how it would work out in practice, but it would fill a gap.

11127. *I suppose I.C.F.C. is a subsidiary of the banks?*——It is. I have tried to explain what I.C.F.C. and "Edith" are. I have heard people talking very bitterly about estate duty on family businesses, and I have told them that these means exist to provide them with funds; but there is a certain nervousness about coming to them.

11128. *Professor Sayers*: *It is the strangeness of name and the remoteness geographically?*——If the banks could be the selling agents of I.C.F.C., certainly it would fill a missing link.

11129. *Do you think it would be advisable for the banks to go as far as they do, for instance, into the executor and trustee business, and have their own departments working through their own offices all over the country?*——It might be a good thing. The executor and trustee is a different kind of business, of course.

11130. *Sir Oliver Franks*: *Accepting the view you put forward that there may be this gap, is not the money that is wanted for medium or longer-term really very like risk capital?*——Yes.

11131. *Is not one of the difficulties that most small businesses are personally owned by a family or an individual, and they have an entirely natural dislike of seeing the equity of their business owned in any quantity by someone else; and yet if a body, whether it were a bank or I.C.F.C. or any other body, is to get a return on its money commensurate with the risk element, it has to have some equity, or the rate that it charges on a debenture or preference loan is so high that it seems usurious? This ties up with the natural unwillingness of people to surrender sovereignty?*——*Mr. Sara*: That is true. With the intervention of insurance companies into equity capital or indeed with the discussion about future Government pensions schemes the same problem arises. If this money is going to be channelled into industry, will the lender have a say in the management of that business or not? The insurance companies, as everybody knows, have tried to put the money in without saying anything.——*Mr. Bower*: The influence of taxation is rather breaking down that autonomy and independence which is natural to a man, because the surtax regulations are aimed primarily at the family business under the control of five persons or less, and the iniquitous methods of valuing interests in private business for death duty purposes is frightening people. If they can bring some friends or a trusted manager into the management with them to get away from the menaces of the taxation regulations, it is getting quite attractive to them. That is the doctrine I have been preaching to them. It is no use cursing the Government when the remedy is in their own hands. One meets with the King Lear argument: "if I part with my kingdom, what have I left?"; but I think that people are moving gradually away from the autonomy which you mention.

11132. *That is an important consideration in relation to any major provision of capital for a small business where the risks are in the nature of things rather greater?*——Yes.

11133. *Professor Cairncross*: *Do you think there might be something to be said for a system of guarantees for loans made to small businesses, whereby a bank, say,*

* *Note by witness*: Owing to a typing error in the analysis of the survey as submitted to the Committee "difficult to finance" (column 5) was defined as referring to: "Higher costs of borrowing: C.I.C. restrictions"; as the relevant question (3 (v)) in the questionnaire shews, this should have read: "Restrictions of bank credit: C.I.C. restrictions" (cf. Qn. 11171). The direct effect of the increase of interest rates on firms who replied to the questionnaire is therefore to be gauged not (as stated in this answer) by the response in columns 4 and 5 but by the response in column 4 alone.

might make the loan and someone else would provide a guarantee?——*Mr. Sara*: We have not encountered this proposal.

11134. Would it he resisted if a rather high rate were charged by any institution entering this field?——*Mr. Bower*: One could not go beyond the market rate.—*Mr. Sara*: Firms will in fact buy equipment through hire purchase companies, and pay over 10 per cent. for that facility; but, as Mr. Bower says, that is high by comparison with the rate on bank loans.

11135. In other countries this need is met by private institutions which charge very high rates of interest and are on balance fairly highly remunerative. In this country I.C.F.C. is not able to charge high interest because there would be questions in Parliament. Do you feel that there is scope for an institution which would charge rather high rates?——*Mr. Sara*: There is such an organisation: the United Dominions Trust, who do the bulk of this kind of work as I understand it, and will in fact lend capital against specific assets at round about 10 per cent.—*Mr. Bower*: They have had the field to themselves; now the banks have solidly gone into that business rates of interest are coming down quite substantially. That is what I mean by the force of competition; one cannot go beyond a certain beight above the ordinary run of money. One is pinned down to the market somewhere.

11136. My impression from what you told us was that there was no market; that the difficulty was that the average private business had no alternative but to go to the bank, and if the bank said it was not interested in making a long-term loan, it could not go elsewhere?——*Mr. Bower*: I am impressed by the very small number of people in this survey who have bought equipment on hire purchase.—*Mr. Marsh*: There are two separate problems, the problem that can be met by a hire purchase loan, and the longer period, say, ten years. That is where I think the principal gap is, and I think that the gap could probably be filled by I.C.F.C.—*Mr. Sara*: Our questionoaire has some evidence on this point. Out of the 3,404 people 225 sought and obtained short-term finance otherwise than through a bank, and 84 sought but could not get it. They represent 7 and 2 per cent. of the total. The bulk came from what are described as finance companies, a little from insurance companies, a little from building societies (which is another way of getting money for small firms if they have buildings), and 36 per cent. came from other sources. It looks as though there is a channel known and used, but not used very much.

11137. On section E, hire purchase, you show 203 people who say that they have purchased machinery on instalment terms, but I am a little baffled by the 500 people who go on to say "no" to question 2, which presumes that they have already answered yes to question 1. Can you explain that?——No. I think they must have misunderstood the question.

11138. Would you agree that there is an increasing tendency among small firms to resort to hire purchase for the acquisition of plant?——*Mr. Bower*: I would agree, but it is slow and we have to break down their natural reluctance.

11139. And perhaps in some ways it is not uneconomical, given that it is not a charge on the business?——No.

11140. *Mr. Woodcock*: You do not think that those who replied are exceptional in this respect?——I would describe them as "the man-in-the-street" so far as business is concerned.

11141. The people outside your Association would not noticeably differ from the people within?——I should not think so. There is a very wide selection of businesses; anybody may join who has a business, other than retailers.

11142. *Chairman*: Why is it that the small firm inherently has less security to offer than the large, because we must assume that proportionately its needs are smaller?——I was very impressed by the statistics issued by the Commissioners of Inland Revenue that of some 1,900,000 businesses in this country no less than 1,500,000 have an annual income of less than £1,000. That is one answer to your question; they are not earning any money to get the assets to provide security.—*Mr. Sara*: Is it not also true that a large firm can pledge its reputation in the way that a little firm canoot? A little firm in most cases has to offer a tangible asset as security, whereas with a big firm it would be regarded as insulting to ask for similar cover.

11143. *Professor Cairncross*: Would you agree that the small firm has a long way to grow, and has to grow very fast, to catch up with the big firm? It is partly a problem of the speed of growth. In the nineteenth century it was presumably solved largely by growing out of profits?——I am sure that that is the answer.

11144. *Professor Sayers*: If the I.C.F.C. increased its regional organisation very much and made itself known, would that substantially help, or would it help much more if one had a sprinkling of I.C.F.C.s, not just one, so that it was not one organisation's decision whether a man should have the money or not, and people would feel that there were alternative organisations to which they could turn?——*Mr. Bower*: That would he the answer to the remark made, that if the I.C.F.C. charged too high rates of interest there might be questions in Parliament. If there were a dozen of them there would not be questions in Parliament.

11145. *Professor Cairncross*: They might be more venturesome. If you set up institutions of this kind with public financial hacking, they may set up standards of credit that would remove some of the borrowers from the picture; but they may be the very ones they want to help?——Is it not in the hands of the people who create the organisations to tell them what their objects are?

11146. *Chairman*: I would like your full view on this; I think it is rather important. If the banks are going to compete in general, does it not seem rather odd that their subsidiary formed for this purpose should he monolithic?——*Mr. Sara*: There is no doubt that the business community must prefer a variety of sources to one source It is a sound principle not to have a single supplier of anything.

11147. *Sir Oliver Franks*: Is the I.C.F.C. ready to provide finance in sums of less than about £50,000?——*Mr Bower*: It will lend less than that. I have in mind a printer in the West Country who wanted about £10,000. He was advised to get his money from I.C.F.C.

11148. *Professor Cairncross*: Do you think there is any particular range of capital requirements that is particularly difficult?——No, I do not think so.

11149. It extends right through the list?——*Mr. Sara*: It is more difficult the smaller the amount and the smaller the firm.

11150. It has sometimes been put to us it is easier to borrow a sum of, say, £50,000 or £100,000 than £20,000 or £200,000. You do not recognise anything of that kind?——*Mr. Sara*: I have no experience of it myself.—*Mr. Bower*: It is less difficult with £20,000 than with £200,000 because £200,000 is big business. For a mortgage of £200,000 it would have to have capital employed of about £500,000. There is an element of size which there is not in the £20,000. In this matter I would not blame the banking institution at all; I would rather refer to the slow growth of the many small businesses. Borrowers have themselves to feel the urge to expand before they go to seek the money. I would like to see the bankers attracting them and encouraging them to grow instead of being static all the time.

11151. *Chairman*: I helieve Mr. Marsh has something to say ahout export finance?——*Mr. Marsh*: We have suggested that there is a gap in the arrangements available for people who are exporting on medium and long-term credit now, that at one time was filled hy the British puhlic who subscribed to foreign issues in the City. They both provided the capital and took the risk. They built tramways and all these other things that have been defaulted upon. Nowadays, while the risk can be carried hy the E.C.G.D., the finance has to he provided by the contractor. In my view and in that of a number of our constituents it is wrong, in the sense that it is not what people have been accustomed to in the past, that they should have this new situation thrust upon them and he obliged in effect, as long as there is a certain proportion of their business in the form of long-term credit, to have capital tied up in that way. There should be some institution, just as the Germans have their A.K.A., and the Americans their Export-Import Bank. I am not advocating anything necessarily of that form but merely for the moment stating that the prohlem exists.

The following witnesses, representing the National Coal Board, called and examined:
H. W. HEMBRY, Esq., Finance Member of the Board, and
A. W. JOHN, Esq., Director-General, Finance.

11181. *Chairman*: Mr. Hembry, would it be convenient for us to take the memorandum* with which you have kindly supplied us?——*Mr. Hembry*: May I make a very short statement first which might help the Committee to understand the thinking in the back of the Board's mind on this long term planning?

The Coal Industry Nationalisation Act, 1946, section 1, reads:—

"There shall be a National Coal Board which shall on and after the primary vesting date be charged with the duties of (*a*) working and getting the coal in Great Britain to the exclusion of any other person; (*b*) securing the efficient development of the coal mining industry; and (*c*) making supplies of coal available of such qualities and sizes in such quantities and at such prices as may seem to them best calculated to further the public interest in all respects including the avoidance of any undue or unreasonable preference or advantage."

and later:

"The Board shall secure that the revenues of the Board shall not be less than sufficient for meeting all their outgoings properly chargeable to revenue account."

This section puts the responsibility squarely on to the Board to act in the public interest in making supplies of coal available. Their interpretation of their responsibility has been that they should raise the output of coal as high as possible, to meet the ever increasing needs for energy and to supply the coal from indigenous sources. This has been the predominant consideration in the Board's planning policy. Their estimates of demand form the basis for the production plan, and their regard has always been directed towards balancing production with demand at the earliest possible date. With this in mind the Board have always felt that they should not allow short term influences to prejudice their long term planning.

11182. Do you mean influences on the side of demand?——Short-term demand has to be taken into consideration, but in a plan which is of such long term one starts off with the estimate of demand in the long term. The production plan which has to meet that will also be long term. If I may say something about the national plan the Committee may understand how vast and complicated it is.

When the national plan was first formulated it was the first time in this country that a survey had been made of the whole coal industry, which took into consideration the coal reserves, the potential production annually in the short term and long term, the demand, the availability of labour and the requirements of finance to reconstruct an industry which had been for some time in decline. That plan envisaged the reconstruction of more than 250 collieries, the construction of about 20 new large collieries and about 50 new drift mines.

The period of planning of a major reconstruction or a construction is of very long duration itself. The period of work will run into very many years, maybe eight or ten. Once one of these projects has started it can only be stopped with serious loss to us and to the contractors on the job. Even delay means serious loss because once we start we must press ahead to the point where we win coal as quickly as possible. During the interim period we are building up interim losses and interest. So with a plan like that based on the long term demand we cannot suddenly change the nature of the plan without serious dislocation to our long term thinking.

11183. The difficulty if not impossibility, of short term adjustments on these large engineering schemes primarily applies to the new colliery. Do you not do a good deal in the way of adaptations and alterations to the capacity of existing collieries?——Yes. The total capital expenditure of the Board over the eleven years commencing from vesting date to the end of December 1957 was £661 mn. Of that total £218 mn. was expenditure on major schemes; of that £218 mn., at the end of December 1957 £157 mn. was still in the pipe line. From that expenditure we expect to get our new production; but even so the first call on that is the replacement of our wastage. We are an extractive industry; we consume ourselves at the rate of about four million tons a year. A coal face lasts on average approximately two years. That means we have to provide approximately 90 million tons of new face each year. The great bulk of that can be found from alternative faces without a great deal of capital expenditure but some four million tons has to be found otherwise than that.

11184. *Mr. Jones*: Probably from new seams?——Yes, or completely new locations.

11185. *Chairman*: If it is new seams, the basic capital works that make the colliery remain still in your service?——If it is a new seam in an existing colliery, yes. As I say, we consume ourselves as we go on and we have continually to replace lost capacity. That of course applies to other extractive industries as well. Other expenditure on collieries in the period of eleven years was £289 millions. Our experience of that expenditure is that it is all required to replace the man-made assets of the pits and for the maintenance of current output and efficiency. That is more susceptible to some degree of contraction than the major schemes, because it contains shorter term work which can be deferred for some time; but it cannot be deferred for long, if the maintenance of our capacity and efficiency is not to suffer. Then we have expenditure on ancillaries of £117 million; that is still more susceptible to some contraction. We are big coke oven operators, and we are the second or third largest brickworks in the country, so that we have responsibilities in these directions as well as for coal. Finally we have £37 million of house building, with associated colliery expenditure, pithead baths, medical centres, all built round major schemes. These are phased into the major schemes. The houses will be required to house miners for new sinkings or for reconstructed pits where the man power is to be increased. If we get out of phase then we finish with a pit inadequately manned.

11186. That gives us a general picture of an industry whose broad policy is laid down by statute, to which a number of considerations apply that would not be applicable to an ordinary commercial concern, which has been under very considerable pressure since it was nationalised, which is involved in large-scale long-term planning and has not a great deal of capacity for adapting its capital expenditure at short notice. That is the general impression of what you are conveying to us. Within that picture, which we readily accept, we want to come to grips with you on how far, if at all, variations in interest rates on capital are relevant to the decisions you take with regard to expenditure. First, investment in stocks: if I follow the theme of your memorandum it is that the reasons for keeping a close and constant watch upon the volume of stocks is that they eat up money anyway, and to find the rate of interest you are paying for your money going up does not add any additional incentive to your natural wish to keep down your investment in stocks as much as possible?——That is true. Our investment in stocks and stores is inevitably heavy, scattered as it is all over the country. Our aim is to get it down to the lowest possible figure consistent with safety. We would do just that whatever the rate of interest. We do not speculate in the purchase of stocks and stores and commodities. We prefer to hold as little as we can, because they are costly to finance.

11187. You do not speculate, you would say? You are not moved by a favourable buying prospect?——In some respects we might be. When there were shortages of steel we did build up to some extent our stocks. When we were anticipating some difficulties about the import of timber we built up our stocks. But broadly, and certainly with regard to purchases of general stores, we would not be interested by interest rates. On the subject of stocks of coal, a couple of years ago we would have loved to have had a small stock, some four or five million tons. Today stocks of coal have built up to a level which is high from our point of view and which is growing. But we cannot suddenly stop the production of coal in order to stop the growth of stocks. To stop a mine is something long-term in itself; having once closed a mine, we cannot just open it again when we want to. It may mean a permanent loss of capacity.

* Memoranda of Evidence Part X No. 1.

11152. You do not feel that the banks can meet them where they get the banker's guarantee from E.C.G.D.?——I do not know how many of those special banker's policies have been issued; I should say less than twenty and all for very large sums. We are concerned about the business that is being taken now for, say, £100,000 to £250,000 on four years' credit, for which there is not that facility.

11153. It is your understanding that these bankers' guarantees are only a few in number and only cover very large transactions?——That is my understanding.

11154. *Professor Cairncross*: What does a firm do now about getting finance to cover exports of £100,000 on four years' credit?——It either provides its own, or goes to its banker, or, if the banker has lost patience with its overdraft, it goes to the market.

11155. You think that businesses are obliged to raise the money on a long-term basis and carry it as part of their capital?——*Mr. Sara*: That is the point. Whereas before the war there was a source of finance for this kind of trade, now there is not; and whereas exporters in other countries apparently have access to money outside their own capital resources, in this country it is not possible, for these medium and small amounts, to get it. We think that this is a gap which must have adverse effects on the export trade and their competitive position in it. —*Mr. Bower*: It is a very difficult question, because it is practically accepting money in three or four years' time of less value than the goods on which credit is given. An export credit race between nations is one of the worst things we can possibly have. What the solution could be does not lie with business men or institutions here; it rather lies with governments. We are pinning our hopes on the objects of the Montreal Conference and the discussions at Delhi which may provide some capital through government sources.—*Mr. Sara*: Mr. Bower's remarks apply, of course, to the Commonwealth.—*Mr. Marsh*: The reason why the old system broke down was because the borrowers were no longer considered credit-worthy.

11156. There is surely the influence of another quite distinct factor: the growth of trade in durable products. Is not engineering equipment a much larger fraction of international trade than it used to be?——I do not know. I should have thought there was a period in the earlier part of this century and the later part of the 19th century when we were building railroads in the Argentine and even in the United States when we were exporting a lot of very long-life equipment. My point is that, even if such projects pay in the long run, the trouble is time. E.C.G.D. have extended the period of guarantee, but many of these large foreign schemes seem to be scarcely viable in the period to which credit is limited. In the old days a loan would be made for twenty years or such a period as that. Now these credits run for seven or possibly ten years.

11157. *Mr. Woodcock*: But you would not want to get into a race?——That is one of the difficulties. There is, of course, an understanding between the different export credit organisations.

11158. *Mr. Jones*: What period does the E.C.G.D. cover?——I think the longest is about seven years from date of shipment.

11159. Is there anything outside that? Is there no private insurance?——I do not know of anything else.

11160. *Sir Reginald Verdon Smith*: You were speaking of contracts to the value of more than £100,000. Is there a problem at figures lower than that?——I think the same problem exists lower down. I do not know quite where to draw the line. If one were talking about £5,000, one would say surely that any firm who does export business should be able to carry £5,000 for four years; but it is the accumulation of these sums I am concerned about.

11161. In the circumstances where E.C.G.D. are not prepared to provide cover for small transactions, and assuming a high volume of durable consumer goods, perhaps orders affecting mainly smaller firms in the export market, is there a problem in your experience here?——I am not aware that there is any limit below which the Export Credits people will not issue guarantees. They have the blanket policy for periods up to two years on which one may cover business of all sorts of values.

11162. *Professor Cairncross*: Is there reluctance on the part of the small firms to make use of E.C.G.D.?——*Mr. Marsh*: I should not have thought so; they have sold themselves pretty well.—*Mr. Sara*: They have offices up and down the kingdom.—*Mr. Marsh*: And the banks have also sold E.C.G.D., as well as E.C.G.D.'s own organisation.

11163. In your general memorandum you suggest that the Birmingham questionnaire yielded about 30 per cent. as the proportion of members who postponed or cancelled plans for development after 1955. This looks a very high proportion. Do you feel that the ordinary business is always postponing or cancelling some plans anyhow and these would get into this percentage, or do you think this is a proportion of the plans that were taking shape and would have been carried through but for changes in the economic climate?——*Mr. Sara*: I would have thought the latter. I do not think that there is a very high proportion of plans which a business man would say he has cancelled for reasons other than change of conditions: there are some, of course. They look into them, and find they are not as favourable as they thought because they did not know all the answers before they started. I think one could reasonably assume this 30 per cent. represent plans that had been cancelled because of the change of circumstances between 1955 and 1958.

11164. I ask the question because the implication of these figures seems to be that, had there been a constant rate of interest, or had market conditions remained as favourable as at the beginning, the total volume of investment would have been considerably higher?——*Mr. Sara*: We must not confuse the level of investment that took place between 1955 and 1957 with the plans that were cancelled in that period, which would relate to a later period. Surely we could argue that the plans cancelled as recorded here affect the rate in 1958 and 1959 rather than in the earlier period.—*Mr. Bower*: It might still have been quite a good thing, to take away the fever of the economy.

11165. *Professor Sayers*: In relation to the plans of these businesses, what would you say is the average time lag between a decision whether or not to go forward with the plan and the putting up of the bricks and mortar, the installing and maintaining of the plant and so on?——*Mr. Sara*: I can give you an outside limit from my own industry. If we say that we will go ahead now, that plant generally speaking will be in commission in three years' time. "Going ahead now" implies that we have our plans drawn out and we then start placing orders. It is usually three years for a plant of any size or magnitude. That would be, I should say, an outside limit. I should have thought that, if one is talking of any fixed assets the lower limit would be a year to get a building erected and to get an electric motor or two in place.

11166. *Chairman*: A year from the making of the plan?——From the decision to go ahead, from the moment where one knows exactly what one is going to do.

11167. *Professor Sayers*: So that if there is a change in the economic climate, whether it is a change in the general market outlook or a specific change in Government policy, that leads to postponement or cancellation of plans today, one would expect that to have its effects on activity in the sense of the final installation of new plant and so on almost entirely within three years?——*Mr. Bower*: It would very much shorten the length of delivery. —*Mr. Sara*: One must distinguish between the effect of these things and the completion of the equipment. In between the decision and the completion one has builders working on buildings, electric motor manufacturers making electric motors and so on; so the effect on the economy does not wait until the erection of the plant. But that the whole process would be complete within three years I think would be a fair statement.

11168. Over what sort of period is the process of investment spread through the various stages: first, a nebulous idea in somebody's mind; then the decision that it is worth looking into and the first plans on paper; then detailed plans drawn up; then a decision whether or not to go ahead; then the placing of orders; then the process of construction and manufacture; and finally the completion of the building and the installation of the plant?——*Mr. Sara*: I know of no factual evidence on this point. If you felt it really important, it could probably

be collected. I should think that the best index of it would be a graph showing the rate at which a firm put out expenditure. It would obviously differ for different kinds of business, because it would depend on whether they were in the habit of making progress payments or whether the contractor was apt to carry that himself; but I should have thought one could have collected evidence on this. I do not know of any, and I would have thought individual examples would be misleading.—*Mr. Bower*: Investment would be *pro rata* with the progress of the work. A machine would come in and be paid for; architectural work would be going on with progress payments. With a slight time lag the payment for it would advance with the progress of the work. The point on the economic climate is that, if business is slowed down by economic measures, instead of having six or nine months' delivery dates one gets a three months' delivery date. The whole period of investment becomes shortened by the economic climate being stiffened.

11169. *Professor Cairncross*: In the Birmingham inquiry about 40 per cent. of those who postponed or cancelled plans attributed this to an increase in interest rates. That is a very high proportion. Did it not surprise you?——*Mr. Bower*: I would not have believed it.—*Mr. Marsh*: It may be local to Birmingham.—*Mr. Tonkinson*: This case study from Birmingham was appended because Birmingham was the only Chamber of Commerce that undertook to try to find facts for this Committee in this form. The questionnaire was different in many respects from our own, and I have no explanation of the results. It may be something that was peculiar to Birmingham. I wonder whether this may have had something to do with the recession in the motor industry.

11170. If we leave the Birmingham inquiry aside for the moment, and concentrate on your own much more elaborate inquiry, you found that nearly one firm in three had postponed fixed investment projects over the period of six months between September, 1957, and March, 1958. Did that not seem a very high proportion of firms? Were you not surprised?——*Mr. Bower*: No. I would say that the decision whether to go on with a plan or not depends on the expected profitability of it more than on the actual cost of putting it up. If a firm thinks that it is going to earn 20 per cent. it does not mind paying 7 per cent. interest; it is worth it. If it can only see a margin of 7 per cent. on its investment, it thinks twice.

11171. We are interested in knowing what proportion of firms change their minds because of changes in interest rates; the figures that you supplied to us indicate that it may be of the order of 8 per cent.* Is that the impression you formed independently of this inquiry?——*Mr. Sara*: I do not know that in the absence of some figures like this I would have liked to name a figure at all. I have always thought the figure was relatively small.

11172. *Sir Oliver Franks*: This 8 per cent. is from one point of view a small one, but from another point of view is a sizeable margin. If interest rates were really effective on as much as 8 per cent., then they would have been having a very considerable effect, because all these things operate at the margin of economic activity. This question is therefore one of considerable importance, and the nearer you can come to actual fact or direct impression the better; it is a terribly difficult subject to get anything clear about.——I am aware of that implication. Since these figures have been produced there have been many who have told us that, if that figure is in fact as high as that then the effect is by no means negligible; they argue that the "slackness of business" column at the beginning is made up of a lot of transferred "higher costs of borrowing" and "difficulties of finance" which in answers from other firms would have appeared in columns 4 and 5. I find that difficult to accept.

11173. *Professor Cairncross*: You mean transferred because a reduction of activity at one point affects somebody else at another?——Yes, and the man who finds his business slack does not realise that it is due to some other firm who have cut their programme because of interest rates or borrowing difficulties.

11174. Have you come across specific firms who have been prepared to say categorically that it was the change in interest rates that had caused them to modify their plans?——Apart from this questionnaire I have not. It would be the little firms who would say this rather than the big ones.

11175. *Sir Oliver Franks*: You come from the north, Mr. Marsh; do you know of anything in your area?——*Mr. Marsh*: It is very difficult to say. When the climate changed from inflation to tight money one of the reasons why people were spending money on plant disappeared; the two things may be related.

11176. *Chairman*: If you have an item to which their attention is drawn called "bigher cost of borrowing" as a cause and they deal with that, why, if you have another item called "difficult to finance", do you suppose that that covers anybody who says the cause was the higher cost of borrowing?——*Mr. Sara*: We meant by "difficulty of finance" money being restricted other than by putting up its price [cf. footnote to Qn. 11119].

11177. *Mr. Woodcock*: Your statement that "monetary measures since 1951, and particularly since 1955, have had no substantial effect" is pretty decisive. You do not qualify it much in your paper; do you want to quality it?——That is the burden of our song.

11178. *Professor Sayers*: In spite of this 8 per cent.?——We think that is a small figure. I am aware of the people who think that it is a large one, but it seems to me that in regarding it as a large one they are arguing that in fact only 8 per cent. of the firms were conscious of the fact that this was at the bottom of their troubles, and that there were a lot of other firms that acted because the rise in interest rates affected their income. I fail to follow that. I agree with Mr. Marsh that one of the reasons they stopped ordering things was that they thought that prices were no longer going to rise.

11179. *Chairman*: Do you think that it is easy for people after the event to allocate the causes which led to these actions?——*Mr. Bower*: I do not; I think it is very difficult. We only wish that this had been clearer than it is. We have considered going on with this sort of survey, but we are reluctant to do so unless we can see some very good reason; there is a good deal of work involved both for the firms and our organisation. If we did it again we might improve it to some extent, but my impression is that it is very difficult to get precise answers to these questions. We can only offer you this as the best we can do.

11180. *Sir Reginald Verdon Smith*: Have you any view as to why there should be such a marked difference in optimism between the larger and smaller firms?——*Mr. Sara*: It appears from the evidence that smaller firms were more adversely affected than large ones by credit restrictions and the other measures taken at the same time; therefore one would expect them to be less optimistic. It would be strange if the figures did not run together, and they evidently do. That is the only evidence we are entitled to bring forward, and certainly the only evidence on which I have any knowledge.—*Mr. Tonkinson*: I think that there is in that figure some bias, in the sense that among the smaller firms there was a bias in the sample towards areas like the Yorkshire and Lancashire textile areas. In some of those areas there was a very high response rate from the smaller firms; that may have affected the total to some extent.—*Mr. Sara*: The figures given for the textile industry are proof of Mr. Tonkinson's point.—*Mr. Bower*: It is borne out in the results of the recent F.B.I. survey; the larger the firm the more optimistic it appears to be.

Chairman: Thank you very much Mr. Bower; we are very much obliged to you and your colleagues for your help.

* *Note*: In the light of the footnote to Qn. 11119, the figure in this question and subsequent questions and answers should be 4 per cent. rather than 8 per cent.

(*The witnesses withdrew*)

(*Adjourned until* 2.15 *p.m.*)

11188. *Mr. Woodcock*: Does that mean that those considerations would entirely in all circumstances outweigh the rate of interest on the money you have sunk in these stocks?——I think they are bound to. We cannot close big mines for the sake of the rate of interest we might be paying, because we might not be able to open them again when we wanted them, and that would be still more expensive.

11189. *Professor Cairncross*: What do you reckon to be the capital cost per ton of new sinkings?——Of the order of £8 to £10 per ton of output.

11190. Taking coal as against other fuels, are not the capital costs relatively low?——I really do not know the answer to that as far as other fuels are concerned.

11191. Compared with electricity and gas, for instance, the capital costs are very much lower per unit of output? ——*Mr. John*: I have not a clear idea, but those are secondary fuels and not primary.

11192. Yes, but there are often alternatives before industry and private consumers in the kind of fuel they use, and what they use depends to some extent on price. Would not a higher rate of interest be in that sense to your advantage, in that it would over a longish period add less to your costs than to the costs of some alternative fuels?——*Mr. Hembry*: I should think that is so.

11193. In making projections of the demand for coal in the future do you look at the prospective relative price of coal and other fuels, or ignore them?——We are bound to do that indirectly, because we have to assess what will be the demand for coal in relation to other fuels. We are at present examining the national plan in the light of the present trends, and considering again the level of demand not only in the long-term but in the short-term.

11194. In that comparison do you look at the prospective price of coal compared with some of the other fuels, or does it seem too far away?——In our own planning we assume that coal will remain at present-day prices. We cannot assume a change. Presumably therefore we would make the same assumptions in other fuels. In considering our plan we are really more concerned with quantity rather than value.

11195. I can appreciate that up till now that has been the position; you have been working against a shortage. But looking to the future there may be some uncertainty about the demand for different fuels. Does not the relative price make some difference to how much you must produce?——In the end it will certainly make a difference, but I do not see how we could evaluate the price of coal, electricity and oil, say, fifteen years hence.

11196. There have been marked trends during the past fifteen years; you are not allowing for that continuing?——We are examining them in relation to demand and quantity.

11197. You do specifically take account of the past trend in relative prices?——In quantity; and what we can obtain in the way of information from our customers in the future will tell us roughly what they expect will be their demand in future, again in quantity.

11198. Your customers cannot tell you what the demand will be, except on the assumption of continuing present price relativities?——The steel companies and electricity companies all have their own estimates of what will be their consumption of coal.

11199. But where do prices enter into this?——I do not see how they can.

11200. *Professor Sayers*: You project the trend in quantity, so that you are making an assumption about a trend in price?——Indirectly, I agree.

11201. *Professor Cairncross*: There has been a marked trend towards the production of small coal as against large, partly associated with mechanisation. This was foreseeable; has it not had some effect on the prices you charge for small coals, if you are to dispose of them? ——Not as yet. At the time our mechanisation scheme went into effect we were very short of coal, including small coal; we were importing small coal at that time. There is an unbalance now between the sizes of coal we have, and there could be shortages of large and surpluses of small.

11202. Have you not revised your price structure over the past ten years in a sense favourable to the consumption of small as against large coal?——We discouraged the use of large coal in industry.

11203. *Mr. Woodcock*: How? By price?——Yes.

11204. Then you could equally encourage the consumption of small coal by price?——I do not think so. We have certain stocks on the ground. If we were to offer to reduce the price of small coal to the Electricity Board I do not really see that they would take an extra ton more than they take now.

11205. When you are estimating what the demand will be, you must take account of what people will take at a price?——That must enter into our thinking, yes.

11206. *Chairman*: The modern method of increased machine getting of coal tends to generate per ton of coal got a larger proportion of small coal than in the past? ——Per ton of total output. On the other hand we are experimenting with new machines and modifications of existing machines.

11207. *Mr. Jones*: If you could introduce new machines for power loading, which would increase the proportion of large coal to small coal by four or five per cent., would you not more or less have overcome your problem?——We are not at the moment, as we see it, seriously short of large coal. We are not expecting a shortage in the winter, but there is at the moment an unbalance between the two.

11208. *Professor Cairncross*: When you look at any trend of this kind and you find that small coal looks like becoming an increasing proportion of your total output, does that affect your prevision of the demand for coal? Does not small coal compete with a different set of fuels from large, since the uses to which small coal is put are not the uses to which large coal is put?——No. Our aim is to increase the production of large coal as best we can. We have certain flexibilities, and our aim is in the future not to produce such an unbalance as we have got at the moment. Clearly at the moment there is an unbalance; but one must remember that eighteen months ago we were short of coal in this country; we were importing small coal. It should not be assumed because of what has happened in that short time we are going to have a serious unbalance for the whole of the future. This sudden change in a matter of eighteen months is not so serious as all that, and one cannot know what pattern of demand will emerge when we come out of this recession. We have in the past had a marginal shortage of coal; today we have what is in my view a marginal surplus.

11209. *Mr. Woodcock*: I think the question is rather the other way: do you assume that in five, ten or fifteen years hence, in some temporary upset, you will be able to sell all your coals at the price you are selling them now?——We have started an examination of the plan; we shall re-assess the demand in the long-term and our production plan will be based on that.

11210. But when re-assessing it must be demand at a price?——Indirectly that must come in; but there are discussions with electricity, steel, and other large consumers, and we can only assume that they will assess their requirements of coal and we shall then be able to work to that plan.

11211. *Professor Cairncross*: The price of electricity today in relation to the price of coal is very much lower than it was before the war. That is a trend that may or may not continue. It is not a trend that depends on balance between output and demand in the coal industry between one year and another; it depends on much more continuing factors. It is something that I should have thought it was possible to take a view about. Do you allow a view of that sort to affect your expectations about the future demand for coal?——Would it not come indirectly into the planning of the use of oil, electricity, atomic energy and so on?

11212 It can come in there if there is a specific effort to visualise the relative costs as they will develop. I thought from your earlier answers that you thought this was something beyond the wit of man to foresee, and that it might be more reasonable to take current costs as a basis for a decision?——I do not think that

we could with any degree of accuracy foresee the price of coal in ten or fifteen years from now.

11213. Not even in relation to the price of electricity?——I would doubt that too in view of the progress of atomic energy.

11214. *Sir Oliver Franks*: Does that not mean, given the length of time you have described for major developments, that your risk of being caught totally on the wrong foot must be very high, if you are as powerless as that to judge what price and demand will be?——I do not think that that would necessarily follow.

11215. You do not think that the preference of the public, and therefore the degree to which they make use of different forms of power, is changing visibly year by year, and that, adding this up over ten years, very substantial differences are likely to result?——Yes; but we have a certain degree of flexibility in the quite substantial number of mines on which there is likely to be no capital expenditure and which will continue unchanged as long as may be necessary.

11216. These are mines mostly operated at a loss?——Not necessarily all of them; mines which will become exhausted in due course, some operated at a loss, and others not.

11217. *Professor Cairncross*: If you have to some extent the alternative of carrying on existing mines or sinking new mines, the relative cost of doing the two things is important. Is that relative cost in any way affected by changes in interest rates or are capital charges too small to affect them?——I do not think that that would be affected by rates. Our problem is to maintain our capacity and replace our wastage. Our big new schemes provide for that, and give us our addditional capacity we require.

11218. You said that you could conceivably let some existing capacity go out; could you not equally give up thinking about some new sinking?——As the position has not risen yet I would not like to commit myself.

11219. Looking some way ahead, envisaging a surplus of coal that might go on for ever, the situation might arise, and at that point of time it would be important to know what would be the relative costs of the two courses of action?——No, I do not think in general that that enters into it.

11220. *Mr. Jones*: Is not the situation the industry is called upon to face a situation which demands reconstruction to efficient and economic standards in order that certain units in the industry can continue? Is it not mainly a case of reconstruction of existing collieries rather than new sinkings being undertaken?——That is right.

11221. Where you have to undertake a new sinking is it not a much bigger project in 1960 than ever it has been in the history of the coal mining industry, because of the depths of the seams?——Yes.

11222. If you visualise that a certain area has to give you a production of a million tons a year, does that not mean that you have to take into consideration the fact that you cannot start to get the first coal from a new project for ten years? Must you not have this system of long-term planning in order to keep on your feet as an industry?——Yes.

11223. *Professor Sayers*: If that is so, it means that new capacity is going to be very expensive in terms of capital outlay?——In comparison with the past, yes.

11224. When you are thinking whether to develop new capacity or keep in production some old capacity the difference in capital cost would be very big indeed?——It would be big. The return, of course, would be better.

11225. Would not the choice between the two seem to depend partly on what the rate of interest is? If there were a big change in interest rates, if the rate went up, say, to 20 per cent., the choice might well be altered in particular cases?——It could arise in the future; it certainly has not arisen in the past.

11226. Looking to the future, would a difference of interest rates between 3 and 6 per cent. be relevant to the choice between opening up new capacity and not doing so?——There are so many other considerations which have got to be taken into account that it is very difficult to answer.

11227. *Sir Oliver Franks*: Over what length of time do you normally assume that a newly constructed pit will be worked?——*Mr. John*: Normally we would write a pit off over a maximum of forty years. On the interest point, I do not think the difference between 3 per cent. and 6 per cent. would be sufficient to influence a decision between reconstruction or a completely new pit. Broadly speaking we have tried to even out the rate of interest in looking at these long term projects; originally, as far as I remember, we adopted a conventional rate of interest of 4 per cent., when the interest rate was moving up from $2\frac{1}{2}$ per cent. until it reached a little beyond 4 per cent.; we then moved it up to 5 per cent. We took the view that in looking at these long-term projects we should have regard to the long term rate and not the short one, and that we should move up broadly in response to it, but not with every short term fluctuation.

11228. *Professor Sayers*: You say you even out the rate of interest. If you are considering whether to develop a pit that you reckon is going to last forty years, is not the rate of interest that is relevant to this not the average rate of interest over forty years but the rate of interest at which forty years money can be borrowed during the five years in which you are spending money on opening up the pit? Is that your practice?——Yes. We do not usually borrow for a term of forty years. We used to borrow from the Exchequer on the basis of fifty year terminable annuities on which the average life is twenty-five to thirty years; latterly we have come down to a fifteen year basis, borrowing on Exchequer advances repayable by equal annual instalments over fifteen years. On that basis we have to go on the rate of interest known to us. What the rate would be on a forty or fifteen year loan over the whole five years ahead is something we are not able to forecast precisely when we take the investment decision. We take this view in a broad way rather than a detailed way, on the basis of current information at the moment of investment.

11229. It is the long rates you are looking at?——Yes.

11230. *Mr. Jones*: So the borrowings you have made this year at 6 per cent. will be redeemed on the basis of equal annual instalments covering principal and interest over fifteen years, and the 6 per cent. will operate over that period?——That is so.

11231. I take it 6 per cent. no longer obtains, and that the Treasury, through the Ministry of Power, are now providing money at a much reduced rate. How near does it come to the Treasury Bill rate at which the Government are borrowing?——This is not really the Treasury Bill rate at all. It is broadly the rate the Government themselves would pay if they were borrowing for fifteen years, repayable by equal instalments. The current rate is $5\frac{1}{4}$ per cent.

11232. *Professor Cairncross*: Would I be right in supposing that operating costs even in a completely modern mine represent a very high proportion of total costs, and that the capital costs, even although they have risen as a proportion of your total costs compared with pre-war practice, are still fairly small in relation to some of the major industries in this country, like chemicals or steel?——*Mr. Hembry*: Yes. Of our total costs 60 per cent. is wages and wages charges.

11233. You said that the capital cost of new sinkings was about £8 to £10 per ton of output. What price would that ton realise?——*Mr. John*: About 85s.

11234. At the same time the interest charge on £10 that you are currently paying is of the order of 10s., the strict interest charge. That would give an idea of the relationship between the pure interest charge and the other costs involved. Is that fair?——*Mr. Hembry*: I think that is a fair statement.

11235. *Mr. Jones*: The capital charge would not be as high for reconstruction schemes? It could be £4 or £6, but would be less than £10 per ton?——It would vary, of course, but it would be less.

11236. You are responsible under the Act for making provision of coal in sufficient quantities and at the right price, and responsible therefore for developing efficiency in the industry. If you did nothing in terms of reconstruction and nothing in terms of new sinkings what would be the position in the coal mining industry at the end of ten years? According to the answer you have given to the Chairman, instead of having a capacity for

the present output of about 210 million tons you would have a capacity for 170 million tons. Is that not one of the things that must have principal consideration?——As I explained earlier on, we are losing capacity at the rate of 4 million tons a year, which has to be replaced. If we did not replace it, then as you say we should have lost 40 million tons capacity in ten years.

11237. *Sir Reginald Verdon Smith*: In the past you have not been restrained by the size of demand. Assuming that your present surplus is comparatively marginal but is nevertheless continuing, does this leave you with any major change of emphasis? Would you regard the profitability of particular projects, as well as the necessity of physical output, as being a criterion by which you would judge whether schemes should go forward or not?——Hitherto it has been our problem to increase production to meet demand, but if our capacity is going to continue to be more than the demand presumably we shall be selective.

11238. *Mr. Jones*: In paragraph 9 (ii) of your paper you say that the Board's plan is subject to the approval of the Government through the Ministry of Power, who also examine the annual programme. I take it that, whilst the principles of the plan are accepted by the Minister when the plan is endorsed, there are continuous and continuing reviews of the sort of capital schemes you are going on with?——Yes. Each year we submit our annual programme to the Minister. We consider the programme as it has gone in the previous two years, and we consider the following three years; we are given a firm allocation for the immediately succeeding year and provisional allocations for the two years following.

11239. There has been a lot of discussion in all sorts of places about nationalised industries financing a greater part of their capital development by internal resources. In normal circumstances do you think it would have been possible for the Coal Board to have financed a good deal of its capital development at a time when coal was at a premium, and would you think it was possible to do that in the present state of the fuel market?——Our total requirements for finance for fixed investment and working capital since vesting date have been of the order of £670 million. During that period we have financed internally almost exactly one-half. In the plan *Investing in Coal* it was stated, as we say in the paper, that we were expected to finance some two-thirds of the plan from our own resources, only about half in the first five years, rather more in the second five years, but subject to certain assumptions on price level, and that we would be able to wipe off the deficiency which the Board carries. This has not happened, so that we shall not be able to do exactly what we said we would do in that plan.

11240. *Professor Cairncross*: Would you regard it as more satisfactory from the point of view of administration that you should rely more or less entirely on yourself for finance?——It would only be possible if prices were higher, and we were able to make a quite substantial surplus. It would be pleasant if we were able to make such a surplus, but it is not possible at the present time.

11241. Would it make any difference to you if you were financing these plans out of your own reserves rather than going to the Government?——Unless our available finance was much greater than it is we would be unable to finance the entire programme; then I do not think that we should be carrying out the terms of the Coal Industry Nationalisation Act.

11242. *Mr. Jones*: There must be a substantial amount of liquid capital involved in your present stocks of coal. In view of the fact that that value may not be realised within two or three years, on what basis will that be financed in the accounts of the Board? Will you have to take long term borrowing and pay 5½ per cent. interest?——If we were unable to get rid of the stocks that would be the case. Up to the present that has not happened. It is only in the last year that we built up hig stocks, and that is unfunded at the moment.

11243. *Chairman*: Have you raised with the Government the question of obtaining short term loans to carry a volume of stocks of this kind?——At the end of last year this particular block of finance was left unfunded, and we shall have to discuss the matter again with the Government at the close of this year.

11244. You have temporary borrowings as well as funded borrowings from the Government?——Short and long-term advances. We have temporary borrowing powers as well, to a maximum of £20 million at any one time. We have only used that once in our history.

11245. *Professor Cairncross*: You feel satisfied that you should have to rely on the Government for long term capital and have such a low ceiling on your short-term borrowing?—Yes; it works.

11246. Presumably you could, if you had to carry these large stocks, finance them rather more cheaply on short-term borrowing at the present moment?——*Mr. Hembry*: Yes, but the problem is not solved yet. We do not know what line the Government will take at the end of this year on our stocks—*Mr. John*: At the moment they are financed at 3¾ per cent.

11247. *Professor Sayers*: About £65 million is locked up in stocks?——*Mr. Hembry*: Yes.

11248. *Professor Cairncross*: Under what powers do you get that short-term borrowing?——*Mr. John*: Under the Act the powers of the Government to advance money are not limited as to whether they fund it or not. We get the money advanced as though it was on a current account with the Government. In that we have the co-operation of the joint stock banks and the Bank of England. At the end of each year we review the amount that has been advanced, and a decision is then taken as to how much of those advances are going to be funded, and we know that they will then carry the rate for fifteen year advances. We go through what we call the hard core of our advances, and any balance not considered hard core is left unfunded. At the end of December 1957 there was in all a balance of £64 million which was unfunded; that balance the year before was only £25 million, and the difference between those two figures was largely accounted for by the fact that stocks had grown so rapidly. The picture was not then clear as to whether they were going to be long term or not, but we shall come back to this question again at the end of this year and no doubt we shall have some difficult discussions with the Treasury as to what is going to happen.

11249. *Sir Reginald Verdon Smith*: Is there any limit on your borrowing from the Treasury?——Yes. There is a maximum of principal outstanding at any time of £650 mn., and a limit on the net increase of advances each year of £75 mn., as described in paragraph 7 of our paper.

Chairman: Thank you very much, Mr. Hembry; we are much obliged to you and your colleague.

(The witnesses withdrew.)

THE RT. HON. PETER THORNEYCROFT, M.P., called and examined.

11250. *Chairman*: Mr. Thorneycroft, thank you for your memorandum*. It really answers the points† on which we wanted to draw you, so I do not know that there will be a great deal we shall want to add to it. But we should like to be quite clear about your attitude, because it is views we want on this; has your experience of the relations between the Treasury and the Bank amounted to finding that the Bank was for effective purposes an independent body?——*Mr. Thorneycroft*: Yes, I think it is an independent body. It has certainly far more independence than one would judge by looking at the statute governing it.

11251. Would that mean, as far as the power to give directions is concerned, that the atmosphere it carries with it is not really in your view an important element in the relationship between the Treasury and the Bank?——In many ways it is an important relationship; indeed a similar sort of relationship exists between, say, a Minister

* Memoranda of Evidence Part XIII No. 40.
† See page 846.

and the head of a nationalised industry. It is a weapon so powerful that a Minister would only use it in the very gravest emergency; by the time he got to that stage relationships between the two would really have broken down.

11252. The presence of the power, although it is not easy or desirable in practice to invoke it, does influence the attitude of the Bank to the Treasury with regard to policy, and that of the Treasury to the Bank?——I think it is proper it should be there. It recognises what is the fact, that in the final resort the solution to many problems must be with the Government of the day.

11253. But it creates a background in discussion between the Bank and Treasury in which it is recognised the Treasury has the greater weight?——Yes, it recognises the fact that the final word is with the Treasury.

11254. *Mr. Woodcock*: Does it not mean that the Bank would have to convince the Chancellor rather than the Chancellor convincing the Bank?——I would not put it quite so clear cut as that. In the short time I was at the Treasury these things were done in mutual discussion; the thing was of such complexity that one could not draw that line. It was a pooling of knowledge and ideas; there was not a sort of "onus of proof" atmosphere about it.

11255. *Chairman*: I am looking at your answer to our question (*a*) in paragraph 10. You say:

"The Act of 1946 provides the framework of the relationship. It perhaps hardly reflects the reality which has grown upon that skeleton. The Bank and the Treasury are in fact separate institutions arriving at a common policy by discussion."

I would deduce from that that, unless the discussion resulted in each side being able to agree about a policy, the Bank would not feel that it was under any compulsion to act. Would that be right?——Yes. Let me take one example which is not now of very great importance: the so-called Kuwait Gap. For a time the Bank was opposed to taking direct action to close it, but the Treasury was in favour. It was closed a little later than it would have been because the process of discussion took a little time. I am not arguing who was right and who was wrong, but that is typical of the sort of problem which has to be faced and solved by mutual discussion.

11256. *Sir Oliver Franks*: What would be your reaction to what might seem the paradox that, comparing the position of the Bank in the thirties with the position as you have described it in the fifties, the nationalisation of the Bank has served to emphasise the reality of its independence?——I think that that could be quite a fair statement. The reality has not changed with the Act; if anything perhaps it has been emphasised with it. The Act perfectly properly lays down where the ultimate responsibility is, but in practice the system is easier to run with most of the monetary problems treated by a separate institution.

11257. *Chairman*: That means that the balance of expertise lies in the Bank and not outside it?——Exactly, in monetary policy.

11258. Does that put the Treasury, when it wishes to emphasise its point of view on these subjects, at a disadvantage?——Sometimes, I dare say, both sides think that they are blinded by the science of the other. That does happen, but I do not think that it is a marked disadvantage. The Bank have always been forthcoming in producing their arguments if asked to do so. I have suggested here that perhaps some advantage might flow from rather more meetings at the technical levels as well as the top officials, but by and large I think there is a fairly good sharing of expertise.

11259. *Professor Cairncross*: Would you agree that the Chancellor likes to know what are the alternative courses of action open to him, not to be faced with a memorandum just recommending one particular line?——Yes.

11260. Do you feel that under present arrangements he gets alternatives set out before him as usefully as possible?——There is always room for improvement in these things, but the Chancellor is never refused anything he asks for from the Bank.

11261. *Mr. Woodcock*: If he did not ask, he would not get them?——One has to ask in this world. He gets so much any way that I think on the whole that he had better ask for it. When I say the Chancellor, the permanent head of the Treasury or any senior official would be in the same position.

11262. *Chairman*: That means that there are two streams of information coming up to the Chancellor, who has in effect to harmonise the two if there is a conflict; one flows from the Treasury with adequate information obtained from the Bank, and one flows from the Bank direct?——Yes, I think there are two sources of advice.

11263. *Professor Cairncross*: In the major issues of policy where it was necessary to decide, particularly where there was a conflict of view between the Bank and Treasury, did technical expertise count for a great deal, or were these general issues where it was of importance to have a view about general policy?——The borderline is rather a fine one; in some issues, like exchange control for example, there is a great deal of technical expertise, and the judgment as to whether one really can stop a hole or whether the effect of stopping one hole will be to open another somewhere else is a technical problem as well as a judgment of policy.

11264. In the matter of a possible change in Bank Rate, would the Treasury be at a disadvantage if it did not have access to the Bank's information?——It would be a disadvantage if it did not have it; but on a matter of that kind the Bank would be at pains to put forward every bit of information at its disposal; any major move in Bank Rate would be a matter of such importance that it would be discussed in great detail between the Governor and the Chancellor, and between the officials of the Bank and the Treasury.

11265. Would you have felt impelled to pay more attention to what the Governor had to say than to what your own officials had to say?——No, I do not think so. I would not put them in a list of priority. One naturally would give a great deal of weight to what the Governor said on a matter such as Bank Rate which is very much within his special cognisance.

11266. *Professor Sayers*: When it was a matter of the management of the debt, did you find that the advice came up almost exclusively from the Bank or from the Treasury; on such questions as funding, for example, or the prices at which the Government broker should be prepared to operate?——It would be wrong to imagine that the Treasury were in any way really moving in on the day-to-day operations of the Bank in that matter. On wider issues as to how the debt should be funded or the kind of policies the Government broker was pursuing over a long period, discussions could and did take place.

11267. Do you not feel that in such discussions the long-term considerations generally have as much weight as day-to-day market considerations?——I think so. The Governor and Chancellor meet very regularly. It is normal practice that they should. Each will put to the other the major issues of the day as they are developing. On that kind of major policy approach all issues were discussed fully. I am not saying that more could not be done, or that there could not be advantages of more closely reasoned written papers being put forward. There is scope for improvement there. But I did not find myself at any disadvantage in this relationship.

11268. Did you find that either the Bank or the Treasury were insufficiently armed with the relevant facts?——Each was better armed with his own ammunition than the other's. For example, when the Treasury spoke to the Bank they were less well armed on the technical aspects of funding than the Bank, but when the Bank spoke to the Treasury about the money supply and the level of Government expenditure and so on, they were less well armed than the Treasury. Inevitably each knows his own particular field better.

11269. *Chairman*: Do you think it produces the most desirable arrangement that the Bank should be obliged to accept the Chancellor's ruling "in the last resort"? Would it not be better if at an earlier stage the Bank was brought in to smooth the effectiveness of Government policy?——I think that that is a fair comment; may be I have not chosen precisely the best words here.

11270. They are words used by others than yourself.——I had in the back of my mind that in fact one does not use the power of direction with the Governor of the Bank of England in ordinary circumstances. One discusses with him. He has the knowledge that in the Government is the ultimate power. I merely meant that it ought

to be recorded in a statute, so as to show where the power really is in the matter. I did not want to give the impression that it should be the practice of Chancellors of the Exchequer once a week to give a direction to the Governor of the Bank of England as to what he ought to do; not many people would serve as Governor under those conditions.

11271. *Mr. Jones*: In a system like that, if one was moving towards the necessity for giving directions, would there not be a disposition on the part of the Governor to resign, if the Chancellor should seek to use the power to do that?——I think that it is good that the power should be there; all I meant was that I do not think that in practice it is likely to be used.

11272. *Chairman*: Given that the Bank is to a large extent an independent body, what is the parliamentary position with regard to the Chancellor making himself responsible for its actions? Is it exactly the same as the convention with regard to other nationalised bodies?——I should say so. I do not recall whether it has actually been tested or what the parliamentary precedents are; I would think that the Chancellor would normally answer any question about the general monetary policy of the country, but would seek to avoid, if he could, questions on the day-to-day working of the Bank. But as people do not put down questions on the day-to-day working of the Bank, I do not think that that point has ever arisen.

11273. Perhaps they do not put them down because it is more or less understood that it is not a parliamentary matter?——I do not think that it would be felt it was appropriate to cross-examine the Chancellor every day on what the Bank had been doing the week before; whereas on major issues, such as Bank Rate or general funding policy, it is not so much a matter of answering questions as of matters being raised in debate.

11274. The Chancellor's position would be either that be would say that he had approved the action, in which case he would defend it, or else that he would say that it was done without his consent, but that he proposed to see that it was changed. Would that be the alternative?——I do not think that that situation would last very long; somebody would go very quickly in those circumstances. A Chancellor's position would be impossible if he was getting up in the House of Commons and saying that he acquiesced in this action by the Bank but on the whole he thought that it was a mistake. Either there would have to be another Chancellor or another Governor.

11275. But some things might be done by the Bank without having been referred to the Chancellor, without the Bank realising that they would raise a question of policy; so it would become a retrospective question. His alternative would then be to defend it if he thought it right or else to bring about a change?——I think the position is the same with regard to the Treasury. It very often happens to a Minister that actions are taken on the periphery of his Department without his express knowledge, and he has either to disown them or back them up.

11276. The relationship would be the same?——Yes.

11277. *Mr. Jones*: Are you not dogmatically stating that public accountability in relation to the Bank of England would not work?——Questions on it would be answered by the Chancellor of the Exchequer. Public accountability, as we know it in our Constitution at the moment, has to be through a Minister of some kind to Parliament, and if it was not the Chancellor it would have to be the First Lord of the Treasury or some other Minister who would have to answer for it. I think that it is best to have the Chancellor; to have two Ministers, one answering for market operations and the other for fiscal policy, would be difficult.

11278. *Professor Cairncross*: Do you regard it as a function of the Chancellor of the Exchequer to expound monetary policy, to explain what is intended when the Bank Rate changes, or what lies behind restrictions of bank credit?——He is certainly called upon to do so in debate; and it is very difficult for the Chancellor to get through an economic debate, or indeed the presentation of a Budget, without devoting a considerable passage to that aspect of his policy.

11279. Do you think that his functions in that respect in any way inhibit the Bank of England from putting themselves over with the public and taking the trouble to develop an understanding of what is being done?——At the moment public accountability is through the Chancellor of the Exchequer to the House of Commons; but in addition to that the Governor from time to time makes a special statement, like the speech at the Guildhall dinner every year, in which he devotes a considerable time to the mid-term view of monetary techniques. I think that all that is perfectly good and proper. I would doubt whether great benefit would flow from constant public statements by the Bank, perhaps criticising other aspects of economic policy, any more than much good would flow from statements by the Chancellor criticising the Bank. There is a limit to the benefit which either institution would derive from that.

11280. *Mr. Woodcock*: What about a quarterly report?——There is a difference between factual information and opinions on policy. There is no reason why the Bank should not publish, in any detail which is convenient to men in public life and students of these subjects, a full factual report about the situation as it is developing; but I would think it best to have accountability through the normal channels, and to do it in the ordinary way. If monetary policy is challenged, it ought to be done in the House of Commons.

11281. *Sir Reginald Verdon Smith*: You say that the House of Commons system is best, as compared with the situations prevailing in other countries, which in fact gives Governors of central banks a far freer hand?——I am very far from saying that this pattern would be right for other countries; but as we have a pattern of public accountability and responsibility through a Minister to Parliament, on the whole I think (I hope I am not too prejudiced, having been a Chancellor myself) that it is better to stick to that method of doing it.

11282. *Chairman*: What would the drawback be in the Bank putting out a great deal more factual information, plus a great deal more in the way of attempting to explain what is being done and why it is being done? It would be impossible, I suppose, to regard the House of Commons as able to be a repository for all the information that is needed for those who are interested in the appraisal and appreciation of monetary policy. Why should it not be supplemented?——I do not see why such factual information as the Bank themselves think it wise and proper to put out should be limited, and I would not urge that it should. If the suggestion is that things might be said to indicate what changes in policy there might be in the Bank, that might lead to a great deal of speculation of various kinds as to what the next move was. Every word read would be studied in the desire to wring from it an indication of the Bank's future policy, changes in the Bank Rate, etc. Others would look to see whether there was any difference in approach between the Treasury and the Bank of England, and I would deplore anything which in any way exacerbate the differences between two delicately balanced institutions. But I should have no objection to full factual information, limited to what the Bank thinks safe.

11283. *Mr. Woodcock*: Would it not be an advantage to the Bank if people read these reports and were able to assess what the Bank was going to do? Would it not make for a more perfect market? Would it not give more bite to the actions of the Bank?——Their actions have very wide repercussions over a vast field, and I would not like a situation to develop in which they were making statements of policy by which people could afterwards claim that they had been misled.

11284. It would be up to people to complain, of course, but nobody would take very much notice. If the Bank did rather more than just issue a few statistics, if they perhaps described what they had sought to do and how they had tried to do it in the past quarter, half year or year, people would, I agree, look very closely at the report; they would derive from it an impression of how the Bank would act in certain circumstances. It might be argued that that would help the Bank to do what the Bank subsequently wanted to do?——It is not for me to judge, but for the Committee! I only draw attention to the fact that statements which might be read as an indication of future actions, particularly by the Bank of England, would have very wide repercussions in the whole economic system.

11285. You do not admit that they might be beneficial repercussions?——They could be, but they could also do a lot of damage.

11286. *Professor Cairncross*: Do you see any inconvenience to the public in matters in dispute between the Bank of England and the Treasury being hushed up not only at the time but for ever after, and in data on which an independent view might be formed being kept from the public? A long interval separated the setting up of the Macmillan Committee and this Committee, and so far as I am aware there is no Select Committee of Inquiry in the House or any other institution where problems of monetary policy can be considered and the full facts disclosed? Do you see anything to prevent the setting up of a Select Committee which might from time to time look at monetary policy?——The feeling that the problems of monetary policy should be rehearsed from time to time was one of the factors in everybody's mind for the setting up of your Committee here. The idea that one should try and dig up every scrap of difference between the Treasury and the Bank at any given moment in time would, I think, be bad for both institutions. I want to see the fullest sharing of their difficulties together. Each of them in their working papers puts up things that are wrong from time to time; all organizations do. If they are to be fully shared with one another it can only be on the basis of absolute trust and confidence; if either of them starts criticising the other's policy with the use of the other's working papers, I think that it would be bad for the relationship.

11287. *Chairman*: I follow that, but on the basis on which we were going, that decisions that matter are worked out in agreement between the Treasury and the Bank, I would not have thought that that was the active danger. The position is argued; various points of view are put; the Chancellor decides, with the help of the Governor and the Permanent Secretary. That being done, would there be danger in explaining in an annual review after the event what arguments had predominated and what the facts were on the basis of which decisions had been taken?——I would have thought that very different papers would be put up if it was thought that they were subsequently going to be publicly analysed. The greatest benefit a Minister in a Department gets is to have really forthright papers from his officials, saying what they think without fear or favour, even if it turns out wrong. He would never get that kind of paper if the civil servant or the Bank official concerned thought that it was going to be publicly examined at a later stage. It is in the clash of opinion inside institutions that one gets the truth; if everybody gives a hedging view one never gets a good opinion.

11288. I can see the advantage in taking a decision on the basis of confidential expert advice, but is there not also a considerable obligation to allow the public to judge the merits of the argument on both sides? It cannot be done in advance of a change in the Bank Rate, but could it not be very important in assessing whether the right monetary policy is pursued or not?——No doubt there are advantages in it, but I would urge that the disadvantages outweigh them. It is important that when officials put forward papers they should speak frankly; the sort of paper they would put up under those circumstances is utterly different from the one that might be expected otherwise.

11289. *Professor Sayers*: Let us not look at it from the point of view of the publication of the papers of the Treasury on one side and the Bank on the other; let us suppose that the Bank's annual report would include a statement that when such and such a matter was under consideration the advantages of the course seemed to be so and so, and the disadvantages seemed to be so and so, and the facts on which the decision was ultimately reached were so and so. That would be a volume of matter which would be built up inside the Bank, using all the papers that had been put up by everybody concerned, but not identifying the proponents of the various arguments. Would not that help the public in understanding what had been done and in coming to a like mind on monetary policy in future?——It would have have some advantages. I would myself rather more favour the course of not analysing it all the time but having more periodic inquiries.

11290. I was thinking of the Bank's annual report. That comes out about June or July each year, and it refers to the twelve months up to the end of the previous February. It is the universal opinion of outside people who deal with these things that the Bank's annual report contributes nothing to the formation of educated outside opinion on monetary policy. Would it not help both the Treasury and the Bank if that situation could be remedied?——I have a feeling that the report, even including this, would still tell one absolutely nothing. On the face of it it would include more information, but it is amazing the amount of information which can be put in without really saying anything of the underlying factors which both sides would probably often find it difficult to bring out. Do not think that I wish to inhibit the Bank unnecessarily. If they thought that they could do so safely, it would be an advantage if they could elaborate a little more, including more facts, if they are helpful. I am not an opponent of that; I merely say that we should try to preserve the security of the relationship between the Bank and the Treasury so that, when these papers are exchanged and these conversations take place, they are not going to be taken up afterwards and used by either side to say how right they were.

11291. Is there not another relationship which is important, between the Treasury and the Bank on one side and the public on the other. It is going to be a much more workable world if monetary policy commands substantial outside support and the institutions which are responsible for it command respect among people who are competent to judge. One of the most disturbing things in the evidence to this Committee is the critical spirit of outside people towards the Bank, a spirit based very largely on the absence of understanding what the Bank has been trying to do, a feeling of ignorance, a misjudgment of facts due to ignorance. Would that spirit be present if there was a reasonable attempt on the part of the Bank to command the support of outside opinion?——I am a little doubtful whether the criticism is on the technical level. There is a misunderstanding of the role of the Bank as an institution, of the importance of sterling, of our position as banker of the world. That kind of thing is very little understood in this country, and it may well be that the Bank might have some role in putting that broader issue over.

11292. Is it not also partly a matter of confidence in the internal policy? Is it not relevant to confidence in sterling that there should be a sense in the world that Britain has a monetary policy, and that that monetary policy commands important support in Britain?——It is important that monetary policy should receive reasonably wide backing.

11293. Is it not important that the Bank should do all it can to muster that support?——That is one of the things which the Governor has very much in mind. In the public speeches that he makes his object is to express in lucid and reasonably straightforward and simple terms what it is the Bank has been trying to do over a period; but it is for question whether part of what the Governor says on those broad issues should be included in a report, I do not see any reason why it should not be; but I am more doubtful about a great deal of argument on the pros and cons of every technical decision; that would have some disadvantages.

11294. *Chairman*: In paragraph 4 of your memorandum you are dealing with your attitude to part-time as against whole-time directors, and you say that a Court of whole-time people would be "a narrowly confined board of career directors." What is in your mind there? Is it that the range from which they would be selected would be narrow, or that when they became career directors they would be cooped up in a fortress?——The latter. One could obviously have career directors drawn as widely as one liked; I meant by "narrowly confined" a board which excluded people who were not career directors.

11295. Do you think that they would be out of touch with what is important for central bankers to know, by virtue of the fact that they had not current outside interests?——I think that they would very rapidly become out of touch.

11296. *Professor Cairncross*: What do you think it important for central bankers to know?——It is difficult to judge. The Act was at great pains not to lay it down, and I think that it is quite right not to lay it down. There is in fact no limit in the Act upon the appointment of directors, and I think we should be unwise to impose one.

11297. As I see it, your stress in this paragraph is on directors who would be in wide contact with other commercial and industrial institutions. Do you feel that is the most important qualification of the central banker?——It is one of the most important things. I would not for a moment suggest that that should be put into an Act of Parliament, but I use that as an illustration of the sort of range. If we start defining it, I think that we shall get into difficulties.

11298. *Mr. Woodcock*: I do not know if they have ever had among the part-time directors a working economist; has that ever struck anybody as being a qualification?——I should not exclude anyone because he happened to be a working economist from sitting on the Court of the Bank; they might serve very well.

11299. But none has ever been appointed?——I do not know whether a whole-time economist has ever been a director; there was not one when I was Chancellor. It would be a controversial appointment, because he would represent a school, or be taken or advertised by other economists as representing a school, of economic thought, and the whole tenor of the Bank would tend to be related to what other economists said was his particular school of thought.

11300. *Sir Reginald Verdon Smith*: You say that you have never met a banker who admitted that he had been influenced in his credit policy by pressure of liquidity ratios. Does that imply that you feel that so far pressure on liquidity ratios has never been a sufficiently severe pressure, or that even if it had been sufficiently severe this technique was not likely to work?——It is a difficult problem; but from what I have seen of the bankers they have so disposed their affairs in the post-war world, with the huge amount of outstanding debt and other matters, as to render themselves largely immune to any normal pressure on liquidity ratios. I am not saying that arrangements could not be devised to make at any rate a reasonable step in the direction of exercising some form of automatic pressure upon the bankers, but on the normal arrangements as they were up to the time I left office I would not say that pressure was really operative in that way.

11301. You would regard the ability to control excess liquidity during those years as being the particular item you would most single out as significant?——Yes, I think that it is important to devise a method of controlling the credit policy in a way in which, up to now, has been lacking. It is a little difficult for me to say this, but I was reflecting on these papers last night and the questions you put to me; and it seems to me that these questions as to the Bank-Treasury relationship and the machinery in the Bank are not really the root of the problem. The root of the problem is in the money supply; if the Treasury is not in control of the money supply, no Bank of England and no mechanism that could be devised, it seems to me, will ever really be wholly satisfactory. I do not say that the Treasury is not in control of the money supply at all, but in the post-war world there are certain built-in factors which do tend to push it up. There was an article by Enoch Powell in *The Banker* dealing with this, and the Select Committee on Estimates has been reporting on it recently. A House of Commons which used to refuse supply now clamours for it. The pressure of expenditure in a democratic state is very substantially upwards, and however carefully one might devise a new mechanism for the Bank it will be flooded and overthrown unless the total supply of money in the country is under control of some kind. The measures of 1957 were generally regarded as moderately successful, at any rate in the circumstances of those times. But they were taken on some pretty crude assumptions. Many people considered that the velocity of circulation was more important than the quantity of money but the crude assumption was that they concentrated on the supply of money. It is those issues, the amount of money that is going round, and how it can be controlled or limited, which are going to have a decisive influence on the success of the monetary operations of the Bank. The Bank have some justice in their complaint that in the post-war world they have been operating against a flood which no machine could really handle.

11302. *Chairman*: We did not mean that the points to which we have just drawn your special attention lay at the roots of our problem; they were really the reason why we were taking the special step of inviting you and others who have held the same office to give evidence.——I thought that I would mention that I think there is this other aspect of it.

Chairman: Thank you very much, Mr. Thorneycroft.

(Adjourned until Tuesday, 4th November, 1958, at 10.45 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-EIGHTH DAY

Tuesday, 4th November, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman* (Questions 11416 to 11519 only)

PROFESSOR A. K. CAIRNCROSS, C.M.G.	W. E. JONES, ESQ., O.B.E.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (in the Chair for Questions 11303 to 11415)	PROFESSOR R. S. SAYERS, F.B.A.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.	SIR REGINALD VERDON SMITH
	MR. R. T. ARMSTRONG, *Secretary*
	MR. G. PENRICE, *Statistical Adviser*

Sir Oliver Franks in the Chair.

THE VISCOUNT KNOLLYS, G.C.M.G., M.B.E., D.F.C., Chairman of Vickers Ltd., called and examined.

11303. *Sir Oliver Franks*: I have been asked by Lord Radcliffe to apologise for the fact that he is unable to be here this morning.

We are very grateful to you, Lord Knollys, for coming, ready to answer the questions which the Chairman put in his letter to you; I wonder whether, before we come to the questions, there are any things of a general nature which you would like to tell us, either about the company over which you preside or about views which you hold which affect the general subject which we are investigating?——*Lord Knollys*: I should like first of all to say something about the Vickers group and how it is made up, just to give a background. The Vickers group comprises a number of companies which manufacture a variety of products, mainly and basically in general engineering and originally in steel (we still maintain a business in specialised steels); ships, shipyard building and ship repairing; aircraft; things like accounting machinery on quite a large scale; earth-moving equipment, which really comes under the heading of "general engineering"; and then, through an associated company, railway rolling stock and equipment to do with buses. We manufacture in different parts of the world; altogether there are 44 works and establishments, all except five at present in this country. Total employment is at the present moment 84,000, having decreased slightly recently from a maximum of about 92,000. Our stockholders now number about 78,000.

So far as the internal organisation is concerned, it is a highly decentralised organisation, with a great deal of autonomy given to many of the companies, who operate themselves very largely. Vickers Limited itself is a holding company, holding in almost all cases a 100 per cent. holding. It acts as the financial controller, and indeed the banker, in regard to all the financial requirements of the companies. Although certain companies in the group raise their own finance, Vickers Limited are really responsible for providing the finance for all the companies in the group. We act as bankers to them and give them limits for their control, in the same way as a banker does with his customer.

11304. Thank you. The first question which we put to you was: What are the main considerations which determine the size and content of your organisation's fixed investment programme? Perhaps you would be willing to talk to us in quite general terms about that. I am aware that there will be rather different considerations in different parts of your business, but that is of interest to us.——First of all, may I ask the exact interpretation of "fixed investment programme"? Is it confined to buildings, plant and machinery, or would you like me to deal with such things as development?

11305. From our point of view the most convenient thing, if you are in doubt, would be for you to go on describing it. For example, we have in mind that on the aircraft side, when it comes to the development of a new aircraft, you are involved in a field where fixed investment might be quite a small part of the total expenditure which is involved. We would be interested, not bothering too precisely about the meaning of words, to hear about the kind of planning and expenditure involved there, and the way in which it has to be worked out and framed over a period of years, if that is so.——The main considerations which affect us in our planning are what we can do to keep alive and keep modern all the existing activities and all the variety of products in the group, and at the same time to be able to develop new products. We may do that either directly in the existing establishments or by acquiring control of companies here or abroad. It is extremely fluid. It is not, I am afraid, planned to the extent that other businesses would be, or to the extent that some people might expect it to be; we are just always looking round to see whether the products of the basic policy of the Vickers group can be kept alive and up-to-date. It is developing all the time.

Firstly, there is the simplest and most straightforward form of investment: the replacement and modernisation of plant. We have programmes worked out by the various works and then by the companies, which ultimately come up to the centre to be approved, discussed and cut down or, expanded, where that may be necessary. The initiative comes from the actual works themselves. They say: "We want new equipment", or: "We want a new type of equipment", and that comes up. The planning is there in that respect.

The development of new products will largely come from the people at the works, who are under the control of a managing director for each company, who has a very great deal of autonomy in planning development. They are the people who have got to think and spot things for the future. One obviously could not do that from the top. They find out new products or new opportunities of acquiring companies which have a product which we think would be profitable; and they see what the market demands in that way. Those are really the main points from which all this flows in the beginning; everybody is looking round the whole time to see where there are new opportunities.

The direction from the top would arise on the general policy of the group. For example, for some years past we have been looking very carefully, so far as Vickers Limited is concerned, as to how far we can diversify both in the kind of product and geographically. To give examples of that on the geographical side within the last two years: we have acquired control of a Canadian company which has a large engineering works and two shipyards; we have further developed our system of engineering works in Australia, to make that complete; and we are just now going into India, participating with other companies to start up the first large heavy engineering works in India, as the Government of India has encouraged us to do.

One thing that perhaps makes us different from a great number of industrial groups is that over the years we have had a great deal to do with defence products. We

are constantly dealing with the problem of very sharp ups and downs in that way, and we are constantly looking for new products to take the place of those which we can no longer make. That is a historical tradition, and has a very great influence on our conscious planning of that kind. We have been doing it recently, as we have done it after every period of activity in defence; for example, earth-moving equipment and tractors were put in to take the place of making tanks because part of the equipment was very much the same. We went into the accounting machinery field, where we acquired the control of Powers-Samas, to take the place in one of our largest factories of the making of gun mountings. We are constantly doing that and trying to adjust ourselves; rather haltingly and not by any means backing winners every time, but those are the kind of things which influence us, and are doing so now.

Then we have been connected with aircraft for fifty years. There again, the same kind of thing has happened. It was a more recent development to go into the civil side. The wheel has turned so much from military aircraft to civil aircraft so far as demand is concerned that at the present time we are producing the last of our military aircraft, and we shall build no more military aircraft unless orders come along. But we are taking the place of that by what we have done in the civil aircraft field. If I can take that as being a part of the fixed investment programme, that has been one of the largest factors in determining the amount of funds which we require. The figures have gone up tremendously both for stocks and work in progress, and there is very large expenditure required for development, during the period between the research and the finished product. We do not ourselves do the basic research, but there is a tremendously expensive development programme on any aircraft for which funds have to be provided until orders for that aircraft come to an end. But by that time we hope that its place has been taken by another one, so that the amount of money sunk in this is fixed to that extent, if one remains in that kind of business. We have to provide funds from our own resources and from outside. It is that kind of expenditure, and the investment in different companies, which produces our main requirement for funds, wherever they may come from.

11306. When the plans and programmes of the subsidiaries come before the holding company, as I imagine they do at regular intervals, are they presented in terms simply of the coming year or do they look ahead further than that? Over what stretch of time are you looking? Does it vary according to the different type of business done in the different subsidiary companies?——The modernisation of equipment is looked at for about three years ahead definitely; authorities are given up to three years ahead, but knowing that that kind of expenditure will go on with fluctuations and that it can be altered (as indeed it has been altered now) and stretched a little if things do no look quite so good, by which I do not mean rates of interest but profits. There is always a certain amount of stretch. As to the main programme of development, perhaps I can explain it best by illustrating from our recent experience. At the end of 1956 we were taking 1957, 1958 and 1959 as to our requirements, which meant that we had to approve and then provide the finance for a great variety of new things. There were the investments abroad which I have described, which took up a certain amount. We needed nearly £6mn. to go into Canada, and a smaller amount to go into Australia. Then we had one large venture which was a combination of modernisation and development; that is perhaps a good illustration of what I think you want to hear about. That was a new dry dock, on our ship repairing side. We have a large ship repairing business up on the Tyne, but for some little time past there has been a certain amount of planning for a new dry dock, since we realised that we had not a large enough dock up there to be able to take in for repair the new, larger ships, and particularly large tankers. That project has therefore gradually been worked up, and final approval for it was given in the middle of 1957. It was a £4mn. venture, which was designed to take some of the largest tankers, first of all up to 80,000 tons and then ultimately 100,000 ton tankers. We had to go a long way ahead in our thinking as to how far that would pay and what would happen to a business in which we have a very large stake if we did not have it. That was worked up from below, and it was approved by the board of Vickers Limited last year. Nothing that has happened in the way of the slight recession, freight rates going down, the shipping industry being what it is now, or indeed the rise in the rates of interest, which came at a slightly awkward moment from our point of view, has changed our minds. We have looked at it and reviewed it; but we made up our mind it was a good thing to do and nothing has changed that, because it was quite basic.

11307. That was a programme over two, three or four years, I suppose; when you finally authorised the programme so that action could begin were there estimates of the amount of money to be spent in each of the years, and was that all authorised at one go?——Yes. The board had in front of them an amount for each year. We concentrate on three-year periods; if one wants to raise a lot of capital from the market, there is about that period between issues. We were looking at this project roughly in two three-year periods; the amount estimated to be spent in each particular period was set out, and part of it spilled over into the second period.

11308. *Professor Cairncross*: Do I understand that, although you did not change your mind about the project, you did review it when the rates of interest went up?——We did not review whether we should go ahead with that particular programme at all, because it was fundamentally right. Whatever the rate of interest—well, nearly whatever—it would not have affected us. It was a 15, 20, 25-year programme, and over the years the rates of interest would presumably roughly even themselves out. This applies to all our programmes. We just looked at the issue at the last minute to see whether the amount to be raised should be the amount we originally thought of or a little less. When all the requirements had been shown and we had allowed an amount for the development of aircraft, which was very large, we came to the conclusion that we required something like £60 mn. altogether over the three-year period. From our own resources we ourselves found, partly from depreciation reserves and partly from retained profits, roughly half; so we were left with a figure of £30 mn. to £35 mn. for which we had to go to the public. The review was as to what the figure should be, not as to whether it should be raised at all, because we approved those things as being essential for our business, particularly the dry dock.

We did discard another dock improvement programme at Barrow, not because of the rate of interest but because we could not see that it would greatly improve our competitive position. It would have cost a lot of money, and it would have been harder to earn it. That was discarded for other reasons than the monetary one.

11309. *Mr. Jones*: Was it guaranteed stock you were putting on to the market?——Partly one and partly the other. We had secured loan stock of £10 mn., and just under £20 mn. of equity shares.

11310. But you would have substantial liquid resources; would they not have an influence on the question of rates of interest on your business overall?——As to the first part of that question, we have at various times considerable liquid resources. Up to 1956 we were running with about £6 mn. of liquid reserves, but as we went ahead with part of this programme we gradually ran that down. We bought an investment in Canada for £6 mn., and aircraft work in progress used up a lot. Then, with all this in view, and knowing where we were going to go in regard to what the expenditure might be, we planned ahead that we should have to go to the public for the amount we could not provide ourselves for this large programme, and then ran down our own resources and drew on our banking facilities, with a view to liquidating the overdraft by getting money from the public, which we did just over a year ago. We are now back again temporarily in the position where we have paid for most of these things, and we have considerable liquid resources again, between £8 mn. and £10 mn. at this particular time.

11311. Suppose that you had had to undertake this scheme on the Tyne on the basis of minimum borrowings on terms of fixed high rates of interest over a long period of years; would it have been economical in any circumstances to have interfered with the development that was taking place and the construction of that scheme if the rate of interest had gone still higher?——No. It is so basic to our whole existence that we should have gone ahead with it on its merits as something which was necessary for us to keep our position in that line of business

over the years. Almost whatever the rate of interest had been at which we would have had to raise that money, we should still have gone ahead with it. We should have had to find ways of earning that money, perhaps in another part of the business. It is one of the advantages of a very varied group system that we are able to do that. We did not have to look at that as a single ship-building company; finance comes from all our operations, and over the years it has been shown that one can afford to do it that way.

11312. It is more economical to go forward with a project of that kind and to keep it going, even though the rate of interest may rise by 1 or 2 or more per cent., than to hold it up and stand the consequences of the delay in the completion of the scheme?——The only thing we might do is slightly delay it or slightly spread it out; but it would not affect going ahead with it as a venture. We might vary whether it was built in two or four years, but a change in the rate of interest would not have affected our basic decision on a scheme of that kind.

11313. *Professor Sayers*: Could I go back to a stage intermediate between the decision that this was something vital and basic, with which you had to go ahead in order to hold your place in business, and the stage where you described the board as having another look at it in view of the recent change of circumstances and the difficulties of raising money? I am thinking of the time when you come to plan the project in rather more than broad outline and it is a matter of seeing just what has to be done, what has to be built, what quantities of material will have to be bought, and so on; when you are sizing it up in broad terms and deciding whether it is a £5m. or a £10m. project, or what. At that stage, the detailed shape of the project must depend a great deal on your planning engineers, and on the technical people who will say: "The walls have to be built so high, and so thick; they have to have so much steel in them for strength", and so on. At that stage is there not technically possible a variety of views as to how strongly it should be built, how expensively it should be built, whether it should be built to stand for thirty years or fifty years?——We depend on our technical people to say what is the most efficient way and what materials are required and what strength is required to do the job it is designed to do. It is not variable as a matter of planning. But the size or the amount of equipment to be put into it is variable. Perhaps I can give an illustration in this case. When we were thinking about this dry dock we started off by saying: "People are gradually moving towards building 100,000 ton tankers. The 100,000 ton tanker, which is just less than 1,000 feet long, is about the limit the River Tyne will take, if the ship is to be able to turn into the dry dock". We set out saying: "If we are going to do it at all, let us do it thoroughly". Then we changed; we said: "There are no immediate signs of 100,000 ton tankers, but there are signs of 65,000 to 84,000 ton tankers. We will make this dock big enough to take 84,000 ton tankers, but we will build it in such a way that it can be extended at a later date to take 100,000 ton tankers, which is the maximum that the Tyne will take"; and so we saved that amount of money in our planning. That was rather different from what you are suggesting, but it is perhaps the same kind of approach. It was done not so much because of the capital cost of it as because we thought that we would not earn enough money to be able to justify it being done. It was a compromise, as so many of these decisions are, not on the technical side, because one can never compromise on that, but rather like with building an office building, when one says: "It can take two more storeys if we want it to".

11314. *Sir Reginald Verdon Smith*: Could you develop a little more the theory of the compromise that achieves the decision? You were saying earlier that profitability, as distinct from the rates of interest that one has to pay on money required, was certainly a consideration which entered into your judgment about stretching capital expenditure of a replacement type a little over a period. You spoke of the annual and triennial budgets coming from the works first and then going through their managing directors to the main board. By what criteria does the board form a judgment about the levels of expenditure? By their profitability in particular cases, by the need for technological competition, or by the need to seek new opportunities? By what sort of measure do you arrive at judgments involving very large expenditures over a long period of time, if it is not a purely monetary judgment?——That is quite a difficult question to answer, because I am afraid the answer to it sounds highly unscientific. It is partly conscious and partly unconscious. It is commercial judgment, I suppose, really. All those things come into it; we go on discussing these things week after week, without necessarily always having planned meetings, but just discussions, and we come out at the end with the answer that it is a good thing to do that particular thing; it is justified technically, commercially and financially. You have probably found yourself that it is very hard at these times to say how one gets to that answer. I am always alarmed at some of the test cases given at various colleges, when young gentlemen are asked to work out schemes and to set out how it is done. They would sometimes be a little disturbed if they knew how one does come to those answers, because it is a combination of the experience, knowledge and flair of a lot of people who have had a great deal to do with it, on which is based the final judgment that that is the thing to do. On top of all the knowledge brought to bear on it in the end there is a flair which one cannot describe.

11315. *Professor Cairncross*: We are interested in knowing where financial considerations enter into it. You have explained that you discard certain projects and let others through. Clearly there will be some projects which you cannot afford to discard because they are essential to your business; but there must be others which you feel do not offer a sufficient prospect of return, or that you think that you should prune, as you pruned the dry dock project, because you do not see an immediate return. In both those cases the return you expect is an element you consider. Do you find that, if you are getting progressively less liquid and therefore are more and more in the position of having to go to the market for funds, you take a stricter view of projects sent up from below and set your levels perhaps a little tighter?——The effect on one's mind about that is very marginal indeed. It would only be in cases where we had something which under particularly favourable conditions we would like to do and think it a good thing to do, but which we might not go ahead with if there are too many obstacles. It need not be a question of money; it might be that we had not the people for management. On the financial side, it would only happen in very marginal cases, if at all, because we believe, and experience has shown, that if it is a really good thing to do and we make up our mind to go ahead with it, we can count on getting the money. Of course, before we committed ourselves to a very large expenditure we should consult a variety of people, those who would help to provide that finance in that way; but where credit is of a certain standard, in fact it does work out and one can get it. The timing has to be looked at, but if it is a really good thing we can count on finding the funds. When we plan to build an aircraft, and have to decide whether we can tie up a large amount of money in the development stage, we believe that we shall find the funds from a combination of ordinary credit resources and ultimately our shareholders. You might think that perhaps that looks a bit haphazard, but experience proves that it does work out.

11316. It is the marginal cases which are of interest to us on this question; we should like to know whether in your experience there have been any occasions on which the prospects of difficulty in making a public issue or of a sharp change in the rates of interest have induced you to change the standard which you apply to projects at all, whether anything has been turned down which, in other circumstances, might have got through?——Not on that ground alone.

11317. *Professor Sayers*: Has it been a factor in your minds in turning the balance against a project?——No, because we look at that afterwards. We see the project as something which is in the interests of the group as a whole.

11318. And you decide to do it before you consider the financial considerations?——We decide that it is a good thing as a whole and then we consider how we are going to pay for it. If it was a very large amount relative to our normal resources, we would find out first of all whether within that period we would be able to obtain the finance for it. So far, going back even before my time, it has never stopped us doing something which was an important thing to do.

11319. Has it ever altered the timing?——I cannot perhaps be quite so categorical about that, but I do not think it has, because the right timing comes in doing the thing at all. Take this dry dock: we have to start doing it now, because we have to have it available by the time these large tankers, which we are building ourselves, will be ready to use it.

11320. But that is something absolutely basic to your business. What about a more marginal project?——It would not be turned down because of a higher rate of interest, unless something happened to the market generally and we were on warning that we could not get anything at all.

11321. *Sir Oliver Franks*: That would be scarcity of capital, not cost?——Yes; but again that has not happened.

11322. *Professor Sayers*: It has affected the timing? ——Not of the project, but of providing the particular kind of finance.

11323. *Lord Harcourt*: You are really saying that in your planning the rate of interest has no consequence, because you as a group are so large that you have always to be sufficiently liquid to time the raising of the fresh capital to suit yourselves; in other words, that the rate of interest will influence the timing of the raising of the capital but will not influence your planning?——Yes.

11324. *Professor Cairncross*: Would you take exactly the same view about the scale on which the modernisation or replacement of existing works was permitted in conditions in which it was easy to make an issue or in which capital was cheap, as you would take when the rates were high and there was some difficulty in making a large issue? ——The effect of the interest rate would be on the actual amount of money we raised at the particular moment. If in September, 1957 the rate had been 3 per cent., we would have tried to raise a rather higher figure to last us longer than we did at that time. The scaling down would come from the amount of money raised at a particular time; it would not affect the project, though the amount of liquid capital available would be rather smaller or larger.

11325. Would the limits which you set on your companies be affected by tight money? Do you not revise these limits at times on grounds which may be associated with the need to carry through other large schemes, for instance?——Not quite in that way. We vary those limits as the case is put up by a particular company, as to what they need on a scheme which we have to approve. Our relationship with them is a little like that of a banker and customer, and I have tried to make it so for control purposes. We make them pay a rate of interest which reminds them of the cost of raising the money. We vary the rate of interest which we charge to our companies, to make them very conscious of what we as the parent company have to pay outside, and they have to take that into account in their costs; but it does not affect it being done.

11326. How and when do you vary these rates?——We do not necessarily vary with the Bank Rate. I hardly brought down the interest rates for our internal arrangements at all when the Bank Rate came down. We raised our last lot of money at 6 per cent., and they have to take that into account.

11327. But that does not affect the size of the schemes which they put up to you for approval?——No.

11328. This is purely bookkeeping?——They have to recommend schemes which are thoroughly sound to carry on their business, and they are reminded of the finance they need to do it in the rate they have to pay us; but it does not affect it.

11329. Why do you think it is necessary to remind them?——I think that all the way down the line they should realise the true cost of what they are doing.

11330. *Professor Sayers*: Is there any point in that, when it does not affect what they are doing?——Yes. It may not affect what we on the board of Vickers Ltd. approve, but the companies have to be conscious of what it is costing us; they have to appreciate the facts of financial life so far as we are concerned.

11331. *Sir Oliver Franks*: If one of your subsidiaries is in effect using for its new development money which has been raised by the group at a certain cost, you are saying that it is reasonable that in forward planning that subsidiary should take the money that it will use into its costing at something like the figure at which it has been raised. This is making them rate conscious, but is it not doing a little more? If the price of the money that they will be using is taken into account at one figure rather than another, will not the level of profit which the exercise of planning establishes be to that extent affected?——That is so.

11332. One must either say that a scheme which is judged proper from the commercial, financial and scientific angles is in general profitable by such a margin that differences in the assumed cost of money are never sufficiently large to make any odds; or alternatively that, if the profitability shown in the planning is not so large, then the assumed cost of money does really make a difference as to what is thought worth undertaking?—— It can have that effect, clearly; the rate of interest they are being charged might make it less attractive. But we should have a final check on that, because they would say to us: "This looks like becoming marginal as a good thing to do because of the very high rate which you are charging us". At that stage it then comes back to us to take the long view and to say whether, having regard to this rather artificial rate we are charging, it is still a good thing to do. As to the final decision as to whether we should go ahead, it would be drawn to our attention that it was marginal because we were charging 6 per cent. instead of 4 per cent., and we would then make the final decision, and say: "It is still a good thing to do".

11333. *Professor Cairncross*: How does that happen? Do the companies come back and ask you that question? ——They are always drawing our attention to the effect of the charge. They would put it to us. It has not come yet, because our programme was largely passed before this happened, but even if they did come I believe that we would go ahead, having noted the fact but not changing our decision because of it.

11334. *Professor Sayers*: Many of these modernisation jobs and replacement jobs must be fairly small things, to which you would not want your notice to be drawn at all; things which must be decided locally, and things where there is a choice of method; for example, whether to put on a building a roof that will stand there forty years and never need anything spent on it, or a roof that does the job pretty well but is going to need replacement in ten or fifteen years and meanwhile may involve certain costs for repair from time to time. This is a case where the level of the rate of interest would, on the face of it, be highly relevant; but this would be a small item, just one particular part of a modernisation or rebuilding job. Would you not expect the local manager to decide that without coming back to you?——The level to which we keep control over capital expenditure of that kind comes up quite high. Each of those companies has a board (which is in fact largely identical with the main board) to which things come up, and the control limit is fairly low. At the present time those concerned, quite senior people, have been looking through the whole of the replacement capital expenditure, and in some cases they have deferred buying machinery or putting a new roof on. Some of these things have been stretched a little. They have said: "We will leave that over until the following year"; but that has been agreed because we are not quite so sure as to the net profits which are going to be available to pay for those things; I emphasise: *net* profits. It may be stretched a year or so further ahead for that kind of reason, because when our profits go down we try to make something last longer. That is the main reason for the kind of decision that you have in mind.

I should make it clear, although I do not want to emphasise it too much, that the criteria of doing something is not just that we must do it or the return we get for it; in our particular case, with a large proportion of our activities in engineering and shipbuilding on Government and defence work, it is our job, if we are going to be equipped for doing anything for the Services, to keep ourselves in condition. Some of the things we do are not at all profitable, but we have to make that extra contribution. That has nothing to do with profitability, but we have to be prepared to do that kind of thing.

11335. *Professor Cairncross*: There was a very large increase in fixed investment in British industry over the period after 1953, and I imagine that your company shared in this expansion. Could you tell us whether in your judgment that expansion was due to special circumstances or whether you think it was a movement to a continuing higher level of investment over a longer period?——We certainly shared in that expansion in the middle fifties. It was very largely on the aircraft side. We were building Viscounts, and part of it was taken up by military orders. It was clear that it was necessary to sell the aircraft at the right time, and we had to re-equip very largely. We expanded a great deal in buildings and equipment at that period. That is really over now. We hope to stay in this field, but none of us can see much greater expansion in aircraft manufacture at this time. The other thing continuing is the dock; but apart from those two things, the new aircraft and the dock, our plans in that way will steady down a great deal.

11336. You do not see anything coming forward which might eventually rival these two in magnitude?——No.

11337. *Professor Sayers*: And these are both related more closely to the course of technical development than to anything else?——Yes.

11338. *Sir Oliver Franks*: We ought, for the sake of completeness, to deal with our questions about stocks. It is important to us to know whether, when you consider the amount of stocks and work in progress, which accumulates if markets are sticky, considerations sometimes arise which make you pay attention to the rate of interest, or whether that is not so?——Stocks as I think the term is generally interpreted in this field do not play a very large part at all with us. Work in progress obviously does. We do not hold stocks of anything we make; we hope to have no stock on the shelves at all. Our only stocks are the raw materials needed to make things which have been ordered by somebody. So the amount of stocks we have in hand is controlled by the orders we receive, which in turn, I suppose one might say, can be affected by what our customers think about the situation, including perhaps the monetary position. But that is very indirect.

11339. You would say that the volume of the stock of any particular material which you hold at any given time is within a relatively narrow margin simply a logical derivation from your programmes?——Yes. We would only have more or less stocks to a very small extent from considerations of scarcity and not much from considerations of price. We may, in ordering certain commodities, possibly copper, or something like that, have waited a short time, if we could afford to wait, because of the price. We stock up a bit more when things are harder to get (for instance, plates for making ships) and a little bit less when they become easier, as at the present moment. But once started we are not flexible in that way.

11340. *Professor Cairncross*: Would you ever order a general review of stocks?——The main factor which runs through everything of that kind is the question whether what we are doing is efficient and economic. Stocks are reviewed to see if they are enough; but again there is a certain amount of "feel" in that. Over the years it has usually turned out about right.

11341. If there was a credit squeeze, or a sharp rise in the Bank Rate, do you think that any of your companies would look to see if there was any small margin of excess stocks?——No. It would he on the scarcity and the prospects of being able to get the material at all.

11342. From our point of view even a 1 or 2 per cent. change in stocks might be worth hearing about, because over the whole of British industry that would represent something quite large?——Considerations of scarcity could produce a figure like that, I should imagine.

11343. But changes in monetary values would not?——Not that much. We either have to have it, or we have not. It is a very slight adjustment in either direction.

11344. If you saw ahead of you very large financial commitments, you would not then feel it was worthwhile scraping a little out of stocks?——The level of stocks is related completely to the programme for making the article. We could not afford to do it, because we should either run short or, if we took advantage of a favourable condition, we should be tying up too much money. We should not have the space to do it, anyway; we have that physical problem.

11345. *Sir Oliver Franks*: May I try to put into words my impression of your answers, to see if it is right? Your programme formed by the major decisions which the central board has made on reviewing the suggestions and programmes of the subsidiary companies is the governor of all the activities. This programme is definite at any given stage over the first three years, and is adumbrated and in part worked out, in certain sections anyhow, for a second three-year period. The amount of stocks you hold, the amount of money you will need to use, the number of managers you will require and the volume of workpeople in particular areas you will need, are all governed by and are functions of the authorised and accepted programme. The business of the central board is to keep that programme reasonably and rightly balanced and adjusted to opportunity. If it does that, it succeeds. Therefore, to our questions whether particular things, such as the price of money, weigh consciously and particularly with you in estimating the programme at any given point of time, the answer is always: "Over any short term, no; the programme itself governs, and it is assumed that all the other things can be provided to make the programme function, including money at whatever the prevailing price may be". Is that a fair way of putting it?——That is exactly so. It is assumed that funds will be available, though, as I explained, we make the right kind of inquiries to make sure that it will be available in one form or another when it is required. These plans for investment are dependent on what other people are likely to need from us, or may want to need; I suppose it can be said that their minds may be influenced by these other factors. Indirectly, therefore, we may be concerned with it, but not so far as our own conscious actions are concerned.

11346. Over the last seven years we have moved from a 2 per cent. to a 7 per cent. Bank Rate and half way back again. Clearly what you have said about the influence of the cost of money holds for those variations of rate which we have in fact experienced. You have also said that there must be a money rate so high that one would have to pay specific and particular attention to it and make decisions which would be different because of it. I imagine we would all agree that at 15 per cent. that would be so. I realise that this is a hypothetical question and in that sense difficult to answer at all, but have you any feeling about where the critical level would come? It did not come at 7 per cent.; would it come at 10 per cent., or is it nearer 15 per cent.? Or can one only answer that by seeing what in fact one decides when confronted by the circumstances?——I think that the last sentence is really the only answer possible. The indirect effect on what we do is the effect on those people who buy from us. About 40 per cent. of our products are exports, and that particular problem does not affect it here.

11347. Do you think that, if the managers of the subsidiary companies took the cost of money as 10 per cent. in their plans and therefore their recommendations, that would affect the type of thing that they come to the board with?——No. If that penal rate of 10 per cent. had not affected the people who buy from us, they would say: "We can make that and it will be a good thing to do". But the profit which we produce for Vickers Limited would be affected, and at that stage the judgment would be transferred to us on the board itself, as to how much we should take that into account. Normally we should not take it into account, but it would not prevent it being done so far as the companies were concerned.

11348. *Professor Cairncross*: With a gilt-edged rate of 10 per cent. would you not require a profit of 20 per cent. to show a return?——Yes. Profit margins are getting a bit slender these days, but it would have to be a figure well above the gilt-edged rate. It would be bound to make a difference if the Bank Rate went up to a point where the margin between what anybody would pay for something, both at home and abroad, and what it cost faded away. I am afraid that is not a very satisfactory answer to that question.

11349. *Lord Harcourt*: You said that Vickers Ltd. normally keep highly liquid. When you have large quantities of liquid funds, do you invest in Treasury Bills?——Perhaps I can give an example of what it is at this moment, when we have £8 mn. to £10 mn. of liquid funds. A considerable proportion of that is in Treasury Bills at the moment, and a declining amount is on loan to local

authorities. We have a considerable amount in Tax Reserve Certificates, and occasionally a little bit in the money market; but always our first line is deposits with our bankers. The largest individual item at the moment is Treasury Bills and the second largest is Tax Reserve Certificates.

11350. Do you operate in the short bond market as well?——No. There is a point about this which may be of interest. In estimating our financial requirements for our business the fluctuations can be such that it is extremely difficult to be able to get any programme for that kind of investment at all. We have extraordinary swings, because it is the sum of the requirements at any one time of a large number of different companies who individually have very large amounts.

11351. *Sir Oliver Franks*: You mean that sometimes, instead of cancelling each other out, they accumulate?——Yes. I have here our cash forecast for the next eighteen months, which has various lines. Allowing for the worst, if all our companies drew on us at the same time the fluctuations are such that our reserve can fade out completely, or can swing by many millions. As I say, at the present moment it is mainly in Treasury Bills.

Sir Oliver Franks: We should like to thank you very much indeed for coming, Lord Knollys.

(*The witness withdrew.*)

SIR PATRICK HENNESSY, Chairman, and J. M. A. SMITH, ESQ., Assistant Managing Director, Ford Motor Co. Ltd., called and examined.

11352. *Sir Oliver Franks*: Sir Patrick, the Chairman has asked me to apologise for the fact that he is unable to be here this morning.

You have had the questions which are in our minds and about which we would like to ask you. Before we come to the actual questions, is there anything of a general nature which you would like to say about your large company or about your general approach to the subject-matter of the questions?——*Sir Patrick Hennessy*: I think that it is appropriate that I should say something. First of all, we are perhaps the exception in the motor industry because we have tried, successfully so far, to finance all our expansion from earnings. That is possibly rather odd in this industry, but we hope to continue with that and we are fairly optimistic that, unless we run into some serious recession, we can do it. From that point of view we have been less concerned about what is happening to money in the market place than some of our friends in the motor industry and other industries have been. It has been our policy to try to operate with such efficiency that we could not only provide for our shareholders but also for a very substantial capital programme which we anticipated a number of years ago and for which we began to accumulate money. We are spending or are about to spend about £65 mn. That has gone up and will go up substantially; we are investing at the rate of about £20 mn. a year at the present time.

The second point is that whatever we do is dictated by our competitors at home or abroad. This is one of the most competitive industries in the world, so that what we do about investment, in terms of the practical things that investment provides, is not always our own choice. We may have perfectly good machinery to-day, and think that it is good enough for another five or ten years; but to-morrow somebody brings out something better, our competitors in Germany or America or somewhere else use it and we have no choice but to follow. The amount of our investment related to our sales is, I imagine, high compared with many other industries, and we are much more liable to changes in the types of assets which we have, production machinery or equipment or buildings, than some other industries entirely because of the exceedingly fierce competition which we have to meet.

11353. *Professor Cairncross*: I imagine that the capital expenditure of your company has varied from time to time, and has been particularly high in the last four or five years?——Yes. During wartime we were restricted in what we did about our own affairs, and immediately after the war we had Government restriction on the expansion of plants. It varies also because we are a growing industry and a growing company.

11354. Is the kind of level of capital expenditure which you have had in the last few years likely to be maintained, or may it increase? Or do you think that you had a particularly heavy investment programme in the middle fifties and that it was one which will not be repeated?——No; our investment programme is always going to be high. The motor car, the commercial vehicle and to a lesser extent the tractor are subject to change either because of fashion or because competition dictates it. For example, these days bringing in a new model can cost £5 mn., and with a big range of them such as we have the amounts of £5 mn. add up fairly fast. Even if we are not expanding capacity at the same rate we are still doing a lot of things which cost money.

11355. Would you say that in the past few years you have been in any sense making up arrears?——Yes. We are making up arrears from the point of view of amelioration, modernisation and expansion. We were working seven days a week, and nights, and doing different shifts, and conditions were not good enough. We have a lot of things to make up. But in this particular industry we are always going to have big investment. It may drop from the £20 mn. approximately a year which we foresee this year, next year and probably the year after, to £15 mn. one year, but that is going to be about the sort of figure.

11356. We are interested in knowing what were the factors governing the big spurt in investment which was common to the whole of British industry, I think, from about 1953 onwards. Can you think of any special factors?——The delayed action which we have spoken of was one factor.

11357. You think that that was the principal item?——Yes, I suppose it was, because there was the delayed action with regard to the facilities we had: whether they were modern, and all that sort of thing. The other thing was that everybody was assessing world demand on a much higher level than previously. I think that applies to most industries; we were preparing to cope with it. I suppose that some part of that is not going to be repeated. On the other hand, if we are going to continue to be competitive—and that dominates everything in our industry—we may be forced into more and more investment because it is the only way we can compete. If our competitor begins to make a motor car in a certain way which saves money or does something else, we have to follow.

11358. From what you said earlier, monetary circumstances have no immediate impact on what you do by way of investment?——No direct effect.

11359. But they might have an indirect effect?——They have an indirect effect upon us, because of our dealers who sell the cars, and I suppose also because of our suppliers who make things for us. If they are restricted, if they cannot put in up-to-date machinery such as we are doing, that is a disability. If our dealers are not able to stock and finance their business of selling cars, that is a very considerable disability, as we found during the time in which money was hard to get.

11360. You did find some effect on the stocking policy of your dealers?——Yes.

11361. Entirely on financial grounds or because the market had dropped away?——We do not expect our dealers to carry the same stocks when the market drops away as we do when the market is good; so that did not have a serious effect on them. But their inability to get money was a restriction; it was designed to be a restriction on trade.

11362. *Sir Oliver Franks*: Was it basically, so far as the dealers were concerned, a difficulty arising from the expensiveness of money or the scarcity of money?——I think that the major thing was scarcity; but the cost came into it too.

11363. *Professor Cairncross*: There is one other way in which monetary restrictions must have reacted very markedly on your industry, and that is through the hire purchase restrictions. Do you think that they had a very marked effect on consumer buying?——Yes, a very serious effect.

11364. And, correspondingly, the removal of those restrictions might affect demand in the opposite sense?——Yes. It is rather difficult to assess it as yet because the market was going down, and even if this recent relaxation halts that it has been effective.

11365. *Professor Sayers*: When you spoke about the indirect effects of dear money and the possibility of your suppliers being unable, because of the monetary conditions, to modernise their plant, were you speaking of actual cases?——No, although I should have no difficulty in finding some if I wanted to.

11366. You believe that there are some among your suppliers who were in that position?——Yes.

11367. *Professor Cairncross*: On grounds of the cost of the money again?——Because people automatically begin to restrict their ideas; they begin to get frightened; they are not as enterprising; they are more careful.

11368. You do not apply this to your own business?——Not to our own company.

11369. *Professor Sayers*: Why do you think your suppliers are different from yourselves in this?——Because our policy has been to finance from our own earnings. That is not general either in the motor suppliers' industry or in other industries.

11370. This would affect people who are unable to borrow; but you spoke also of their taking fright as another factor?——One noticed that during all that time of restriction people were much more careful about what they did. For example, there is the truck business, which is related to industry very closely. It is not a fashion, or something which people buy in a whim or otherwise. We found that the buying of trucks slowed down very considerably. People said: "We are having difficulty in getting money. We can postpone buying our trucks for another year". There was a little more caution than usual.

11371. *Sir Oliver Franks*: This would be after September 1957?——Yes.

11372. *Professor Sayers*: Not in 1955/56?——In 1956 we had Suez, which rather confused the situation.

11373. Your example was taken from among your customers, but when you spoke in general terms you spoke also of your suppliers?——Those customers are also suppliers. They are the same people. The people who buy trucks are our suppliers.

11374. *Sir Reginald Verdon Smith*: When these customers are affected by the general economic scene, monetary considerations and so on, so that the demand goes down, although this may not affect your investment programme it must have a considerable effect on your flow of production and therefore on the scale of stockholdings, work in progress, level of employment, and so on. Does that make widespread differences in the volume of funds available to you and therefore subsequently affect the proportion that you are prepared to lay out on investment programmes?——No, because our plans are very long-term. We forecast as well as we can the world demand for all motor products; then we sort out from that as best we can, for all the countries of the world, what our proportion of that is likely to be over a long-term period of years, from five to ten years. So we cannot be affected seriously by year-to-year changes in the availability of money. There are far more serious things than that. For example, governments in overseas countries quite often restrict us overnight by putting tariffs on us because they have run out of currency or for some other reason. We have to take into account many factors, most of them long-term factors more serious than the availability of money or the cost of money. It is a factor, of course, but with us it is not a major factor. We cannot, just because we run into some monetary difficulty in this country in one year, start affecting our plans for five years ahead, because in the next year it perhaps switches the other way, and if we went on in that way we would be switching from one year to the next. We cannot do it. We commit ourselves. That does not mean that, if we are running into bad times that look like continuing, we do not do something to taper off or delay or postpone or minimise in some way the tail end of a programme. We do not make the final commitments until the latest possible moment. But we cannot allow year-to-year fluctuations to affect the long-term plan.

11375. *Professor Cairncross*: How far ahead would you be committed on your capital expenditure?——At the present time we have placed orders on our programme two years ahead and we are probably committed for another year beyond that. But there are some kinds of commitments which are not commitments in the sense which I think you mean, in the sense that if we have built half a thing we must go on and build the other half whether we want to or not.

11376. *Mr. Jones*: Did I understand you to say that certain of your projects involve planning over a period of investment of ten years?——They involve planning for a period of ten years, and if we are planning physical assets and new models and that kind of thing we have to provide the money to pay for them. But we do not make a commitment in terms of money over ten years. We assume that we are going to earn that money, and we set about doing it. We make our profit plans for years ahead. We set our targets, and say: "This is what we have got to have each year". That is our profit plan, that is our target; and unless we run into Suez, or something of that kind, or our competitors have taken a very considerable leap ahead of us, we find that we can do it.

11377. Provided that you can continue to carry into operation the principles on which you are already operating, you are not going to be affected at all, so far as your internal arrangements are concerned, by the monetary policy of the country?——I think it is fair to say that we would not be.

11378. *Professor Sayers*: Are you saying that if, during the period for which you are now committed, something happened in the world which was going to affect the markets of the world quite seriously, you would have to say that your flow of expenditure on your various capital projects would go on unchanged until about the end of 1960? Is that what your two years means?——Yes. I do not know what that might be, frankly. We did wake up and read in the newspapers about Suez, for example, but that was a very exceptional thing. Naturally we had to take a very good look at what we were doing at that time, which we did. We did not stop anything, but we tapered off and postponed some of the things which came at the end of the programme, and then we waited, because it was not necessary to make commitments on those things at that moment. But as to the basic things for which we were already committed, and not only committed in terms of having placed orders but committed in the sense that we felt we had to go on with them, those we went on with in spite of Suez. On some less essential things which were further away and could still be picked up a year ahead we said we would postpone the actual commitment or definite plans until we saw how it went. But it is very difficult to envisage what sort of things would affect us. If you say a recession, for example, what does that mean? A recession may last three months; it would not affect us if we thought it was only going to last three months

11379. *Sir Oliver Franks*: One might come to the view that in the case of a recession in international trade world commodity prices might be off for two to three years from what they had been, and that it was not very likely that in a period of up to two-and-a-half or three years there would be a violent upsurge, although they might move round a bit. This would mean that the possibilities of exports from this country to primary producing and developing countries could not be so good; they would not have the currency, as you were saying earlier. In this purely hypothetical case, if you thought you could foresee a falling off of export demand for two to three years, is that the sort of factor which would repercuss back on your programmes and cause you to modify them?——Unhappily we do not know about such things until afterwards. If we knew in time, it certainly would. I do not want to complicate this too much, but there are certain basic things which we are committed to. For example, there was a foundry which cost us £8mn. or £9mn. Having started on that, even though the markets went against us there was nothing we could do about it except go ahead. In any case we had enough faith that we were going to want it, if not this year next year, or the year after; and we needed it because our world competitors were doing that sort of thing and we were going to go one ahead of them, as in fact we did. So there was nothing we could do about that. Your point is typical of what has happened this year. Commodity prices have been down, and some of our best export markets have been cut substantially, and

no one knows how long that situation is going on for. If you do, I wish you would tell me, because we should then know what sort of action we should take about it. We have not done anything about cutting there, but we have been helped by the United States market, which has covered up not only the difficulties of the European market but also the difficulties of the Commonwealth markets. We cannot do anything about it in our industry because we are designing and building motor cars and what we call "facilities" (i.e. factories, machinery, equipment, dies and everything else) for years ahead. That there is a bad year in commodity prices and Australia shuts us out does not mean that we can stop that. We are going to need those motor cars four or five years ahead whatever may be happening to-day or next year. We are an unhappy industry from that point of view, that we make our commitments so far ahead of the time that we cannot tell whether our markets can accept the product or not.

11380. *Professor Sayers*: If there was an announcement of a major switch in monetary policy in this country (excluding any changes in the hire purchase arrangements) would that cause you to alter your plans at all, thinking of this possible change in the monetary policy as of the order of those you have seen in the last five years?——No. After all, they are temporary, are they not?

11381. They have never been announced as temporary?——That is how they have worked out. Unless we are going to see the country in trouble for ever one assumes that these monetary policies are not permanent; not as permanent as our old-fashioned roads, or something of that kind. How can we therefore change a long-term plan for them?

11382. In any such case, do you consider at all any re-phasing of a plan?——Yes. Despite anything I have said, we are naturally revising our estimates of demand for every country perhaps twice a year, and as we revise our estimates of what our requirements are likely to be for the next three, four or five years we naturally take another look at our plans and see whether they require expansion in this area or that area, or whether there is some indication that we have gone too far somewhere. If we thought that we had gone too far, and the thing was capable of flexibility, we would naturally try to limit it to the new look.

11383. *Sir Oliver Franks*: Earlier on you were inclined to say that changes in the price of money, on the scale that we have known them in this country for the past five years, did not directly affect the decisions which you yourselves took on capital investment, though they affected your suppliers or your dealers. At that point in the discussion you said that there was no direct effect, but that there might be a substantial indirect effect of monetary measures on the way in which you looked at or even revised your investment plans from time to time. When Professor Sayers was putting his question about the impact of a change in monetary measures on the scale of, say, September, 1957, you said in reply that you would look again, and, as you estimated changes in demand, you might vary, because there is a range of things which you plan where variation is possible, just as there is a range of things where you are really committed and must go on. Were you talking exclusively of what I call the indirect effect, or do you include the possibility of a direct effect?——I said that we review our estimates of world requirements country by country twice a year, taking into account all the restrictions which can be applied by the different countries and taking everything else into account: conditions created artificially in the home market by purchase tax or hire purchase restrictions, or the shortage of money not as it affects us directly but as it affects the overall picture. We would look at that a couple of times a year, and we would naturally look at our expansion or modernisation programme or new model programme, whatever happened to be relevant to all these circumstances; but the effect of the monetary policy on that sort of long-term investment planning is not one of the major factors, and with us less even than most because of our policy of self-financing.

11384. *Mr. Jones*: You would look at the markets rather than the monetary implications to yourselves?——Yes. You may say that the monetary implications have some effect on the market places; undoubtedly they have, but how long-term? It is rather a complicated business in our industry, but let me try to illustrate it for you. One of our investments at the moment is a £5mn. investment on a new car, and we have estimated that we are going to make 500 of these new cars a day when we do make them four years ahead, or whatever it is; that is for the whole world. We are not going to stop in our tracks because of monetary policy and cut that investment down to 400 or 350 cars a day, because, if we make dies and that sort of thing for 350 a day, we cannot afterwards make 500. So from the practical point of view we could not be controlled by what happens in the money market place, unless we took a one-year view; and with our kind of investment we cannot take a one-year view because we are planning production four or five years ahead. How can we take a view about monetary policy at home for one year or eighteen months? We have been absolutely foxed by purchase tax. In our estimates some years ago we anticipated that by this time purchase tax would be down to about 15 per cent. It went the opposite way to what we anticipated.

11385. *Professor Cairncross*: You have taken a long view of capital investment, and therefore you have taken a long view of your future financial commitments. You hope to meet these commitments out of profits; what if you cannot?——If we could not, of course we would do something else. But I think we can.

11386. That means that you have to be fairly sure that you will have the profits from which you can meet the costs of the new capital investment. What happens if you hit rather bad times and profits are not what you would expect them to be? Does it mean that you start off on a large programme of expenditure by being very liquid to begin with?——We anticipated that in years ahead very large sums of money would be required for our programme, and accumulated a lot of money before we started. That was fortuitous to some extent, but also planned. Mr. Smith and I began that plan to accumulate that money in 1948 knowing that we had to do all this against our competitors. If we ran into some period when we could not do that, then we would go out and raise money just as anybody else would. We would not say: "We are going to slow down this programme or stop it because we have a kink about not raising money". We should be quite happy to do that; we should have no objection to doing it.

11387. From what you have said I gather you have not made a practice of going out to borrow money?——No.

11388. Would that embrace banks as well?——Yes; we provide our own working capital. We bring in E.C.G.D. to cover some of our export risk.

11389. *Lord Harcourt*: Do you finance any of the hire purchase of your products yourselves?——No.

11390. *Professor Sayers*: Your liquid resources must be very big sometimes. How do you deploy them temporarily; in Treasury Bills?——*Sir Patrick Hennessy*: Substantially, yes.—*Mr. Smith*: and short-term Government securities up to two years.

11391. Do you shift much as between Treasury Bills and bank deposits?——From time to time.

11392. And short bonds?——Yes, dictated entirely by the yield.

11393. You watch the relative yields and are prepared to shift?——Yes.

11394. *Professor Cairncross*: Would that investment in Treasury Bills go back quite a few years?——We have done it for three or four years at least, but not ten years.

11395. *Professor Sayers*: And in the short bonds?——That has been fairly consistent. Some ten years ago we had a proportion in mediums (by that I mean ten to twelve years) but over the last five years we have been concentrating exclusively on short-term bonds of less than two years.

11396. Is your concentration on them on the ground that you really expect to use the money fairly soon?——Yes.

11397. The ten to twelve-year bond is really too long in relation to your requirements of cash?——It is, and also it is, or might be, vulnerable.

11398. *Professor Cairncross*: Is any part of these liquid funds in local government loans?——Quite recently; a relatively small proportion.

11399. Would you reckon to employ all these funds in this country, or would there be any circumstances in which you would use them abroad?——*Sir Patrick Hennessy*: We have got some abroad, to cover dollar buying if we have to buy some machinery.—*Mr. Smith*: To the extent that we cannot get normal forward cover in the market we have to buy short-term American bonds.

11400. This is not related to the return?——Not at all. The return is substantially less.

11401. There have been a number of changes in Government fiscal policy designed to encourage or discourage investment. Is it your view that these changes have any effect in the motor industry?——*Sir Patrick Hennessy*: Yes, they are bound to have. Anything which makes it more difficult to accumulate money is bound to have an effect.

11402. *Professor Sayers*: That is on the motor industry, you said; what about your own company?——*Sir Patrick Hennessy*: So far they have not had any effect on us that I can measure.—*Mr. Smith*: They have not had an effect on our plans, but they have had an effect on our monetary position, in as much as the withdrawal of the tax allowances midway through our expansion had a very substantial adverse effect on our cash position.—*Sir Patrick Hennessy*: But we have still had sufficient cash; it has not affected our expenditure.

11403. *Professor Cairncross*: Expenditure on capital account was not affected, but it might have been affected if you had not had the liquid funds. Some other motor car companies might very well have been affected, if they had not been able to finance themselves to the same extent as you were?——To the industry it had quite a serious effect, and it would have had an equally serious effect on us if we had not accumulated sufficient money for our purposes at that time.

11404. *Professor Sayers*: Do you know of firms in the motor industry or among your suppliers which altered their capital expenditure programmes because of changes in initial and investment allowances?——No, I do not; I have not made it my business to find out. But they all need money, and more money. Without mentioning any of our perhaps smaller competitors by name (although they call them the "Big Five"), they all need money badly, in my opinion, for modernisation and expansion, and to the extent that they are deprived of it they are that much less equipped to compete. Broadly speaking the battle of the motor industry is not at home: it is in the market places of the world. It is there that we are trying to get that extra volume which brings down costs and allows us to compete. However good the overseas business is, on the other hand, we look to the home market for our major profits. Therefore anything that is done in this country to restrict business which is not done to our major competitors, the Germans, the French or the Italians, is obviously hindering the motor industry in this country. If the other fellow does not have to carry the same sort of burdens, then he has an advantage. He may have other advantages as well.

11405. *Sir Reginald Verdon Smith*: When you speak of expansion, are you thinking primarily of the expansion of volume of current and immediately succeeding products of the same sort, rather than of expansion by way of broadening the business or investing one's capital in other lines?——No. Broadly we stick to our own business, because that is what we know most about. We have so much to do there with our money that we have not thought much about going out into other areas of industry. There is tremendous scope yet for us to broaden our activities within our own business, because we do not make everything that goes into a motor car. We can expand by making more of the components which we at present buy outside. We already make our own power, which is unique in the industry in Europe; we make our own glass, our own coke, our own pig iron for the foundry; but there is a great area in which we could expand, if we wanted that kind of expansion, and make things which we now buy. Expansion at the moment, so far as we are concerned, is expansion in doing the things we are already doing in a bigger and better way. We are forced to do that. It would be very comfortable to sit back and say: "We have a magnificent business now, very profitable", but unhappily our competitors overseas are not taking that view. They are all expanding and modernising, and if we do not follow we will not stay where we are; we will go down. It is a very fine rat-race!

11406. It is essentially the element of competition that determines the scale and rate of capital investment; but profitability must also come into it at some point?——Yes. It does not follow—in fact, I do not think that it will follow—that because we have expanded and modernised we are going to continue to get the same return on investment. An overseas nationalised company, like Renault in France, are willing to operate on a low return on investment. One does not quite know how the things are financed, but they are willing to do that. That is the sort of competition we have to face up to. So, even when we are making the investment we are conscious of the fact that we may not earn the return on the investment that we have earned in the past.

11407. *Professor Cairncross*: When you are deciding on the level of expenditure, you presumably take account of the probable eventual return on it; do you have some kind of rate of return that you regard as allowing you to discard some of the things you are contemplating and to accept others?——We do not make any investment at all, however big or small, without considering what return we are going to get on it and also whether there are alternatives; buying from somebody else instead of manufacturing. We have trained a management team which is as capable of going through that exercise as any I have known in Europe, perhaps even more capable, taking the view that management is no good unless it can operate at high profit, and we need a high profit for our business. But the very fact that we have gone through that exercise to the best of our ability and put in an investment does not mean that in three years' time, when the thing comes out on the market, we get the return we estimated, because in the meantime a competitor may have made it only possible for us to get half that return on that investment.

11408. Would you at any time revise the rate of return which you thought was critical on a programme of capital expenditure? Would you at some stage decide that you wanted a higher or a lower rate of return?——Yes. We have a variety of things which would guide us in that sort of thing. Some investments that we might make might be more risky than others, and are liable to be shorter-term, because we cannot see the future as well on some things as we can on others. Some investments are basic investments which we require whatever kind of article we make; our foundry, our glass works, and that sort of thing. Other investments are affected by fashion in the market place, how long a model is likely to last, and a whole host of other things. We take the risk into account and we would expect to get a higher return on investments for a shorter period.

11409. That is variation over a period of time among different things which you have to accept or reject. I was more concerned with whether your criterion changed through time, so that whereas in one year you thought 15 per cent. might be an acceptable basis in another year you were prepared to accept 12 per cent. as an acceptable basis for the same kind of project?——*Mr. Smith*: We continually measure our overall investment with our competitors, and particularly our foreign competitors, and everything is relative.—*Sir Patrick Hennessy*: That is quite true; but also, if we set 15 per cent. as the standard rate we were expecting to get (actually that is not the figure, but if it were) and the staff processed something which only gave a return of 10 per cent., there might be very good managerial reasons why we would go ahead with something at 10 per cent. or less than that.

11410. I can see plenty of reasons why you should depart from a criterion, whatever it is, at any particular time; but does the criterion itself change, perhaps because your foreign competitors seem willing to accept a lower rate of return on their money than they had been accepting in the past?——Our competitors determine almost everything. We would vary our desire for a return on investment, depending on circumstances. Before we could say anything more than that about it, we would have to pick out some particular thing and debate it. I was searching through my mind to find one which might be appropriate to your question, but off-hand I cannot think of one.

11411. Let me take a specific case: you have expanded the range of your operations since the war to cover some components or materials that previously you bought outside. In doing that, do you look to see what the return is likely to be, and is that return a controlling element

in your choice?——There are two considerations: (1) whether it makes us more competitive, and (2) the return on investment. If it makes us more competitive in the sense that we can reduce costs, that is one of our primary thoughts in what we do. We do not like to do it unless we see a return on investment as well; but conceivably we would do something which gave no return on investment if it made us more competitive.

11412. Would not the increased competitiveness be a return on investment?——*Sir Patrick Hennessy*: It might not be, because we might have to give it away in price. It is a rather devious, complicated business about which one cannot make any hard and fast rules. Our staffs are told that we are not interested in things unless we get a return on investment, but nevertheless we are flexible enough sometimes to have to do things where a net return is not going to come to us.—*Mr. Smith*: We have on occasions invested at a comparatively low rate to meet the danger of a monopoly situation.

11413. If you make comparisons between the present position and the prewar position, would you expect an investment to yield a higher return now than in those days?——*Sir Patrick Hennessy*: Yes. We need a higher return; everything costs more. The return we get is for reinvestment in our case, broadly speaking. We have shareholders, too, and we take care of them fairly well; but we require a lot more money *pro rata* for investment now than before the war because everything costs three or four times as much anyhow; so we have to get a bigger return on investment than we planned before the war. But what we get in this industry is dictated by our competitors, and what the Government and bankers and people do to us, if it is not also done to our competitors in Germany or somewhere else, is a disability, whatever it may be. Despite all that has been said about the Ford Motor Co. Ltd., that is the effect it has on our industry.

11414. *Sir Oliver Franks*: We are asking each of our witnesses who is in charge of an important unit in industry whether sudden changes in the cost of money, as in September 1957, cause his organisation to take a look at their stocks and to economise, or not. We have had two views put to us by different types of people: *either* they do look, and they try to prevent their money being blocked up more than absolutely necessary; *or* the amount of stocks held at any time is a function of the manufacturing programme, and while there may be a tiny bit of flexibility on the whole there is not, and what determines the volume of stocks is not the price of money but the manufacturing programme which does. Might I ask where you come out in regard to those two?——*Sir Patrick Hennessy*: In our particular company, we do not carry big stocks at all. We like to regulate the flow of materials and supplies into our organisation so that it is related to the day-to-day requirements, and we do not, in the normal course of events anyhow, carry excess stocks of any kind. We do not believe in having things lying about the place, because they occupy space. There are a thousand very good reasons for regulating affairs so that the stuff flows in and out again. When I tell you that we try to turn stocks over seven times a year, and that we have done better than that, it gives you an idea of how quickly the stuff flows through. But there are other people in industry who probably do not work quite that way. Our stocks at the present time in terms of value are £22 mn. or £23 mn. That includes a whole lot of motor cars which are built and are awaiting shipment. So there is very big money in stocks in this industry; even though we might have very limited stocks at any one moment, those stocks will be worth millions of pounds. In the motor industry it must be *pro rata* in each company a substantial factor. If people are relying on borrowed money, it is a considerable factor, and I should imagine that they would all endeavour to cut down their stocks under those circumstances. Again, our dealers have to carry substantial stocks not only of new motor cars, but of trucks, tractors, spare parts, and all that kind of thing; they have a problem because they are relying on banks and other sources to finance their businesses for them, and they have to think whether they can get the money and what they have to pay for it. It has a serious effect on them.—*Mr. Smith*: We are certainly in the latter category of the two which you mentioned, Sir Oliver. Our stock levels are determined by functional considerations. The penalties for not stocking according to functional considerations are infinitely greater than the ones which have been imposed by a variation in interest rates. If we ran short of stock the consequences would be appalling; and to be overstocked would be, as Sir Patrick said, so physically disturbing that it would not be good business.

11415. If there are no other questions, I think, Sir Patrick, we should like to thank you and Mr. Smith very much indeed for coming to help us this morning.——*Sir Patrick Hennessy*: I hope we have been of some help to you. I do want to emphasise that this industry, as I expect Sir Reginald knows, is exceedingly vulnerable to anything which affects trade, because it has to commit itself so far ahead, whether it is on new models or the kind of equipment we put in, and we have to make these long-term commitments without any knowledge of what our own Government is going to do to us in regard to purchase tax or what any other Government is going to do. However well managed we are and however well we forecast the future, there is a tremendous element of risk in this business, and as a result of that we require a fairly good return on the investment.

(*The witnesses withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

Lord Radcliffe in the Chair.

THE RT. HON. THE VISCOUNT CHANDOS, D.S.O., M.C., Chairman, Associated Electrical Industries Ltd., called and examined.

11416. *Chairman*: Good afternoon, Lord Chandos. Thank you for coming: We have given you five points which illustrate the kind of questions we should like your help on from your experience, but I only want these to be a starting point for anything you want to say. Would you like, before we come to our specific questions, to give us any enlargement on any point of view?——*Lord Chandos*: I think that all I want to say will arise in dealing with the questions you have put to me. The first is: "What are the main considerations which determine the size and content of your organisation's fixed investment programme?" First of all we make a survey of the general outlook for the electrical industry; we believe that the general trend is that the demand for electric energy in almost every country is doubling every ten years, so that the demand for our electrical products, if we keep our position in the industry, will double in ten years. Against that background we examine the fixed investment programme. That is broken down into projects. I thought that might be useful to the Committee if I left with them a typical project report which shows the factors which we take into account. Largely it takes account of the increase in the market. This is a project at Sheffield amounting to about £2 mn. for the manufacture of new traction equipment. This is the report as it was presented to the Company in May 1955. It shows all the considerations which made us invest that money. The market analysis and general background show increasing demands for locomotives other than steam; this report sets out what our position is likely to be in relation to our competitors, where plant should be located, the output per square foot of factory space, and so on. Perhaps you would not mind keeping the figures confidential.*

* *Note:* The project report handed in by Lord Chandos had five sections:

(1) a review of the prospects for home and overseas demand for electric traction equipment over the following ten years, and an estimate of the net trading profit to be expected on the output of the proposed extensions;

(2) a general description of the project, with assessments of the factory space and labour requirements and of the prospects of meeting the labour requirements; recommendations as to sites;

(3) proposals as to the division of operations between existing plant and the proposed extensions;

(4) estimates of capital expenditure on buildings and plant, and of the increase in working capital required for the extensions;

(5) a time scale showing the phasing of work and expenditure.

11417. Would any other considerations relative to financial aspects be brought in?——Once a project has been established as necessary from the company's point of view we have to look at the finance involved. That is an extremely difficult calculation in any large company. The finance required is dependent on a number of imponderables. One is the cash flow, which we cannot estimate accurately. We can make a guess at it, but it depends on the general level of business and the control we have over stocks and work in progress. It is not entirely under our control.

11418. *Professor Cairncross*: To what extent are your decisions about actual capital expenditure, as opposed to methods of financing approved expenditure, influenced by such things as the cost of capital?——First of all we establish that an increase in our production is necessary, and that we can sell that increase in production against the background of the industry and our position in it. Then we come to your second question: "How far ahead does your organisation plan the size and content of its fixed investment programme?" That is rather difficult to answer. We think that the demand for electrical things will double in ten years; to that we apply a number of factors such as further automation, increased productivity and so on, and so we get an idea of how much extra manufacturing space is required, how many more employees and how many more machine tools we shall want in ten years' time. That is rather theoretical; in more directly practical terms we plan for about five years. I have two lists of capital projects, one consisting of recommended projects and the other of those which are likely to come on in the course of events. I do not think that the board of directors can really judge current demands for capital expenditure unless they have some idea of what new demands are likely to be added to the ones which become live. This particular one which I have given you was a definite project; when the board of directors considered that, they would also know that we expected to have to spend £2 mn. on plant for the manufacture of, say, transistors.

11419. *Sir Oliver Franks*: When you say that it would be pretty definite for five years, does that mean that what you would expect to accomplish in each of the five years in terms of the money to be spent is real for each of the five years or only for a rather smaller proportion of the five years? How definite and how articulate is the five years all the way through?——It takes a minimum of three years to bring a new industrial plant into operation. We are only dealing with two residual years which are less definite. I can give an illustration: at the moment we have a capital programme to cover three years and are examining some sites and making preliminary studies of what will be necessary for the other two years. These projects are really practical projects.

11420. It is hard for three years, definite for five; but you are not so committed that you cannot make alterations in the fourth and fifth years?——Yes, that is so, and we have had to, of course. Your next question is: "How quickly and by what means has it proved possible to expand or contract the planned level of investment?" We are governed by the actual contracts which we place. We have never had to cancel a construction contract, because it is so very expensive. What happens when we get nervous about the volume of our fixed investment programme is that we try to improvise here and there. In this particular programme, covered by the project report which I have given you, we have improvised. because we have cut out an office and administration block and put it on the floor of the factory, which is unacceptable as a long term thing. That knocked off £300,000 when we were getting frightened about the total capital expenditure.

11421. *Chairman*: That gives some play even for a contract which has been started?——Some play, yes. But, of course, there is a dangerous tendency that, when we get into a capital squeeze, the board and the executives always take that out on the non-productive part of the operations such as research and so on. That is very dangerous indeed. The first thing that is said is: "What about the educational facilities and the apprentices' hostel? Can we not cut those down?"

11422. *Professor Sayers*: In what sort of situation are those trimmings made?——Roughly speaking, when the estimates are being exceeded. We do not embark on any investment programmes unless we can finance it but when building costs are going up 1 per cent. a month (the building index which we keep, taking 1946 as 100, is now 396·5), you will realise how difficult it is to keep our capital expenditure within any estimate at all. Let us take another example. The Restrictive Trade Practices Act has, in my opinion quite healthily, made an adjustment to the profit margin on certain parts of the business, so the estimates made before that Act are out because the cash flow is reduced. On the question of expanding fixed investment I can only answer with a platitude: expansion depends on the length of construction. One can build a light annex to a factory in seven or eight months, but it takes two years to build a heavy plant and another year to run it in. We can only expand our capital investment programme in the shape of fixed assets in a period of 2½ to 3 years; we can contract a planned element by squeezing certain things out, to the extent that we have not let the contract or do not incur cancellation charges.

11423. *Sir Reginald Verdon Smith*: You are speaking primarily of completely new schemes to meet the sort of expansion over ten years which you told us about. Are you also thinking about what must be a very large proportion of the outlay on fixed assets of an engineering business such as yours, namely, the replacement of machine tools, the modernisation of processing plant and so on, which is a continuous process where the adjustments can be *ad hoc*?——We divide capital expenditure into two categories: normal additions and replacements, and new capital investment. There is a certain flexibility in the normal additions and replacements, and that is very dangerous; it is easy to run down the assets and ease the financial position like that. It is only when things are very tight indeed, when our estimates of the market seem to be proving false, that we cut into the normal additions and replacements.

11424. So you do not allow interference with the normal replacement of machine tools to be influenced by outside economic considerations unless those outside conditions amount to a blizzard?——We have had to cut them down from a fairly lush basis when we thought that our capital investment was getting really beyond our easily ascertainable means of financing it.

11425. *Chairman*: When was that point of decision reached?——About 2½ years ago.

11426. *Sir Reginald Verdon Smith*: Would your judgment about machine tools be affected by taxation considerations such as a change in the investment allowance?——No.

11427. *Chairman*: When you came to this period when it seemed that your plans for capital investment were outrunning what you could finance, was that because the factors controlling the flow of cash had been materially altered?——Yes, I think it was. These calculations are extremely difficult because there are so many imponderables. One of the major effects upon cash flow is stocks and works in progress. They depend upon the availability of supplies. For years and years British industry (not only my own company) has been in a position where stocks and works in progress are an outrage compared with output. So far as America is concerned one cannot compare the figures directly, because the percentage is related to sales value in America and to factory cost by, I think, most British companies; certainly in my own the way to estimate it involves some guess-work. But, roughly speaking, we have had to take materials when we could get them and put them on the shop floor; the Americans, in a much wider economy, are able to make the suppliers carry the stocks. They say to a manufacturer of steel forgings: "We want so many tons of steel forgings in the first fortnight of September; if you supply them in August you will not get paid, and if you supply them afterwards we will cancel the order." Our situation in steel forgings is that we have had to take them when we could get them, and three out of five were bad forgings. So we must, unless we want to interfere with production, have steel forgings on the shop floor far beyond what is efficient, because the suppliers cannot supply them when we want them. We cannot get on to the "hair trigger" system of stocks. We have about £65 mn. locked up in stocks and works in progress and the only way to control it is by guess-work. Then the margin of profits and the rate at which we are turning out things affect the cash flow. The financing of the capital investment programme is based on shifting imponderables. I think we are getting it more nearly right than we used to, but we still get this increase of construction costs by 1 per cent. a month, which amounts to quite a lot of money.

To sum up my answer to your second question: expansion is a matter of two or three years; contracting is a marginal matter but can amount to quite a considerable sum, by a reduction in non-productive assets such as office buildings and a certain improvisation in research and development. Things of that kind are acceptable on a very short-term basis. For example, we have electronic engineers working in huts; we may put off building them a new building for a bit longer.

11428. *Professor Cairncross*: Are the periods ahead for which you are making plans longer than the corresponding periods before the war?——I would not know.

11429. *Mr. Jones*: You say that your planning is specific for three years, and that you plan in a general sense for ten years?——Three years is quite definite; the next two years it is a little more fluid; and for the remaining five years it is more general. As time moves on, we watch all the time the stage at which general ideas become definite projects. It depends largely upon the advances in the electrical industry. The two most striking recent examples are the development of nuclear fission and the developments in semi-conductors. They are completely new things.

11430. You are influenced specifically or entirely by the prospective demand?——Yes.

11431. *Professor Cairncross*: You do bring forward all sorts of technical development?——As an industry we have solved the problem of glare from headlights and the stereoscopic projection of films; but we do not think that there is a commercial future in either. It depends on the relation of electrical developments to the market.

11432. There was a surge of investment in the period 1954-56. Would you give us your view of the causes of that in your industry? Was it related to arrears that had to be overtaken?——To some extent it was due to arrears; and some was due to inflation, of course. Some was also due to the "hotting up" of the power station programme. Technical developments come into it as well; you have to remember that even to-day there are locomotives in Africa burning eucalyptus wood. When the new refinery came in at Aden and diesel oil became available at Mombasa, that altered the whole traction situation of Africa. Those are the sort of considerations which we watch during the second five-year period; the twinkle in father's eye can become children which have to be fostered and fed with capital.

11433. Do you think that the experience of the last five years was something unusual or that this was a period when British industrial investment was moving on to a high level which is likely to continue?——There is no general answer to that. If you take the chemical industry or the electrical industry or the man-made fibre industry, those are all industries in which the capital investment is on a scale which is entirely different from anything that existed before the war. As far as research and development are concerned, when I was a young man a company spending £200,000 on research would have been regarded as a curiosity; now the only two companies of which I am a director between them spend more than £15 mn. a year on research and development. That promotes a demand for capital, because if people find out new things they want facilities to manufacture them.

11434. *Chairman*: These projections of demand for your products on which you base your plans must have their feet planted in the past and must be projected into the future; but you must adjust them (for instance, in the light of the oil refinery at Aden which you mentioned) by a great deal of intelligence which is relevant to the future and not to the past at all?——The doubling of the demand for electrical products is a blunderbuss affair. One reason why it will develop is because of the appearance of diesel oil at Mombasa which will alter the East African railways; they have ordered their last steam locomotive. That is not in addition to the doubling in ten years but is in relation to the particular product; we say that the demand will go on for electrical products including the control gear for traction. The same thing applies to transistors and semi-conductors which are an entirely new field. Germanium or silicon rectifiers will be needed for the high voltage system for British Railways. That is only just beginning, and is something which reinforces the idea that the demand will double in the future.

Your next question is: "How far have changes in interest rates affected the volume, the pattern or the timing of your organisation's fixed investment programme?" The answer is not at all. An industrial project cannot be considered on such fine points as this. If we are conducting our industry properly we do not build a plant that will not earn about 15 per cent. We have sometimes, for instance, with nationalised industries, to come down to 9 or 10 per cent., but it is completely wrong to do so. If to-day the rates of money are 1 per cent. above what we think they will be in three years' time it will not affect our plans at all; it is too small.

11435. Is there no variation of interest rates that would affect the basis of your plans?——Not directly. What it does do with consumer products is to alter our opinion about the climate of demand, which is the largest effect; it has an effect on the climate of demand rather than an effect on the capital course of our programme. A credit squeeze, with very high rates for money and hire purchase restrictions, would probably prevent us from building an extension to a cathode ray tube factory or entertainment valve factory. The direct effect, however, is nil because it covers too small an area to affect the thing.

11436. Does the climate of demand mean that someone else in the field, who is your customer, would feel the impact of changing rates?——There may be a fall on the Stock Exchange; or a manufacturer not covering his overhead expenses is less likely to buy a television or a new radio than if he has had a good profit.

11437. *Professor Sayers*: You are speaking of the consumer field as being directly affected. Is it your view that no industrialist is affected directly by the changes in money rates?——Not as far as my company is concerned. For people putting up a very light building requiring no overhead lift and no long period for machine tools it is more of a "hair trigger" business than for people like ourselves who cannot add to their production in less than three years.

11438. Who are the people directly affected?——Mainly all kinds of "back-yard" production. Light electric fires is an example. Everybody knows that if you put a kilowatt into an electrical apparatus it has to come out. There is no engineering in that. People can build a light shop and go in for making electric fires almost overnight; in seven or eight months' time they will be in production. There are many forms of textile manufacture which can be "hotted up" much more quickly. It is all at the light end of things, where people do not require expensive buildings. In Northern Ireland they are making standard factories which can be put up in eight or nine months.

11439. Are those the products directly affected by changes in monetary conditions?——I would put it this way: that the shorter the period of construction the greater the effect of high money rates upon a firm's capital investment programme. It is not much good my telling my engineers that the Bank Rate is 7 per cent. when the project they are putting forward is for introduction in three years' time; but if they came to me with a particular product and said that it would be saleable in six months' time the effect would be different.

11440. You are supposing purely temporary conditions?——I have never considered monetary conditions to be anything but changing. It has not entered my conception at all that we might have a fixed interest rate.

11441. Is it not possible that interest rates for some period of years ahead might be appreciably higher in market terms than in the early 1950s?——Certainly. That was my own view four years ago, but it did not affect our capital investment programme.

11442. Whose did it affect?——It does not affect anyone with a long period of construction. It has no effect except that it reduces consumption.

11443. You mentioned the trimming of capital projects. Would you tell us exactly what circumstances led to that trimming?——It was not the rate of interest but the availability of money. For the first time in my business experience it became obvious to a number of leading companies that money might not be available whatever rate they were willing to pay. I was addressing myself to the question of interest rates. Changes in interest rates have no effect whatever except on those on a "hair trigger" basis. We have to project our minds for three years ahead.

Coming to the tightness of the capital market, I would say this. Beginning with the oil industry, it is obviously impossible for a modern industry in Great Britain to keep up with research and development upon the savings of the population. We have to depend on our own cash flow. When we are in that position, we do get the wind up occasionally that we are not going to be able to finance our expenditure. The banks were under the directives, so that they could not tide us over from an unfavourable market to a favourable one, and we had to face the question as to whether we could actually raise the money.

11444. You mentioned the period of two or three years ago, 1955-56, as the period at which the difficulty of getting finance swam into your horizon as something leading you to trim your capital projects. Has the relaxation of 1958 had any opposite effect?——No.

11445. Why not?——Because we have financed our capital investment programme.

11446. Have you no new projects coming up?——Yes, but they are not affected by the relaxation, except that the relaxation on hire purchase obliges us to increase our facilities for producing refrigerators and washing machines.

11447. You said that in 1955-56 the feeling that there was this difficulty of financing led to the trimming of certain parts of your capital projects. Are you now saying that in 1958 capital projects are coming out still but are not being trimmed, or are you saying that no capital projects are coming out?——The feature of industry as a whole now is that capital projects are not coming forward. I am not talking of the very big companies. Eighteen months ago the small companies could not raise the money; now they have not the confidence to spend. That I can prove to you from our own order book.

11448. *Mr. Jones*: To what extent is it necessary for big firms to raise the money? What about their own liquid resources?——No industry should or could be liquid. It is not doing business if it is. Our so-called liquidity depends on the readiness of the banks to finance a programme, but none of it should be bricks and mortar. It depends upon that and the cash flow.

11449. These projects depend on your being able to raise the money outside your own immediate resources?——Yes.

11450. *Professor Cairncross*: There may be times in the existence of a large company when it sees prospects of expansion that are more than normal and seeks to embark on a big programme of expenditure which it cannot finance out of current money. The market may be unpropitious and, if so, it may be obliged to curtail its programme. You made some remarks about the influence of the rate of interest in terms which implied that the distinction between the profit expectation which you regard as critical and the rate of interest, which might be 4 or 5 per cent., was so wide that it did not necessarily affect decisions. If the long-term gilt edged rate of interest does change from 4 or 5 per cent. to 6 or 7 per cent. it is likely to be reflected simultaneously in the yield on industrial companies' securities and, taken with high rates of taxation, would affect the rate of profit required from any given investment. If you had a variation of that kind, would it not affect the decision of the board?——Not directly. I have already said that the decision of the board may be affected by what it thinks the demand for the particular product would be under very high rates of interest. For example, it affects house building if the building societies are charging high rates, and that in turn will affect electric light installations and so on. It therefore may affect our estimates of what the demand is going to be. But we get into a jam if we start estimating the demand for the product of a plant which is coming into production in three years' time on the high money rates of today. By and large money rates do not have any direct effect.

11451. I am thinking of long-term rates?——I doubt if the high money rates of Germany have kept back German expansion at all. If we got up to 10 or 12 per cent. that would be a different matter altogether; but I am talking of our well regulated money affairs. The kind of level we have or can expect will not affect us when we start building a production plant. If we are building a plant for £2 mn., and if at this moment money costs 1 per cent. more than when the plant was planned, that will not affect the viability of that project, especially as it will come into production in three years' time.

11452. *Chairman*. If you became satisfied on the board that the long term rate of interest would settle down at a high rate, then when you made a forecast of demand that would be a case for altering your views of the demand?——Yes, but probably very marginally.

11453. *Professor Sayers*: If during the next three or four years you have at some time or other to raise the money to pay for this capital development at the long term interest rate, and the terms on which you got loan or equity capital would be worse for you than in the past, would you not think again about whether the capital development really paid?——No.

11454. Not even if the rates were expected to be 5 per cent. higher than they had been?——Yes.

11455. What is the critical margin?——It is impossible to say. I think you would find if you studied capital investment in Germany that 10 per cent. made no difference to industrial expansion. If we had second sight and knew that it would be 12 per cent., it would be idle to suppose that it would not affect us. But these are theoretical considerations.

11456. *Professor Cairncross*: You say that the expectation that building costs will rise progressively would be a material factor in your decision to proceed with a scheme. Is not that on all fours with the expectation that capital charges might be somewhat higher? Is the rise in building costs more important than the rise in capital costs?——Much more important. If we estimate the cost of a plant at £5 million and it takes two years to build, what would have stood in the books at £5 million would stand at £6 million because of the increase in building costs. If we have to finance it on loan capital, to have to pay 4 per cent. net for the money instead of 3½ per cent. has no effect at all on our planning, or very little.

11457. You are not resorting to loan capital rather than equity capital because interest rates are higher?——That, if I may say so, is a profound misconception, because one is driven to loan capital in bad times and not in good ones. Equity capital is easy to raise in good times but difficult to raise in bad ones. Loan capital is more easily raised in bad times.

11458. I was not putting to you the difference between good times and bad. I would have thought that the choice between loan capital and equity is not just a decision you have to take according to market prospects but according to capital charges?——No. I can only tell you what we do. On this particular theoretical point you will find that Chandos's law is a peculiar one: the better the time the lower the rate at which one can issue equity shares and the worse the time the higher the rate. That goes against the laws of supply and demand, but the bank people will tell you why it is, if you are interested. If your £1 stocks stand at £5 and times are good, and you offer stock at £2, it will not affect the price of your ordinary shares except upwards; but once times are bad and you offer shares at £2 the whole of the clergy will go out of ordinary shares in order to come in again at a lower figure, and the existing stockholders get a biff in the eye because the £5 stock goes down to 50s. This is an occasion when theoretical matters of supply and demand do not work as you would expect. That is known as Chandos's law; it works the opposite way to the laws of supply and demand. I will leave that with you as an agreeable way of thinking!

11459. *Sir Oliver Franks*: The joker in the argument is the Archbishop of Canterbury!——The great body of small stockholders.

11460. *Chairman*: Is there anything additional on questions 4 and 5? I think you dealt with the general subject of stock holdings——So far as investment in stocks is concerned, we find it necessary to have an officer in every one of our fifty plants to keep the stocks and work progress down.

11461. The general picture you gave was that you were not free to order stocks according to an ideal programme, but had to order them when you could get them, and that you therefore carried a larger stock than you wished to have?——That is still so, although it is not so bad as it was.

11462. That has led to the taking of special measures, to try to economise so far as you can on the overloading of stocks?——As in the Army the psychology of the purchasing agent must be that on no account whatever is production going to be interfered with by shortage of stock; so unless there is the closest possible scrutiny of purchasing we are apt to carry far more stocks than we should. That is the only thing that governs it.

11463. *Professor Cairncross:* Are there any circumstances in which you would conduct a special review of stocks?——We used to think so but we have given that up. It is a continual battle from day to day. The stocks in my company amount to £65 mn. That is prejudicing throughput calculations, delivery and all those things.

11464. *Chairman:* When there are any special restrictions of bank credit do you get all the accommodation you want? Does it show itself in any particular way?——Not on stocks, no.

11465. It affects things generally?——Yes, generally.

11466. *Professor Cairncross:* The Government has from time to time made moves designed either to discourage or promote industrial fixed capital investment by varying initial and investment allowances. Has that had any effect on investment in the electrical industry?——I should not think so on big capital. I would not know about smaller capital.

11467. I was taking the question in conjunction with what you said about the situation of 1954-55, when you had taken on rather heavy investments. Was the Government assisting liquidity? Might that have had a marginal influence on it?——I think that is correct. We thought that interest rates would go higher, and on the whole we did not cut back our programme very much.

11468. *Lord Harcourt:* When the cash flow has been favourable and you have had a good deal of cash, how do you utilise that?——First, we take a rather more lush view of the normal additions and replacements. Secondly, we would consider restoring some of the short term economies we made. This particular project which I have put in is an example. About £300,000 is required for an administrative block which is now on the shop floor; we should restore that. Then we should be a little more handsome with regard to our apprentices' hostel, which we cut back by £300,000.

11469. Do you buy Treasury Bills?——Yes.

11470. Do you buy Government short-dated bonds?——Nothing beyond six months.

11471. *Professor Sayers:* When did you begin buying Treasury Bills? Is it something fairly new?——We had a debenture issue of £25 mn. this year; there was a residue of £8 or £9 mn. in cash so we took some short-dated securities. The last time was when we had a £25 mn. equity issue.

11472. *Lord Harcourt:* It is not a new policy?——No; it is simply to take care of unusable cash. We also lend to local authorities for three and six months. It is just to earn something on spare cash; it is not a policy but an expedient.

Chairman: Thank you very much, Lord Chandos. You have been very helpful to us indeed.

(*The witness withdrew*)

THE LORD HEYWORTH, Chairman, and J. F. KNIGHT, ESQ., Finance Director, Unilever Ltd., called and examined.

11473. *Chairman:* We are very grateful to you for coming here this afternoon, Lord Heyworth. I think that the five questions we have put to you deal with points that are very familiar to you. We should like your help on them from the point of view of your own concern. Would you like to take them through with your reflections on them, question by question, enlarging upon them as much as you like?——*Lord Heyworth:* May I start with a few preliminary remarks as to the basis of experience from which I am talking? I talk, of course, on the basis of my experience with Unilever, which is an Anglo-Dutch concern, the capital having been subscribed equally from the two countries. There are two legal entities, one under English company law and the other under Dutch, linked together so that the whole concern is operating as one. The total resources of the concern at the present time are £500 mn.; that is spread about equally between investments in fixed assets and in net current assets. Working capital is a very important element in our operations, more so than in many companies. The working capital element is slightly bigger than the fixed assets. Geographically the resources are about 25 per cent. in the United Kingdom, 25 per cent. in the British Commonwealth of which the United Africa Company in West and East Africa comprises the biggest element, and the rest in the rest of the world, with continental Europe predominating.

As I think everyone knows, most of this capital is employed in consumer goods industries: detergents, human foods, animal foods, and so on. Most of those industries are very little, if at all, sensitive to variations in economic activity; as we have seen in the recent American recession, the one thing that has kept up in the United States is grocery. The United Africa Company engages in merchanting goods of nearly every kind in British West Africa, in British East Africa to a lesser extent, and also in French West and Equatorial Africa and the Belgian Congo. They have some industrial activities, although only a small part of the whole, and plantations, timber being the largest of them. A number of assembly operations are developing. These merchanting operations, by contrast, are extremely sensitive to the level of economic activity of the region. The United Africa Company's ocean shipping is sufficiently important to be mentioned as an ancillary; they own a line of 25 ships, operating between West Africa and Europe mainly.

Taking the business as a whole, over the last ten years our overall rate of growth has run between 5 and 8 per cent. per annum, some part of that being attributable to inflation. The resources for this expansion have been provided as to 90 per cent. from retained profits and from depreciation reserves. We have not had to go to the market significantly at any time for additional funds. Capital expenditure is made up of large numbers of medium and small sized items. The expenditure for a specific development would not normally exceed about £1mn., although the total for a year is £40mn. Normally a project takes anything from six months to three years to complete. The speed with which we execute plans is limited by the management resources which we have available for planning construction and for providing and supervising staff for subsequent production operations when the job is complete.

I think that gives the general background; the main points are that working capital is an important part, and that we have not been subjected to much pressure; we have been able to arrange finance so that we have not, through this period, had to go to any great extent to the capital market.

11474. Should we think of these numerous comparatively small capital expenditures as subject to central control in all cases?——Only generally; in detail, no. We follow a policy of decentralisation and each group has limits within which they can spend. It may be as high as £10,000, or less than that. These items make up about half the total capital expenditure.

11475. How far should we think of monetary conditions ruling in this country as governing your volume of capital expenditure?——The operations within this country are 25 per cent. of the whole, and roughly 25 per cent of our capital expenditure has been in the United Kingdom, possibly more.

Your first question is: "What are the main considerations which determine the size and content of your organisation's fixed investment programme?". There is one over-riding consideration, and that is the philosophy that some growth is necessary to maintain efficiency. For purposes of morale one must be able to deal properly and decently with redundancy and so on. When I say that some growth is necessary, I mean that all good growth must be supported by pruning operations; within an overall expansion we are cutting back and building up all the time. It is the over-riding consideration, which I think is very firmly held, that that is the easiest way to maintain efficiency and is therefore really essential to our operation.

The next point is that recruitment for management is based on this philosophy of expansion. I am the last person to claim that we have been able to achieve a precise correlation between the management we take on and the timing of the subsequent expansion. We are nearly always behind. But there is a definite understanding that we are taking on more people than we need for current operation, and we do not like to vary that from year to year.

It may be taken that in our easier fields of operation and in the old parts of the business, soaps and margarine and so on, the compelling factor is competition. That compels a certain amount of expansion because we tend to set as a minimum the maintenance of our existing share of the developing market; if the market is expanding people feel that they are falling behind unless they hold their share. So we are geared to competition. Great areas of this business are extremely competitive. Certainly it governs any research ideas—some may not be as good as we should like them to be—to ensure that we are holding our own. In those fields potential profitability depends on our maintaining our position; we may have to accept a lower profit ratio in those fields than we would in a new venture altogether.

11476. *Professor Cairncross*: Does not that imply that there is a certain inertia in the fixed assets programme? If you are geared to a managerial structure and to keeping your place in various markets, you would not be anxious to vary the size of the programme from year to year?——We are not free to choose in competition, so we should if necessary have to stretch our management to meet that. In new fields, in most of our business expansion into new prepared foods and that sort of thing, potential profitability is the criterion and the main method of selection. Potential profit is variable according to the risk. We should take a big risk if we believed that the potential profitability was high. There are two factors here, one commercial and the other political, and we have to weigh both of them.

In all the main fields in which we are engaged we conduct research. That compels the exploitation of a new idea, and we have not any tremendous freedom in choosing it; it might be that we had three ideas and to deal with them all at once would be too much, and we might decide just to back two of them. But, after all, if we are doing research, there is only one way to make it pay, and that is to make use of it.

Then, in some of our overseas activities, in West Africa, and in Europe to a lesser extent, the political element is a factor. In West Africa we feel that we are responsible for playing a leading part in any development desired by a Government where we have the necessary experience or expertise. That is not to say that we ignore the factor of profitability; but political considerations sometimes involve us in engaging in things perhaps before they are quite ripe, because we feel that we must play our part. We are an important part of the economy in those countries, and we have an obligation on that account. To a lesser extent that is true anywhere, because we take account of the economic climate of the country. As an international concern we have to be good citizens of the countries where our operations are and we have to take note of Government policies of expansion and so on.

With regard to the question of return, which is overriding in the fields where competition is not the predominating factor, taking the run of all fields we are in, the average return on the gross fixed and working capital is between 7½ and 10 per cent. net after tax. Because we are international we make all our comparisons after tax. This would mean 52½ per cent. in this country.

11477. *Chairman*: You have not, in the circumstances you have referred to, referred to the influence of demand?——We are projecting now what the demand in our established fields will be in all countries. It has to be done at least three years ahead because it takes that amount of time to complete any major expansion of facilities.

11478. But the response to the general feeling that you must grow, that you must meet the managerial staff which more business for the increasing managerial staff which you are creating, is to that extent conditioned by an estimate of demand?——Yes. We would be disinvesting in some fields but investing in others. We can deal with disinvestment much more easily if we have expansion because we can arrange to get more flexibility, so that people who are displaced can be dealt with and all that sort of thing.

The second question is "How far ahead does your organisation plan the size and content of its fixed investment programme? How quickly and by what means has it proved possible to expand or contract the planned level of investment?" I have answered some of that generally. Our procedure is quite precise. Each year we make up a capital expenditure programme, itemised in considerable detail, for all projects that are to be started during the next twelve months. That will cover all projects which may be foreseen as being necessary to be started in this period to meet whatever it may be. Some of them, as I have indicated, will require three years to be completed; more occasionally the project will be a longer one taking perhaps five years; in extreme cases, like a plantation, the expenditure might be spread over ten years. But there are a lot of small things, like improvements and modifications to processes, which will be completed within the year itself and in some cases even in six months. All the major expansion projects will fall more or less into this three-year field.

Once we have started something it is not easy to change direction. Once it has gone past the planning period, minor modifications are possible but there is not much to be gained from changing the pace at which we complete it because the best thing we can do is to keep the dead period of the use of money to the absolute minimum. There is no point in putting a lot of pressure on to slow down because, save in an exceptional case, we should lose as much as we should gain by it.

Your third question is: "How far have changes in interest rates affected the volume, the pattern or the timing of your organisation's fixed investment programme?" It follows from what I have said that changes in interest rates have not affected the volume, pattern or timing of our fixed investment programme directly. Indirectly, of course, it may be that the interest rate is an indicator of a climate which may have been a factor in determining the desirability of a particular project.

11479. Can you enlarge a little on that? It has not affected you directly because you have been self-financed to a large extent?——No; if we feel that we must "keep up with the Joneses", whether we have to pay 8 per cent. or 6 per cent. does not make much difference. It is a horrible business keeping up.

11480. But to some extent you are affected indirectly?——There is a connection. I have said that particularly in our main fields there is little variation, but there is some. In the poorer countries that might mean that, if a country was in a recession or had two bad monsoons, it might reflect itself in the Bank Rate and we might decide to wait another year or two. What generally happens in that kind of country, in soap for instance, is that if there is a bad drop the demand ceases to go on rising, but it does not fall back; if people have acquired the habit of cleanliness they do not go back on it. Another indirect effect of a high interest rate might be to enable us to create a climate in which we can get something done more quickly because it would be reflected in an easier labour market or supply of steel. But that has nothing to do with the point.

11481. *Professor Sayers*: How does an indirect effect come about? If you think that the high Bank Rate is going to lead to circumstances in which it would be easier for you to press on because you would get labour and steel more easily, it must be because you believe that someone else is affected directly. Have you ever changed your course in any way for this sort of reason?——Only in so far as the period taken to complete a project is concerned. It has been a factor we would look at, when considering what is the expectation of getting delivery and of being held up.

11482. *Professor Cairncross*: Do you mean that you would do more investment with a high Bank Rate?——It has never been the subject of central discussions at all.

11483. Would you wait until you saw the results reflected in your sales before taking action?——Yes.

11484. *Lord Harcourt*: Have you been self-financing to a smaller extent when the Bank Rate has been higher? Would the Bank Rate have had any more effect on your

deliberations for that reason, or no more?——I do not think it would have had any effect. If we want to retain our position (and that is dominant in our minds) we are not free to move as we think best.

11485. *Professor Sayers*: You mentioned a criterion of 7½ to 10 per cent. as the kind of net return you would look for on a long-term investment project?——I merely said that that was the average of what had happened. We were looking for more, but that is what has turned up.

11486. That is a matter of experience. In planning do you ever think in terms of the possible yield?——Yes, indeed; we would be in a terrible situation if we did not have to consider that.

11487. By what criterion do you judge how much expansion to go for? You obviously decide on some expansion because you want to have the whole concern expanding, but are you prepared to vary at all from year to year the rate at which you are expanding?——If our research people turned up with something extraordinary we would change our whole technique. We should not bother to "test-market" it; we would market it in ten countries at once instead of one, and so on. Every now and then something like that turns up.

11488. You mentioned the possibility of the amount of money to be spent affecting the basic programme. Have you ever had circumstances that have affected the number of possible projects? Have you ever turned down projects in one year that might have got by in another year because the financial conditions were different?——I think that that could be, because there is a sort of red light in the organisation, which prevents us from being quite free. I am pretty sure it happens, but it does not happen directly to any degree. The climate is changing all the time, and that is causing these people to think that they probably will not be embarrassed if they come along for another £2 mn. project.

11489. Do monetary conditions ever cause people to feel that more at some times than at others?——In countries where the currency is difficult, like parts of South America, undoubtedly our programme is very heavily influenced, not because the project is not a good one but because we do not see why we should put in perfectly good pounds which will depreciate.

11490. *Sir Reginald Verdon Smith*: You said that the economic climate might well affect the judgment of management and the degree of optimism about possible schemes, but you made it clear that you were thinking very much about overseas situations, where economic conditions might vary between good and bad to a much wider degree than we had known in this country. Did the earlier answer apply only to overseas countries, or would you say that the changes in the economic climate in this country in the 1950s have affected the attitude of management in relation to investment programmes?——The atmosphere in each country determines what we do there. What happens at the centre is that when in any particular country there is a great deal of pessimism around we generally start to push back a little; when they get too depressed we say: "Are you sure that is right?" These people are so scientific that they have economic advisers and so on, but in the end the climate they are immediately living in does affect their judgment. The one advantage of being in a different climate, and it is about the only one, is that we look at this from a distance and can say: "You are getting too excited or too depressed."

11491. *Professor Cairncross*: The Government has taken action to influence industrial investment through investment allowances. In your business has that had any impact?——I can trace very little. It might make someone order a fork lift truck in a hurry to make sure that it was delivered before April 5th. But I am talking in terms of three years at a time and no Government policy remains for three years, so it does not influence me. I would be foolish if it did. The finance department would be in a fine mess. The placing of an order for a ship is the only case I can remember where this was mentioned at the time of discussion.

11492. The main effect of initial allowances is to make you more liquid than you would otherwise be. Does it affect your actual capital expenditure?——No, because we are sufficiently conservative in our financial policy for that not to be absolutely decisive.

11493. It might affect your borrowing?——All I would expect is that I might ask a department to watch the effect in their projects; but the effect is not very direct.

11494. If you get an allowance that represents a percentage of your capital outlay and later that is withdrawn, it amounts to a large fluctuation in liquidity?——If we have something between £10 mn. and £30 mn. cash spread all over the world an effect on 25 per cent. of the business in this country would not be a major factor. We never know exactly what cash there will be at the end of the year; all we know is that we shall be £5 mn. wrong up or down.

11495. *Chairman*: Do you carry the benefit of the investment allowance to a special account?——We have never gone in for those refinements. We would have to spend too much time explaining them to ourselves.

11496. Suppose that the conception of the investment allowance was regarded as a normal provision of the Budget structure; would that make any difference?——If it was for five years certain it might begin to be useful. I imagine that from the other end that would be a commitment making the situation more rigid instead of less.

11497. *Sir Oliver Franks*: I suppose some of your products reach the public through points of distribution not wholly handled by you?——Nearly all of them do.

11498. Does the price or scarcity of money have any visible effect on those distributors, as judged by their willingness to take or hold stocks, or is there nothing sufficiently calculated to be noticeable?——The pipeline stocks vary considerably in the main on the boom and bust system rather than on the interest rate. The interest rate comes into the calculation of the boom or bust.

11499. If things are selling well they stock up but if not they cut down?——There is a very big lag. If business is declining, the proportion of stocks in relation to the rate of turnover goes up in this field for a long time.

11500. *Lord Harcourt*: Since September 1957 has there been a tendency for retailers to push stocks back further in the pipeline with the result that you find yourself holding bigger stocks?——We have an accurate system of measurement of the retailer's stock, sometimes perhaps more accurate than he has himself; some retailers do not have a complete knowledge of all their stocks. Stocks have not varied tremendously in this country. The tendency, as American experience has shown, is that, as units in retail distribution get bigger, the total amount of stocks in the pipeline decreases. For a big organisation it pays to know the level of stocks. The smaller retailer cannot spend so much time on it. More attention is paid to the control of stocks the bigger the unit; in America the trend is to get smaller stocks in the retail trade whichever way the rate moves.

11501. Does the cost of carrying stocks tend to force the necessity of carrying stocks back upon you?——We are almost a banker for them; we give them thirty days to pay.

11502. *Professor Sayers*: Have you been lending them more money?——No; we are very strict on that all over the world. If the terms are 30 days, when it gets to 31 days something happens. People are told that they must reduce orders. That is general in our trade.

11503. *Professor Cairncross*: We have had evidence in connection with other trades that the retailer can make the pace through a restriction of the way he adds to his stocks. You say that you exercise control?——Yes. In the East we trade for cash anyway, but in America, for instance, the trade practice in our trade is 1 per cent. discount for payment in ten days, and the retailer does not get 1 per cent. if he pays in eleven days.

11504. Would you say that your trade debts in this country have not grown at a different pace since the Bank Rate went up?——Definitely not. Can I just go on about the things that do determine our investment in stocks? Our only consideration is that we must have the minimum necessary for efficiency. Each of our operating units has to measure the profits it makes in relation to the capital it employs and show the measurements in terms laid down. If they want a high figure, the less they have in working capital the better. Everyone is conscious of that, and that is the pressure on every operating unit

to use the minimum of working capital. If they have their stocks too low for efficiency it would affect profits some other way. It is a pretty good measuring stick.

11505. *Mr. Jones*: That is a matter of business efficiency rather than monetary conditions?——Yes. Very occasionally, however, taking a view of the market in some commodity might result in our carrying higher stocks than the absolute minimum because we thought that we would make a profit, but in the main the price element is taken care of in length of cover. So it is a minor element.

11506. *Chairman*: Do you think that this careful and scientific control of stock holdings is a new or a progressive development in your concern?——We used to preach about it at various levels, and then we put it to everyone on a blackboard and showed every holder of stocks their net return on capital, taking an average of four points in the year, and taking the working capital and fixed capital at replacement value less depreciation. One section may show that its figure is 4 per cent. and another that its is 10 per cent.; the inference is that the 10 per cent. section gets a bigger medal than the other. It is believed to be fair. It is no use putting in a system unless you convince management that it is fair. If they say "We would like to finance things by bank money", we say: "If you only have it for a quarter it only adds against you for one quarter", and that argument is reasonably disposed of. Because working capital is slightly more than half our total resources we spend a lot of time on it. It is one of the things we can control, whereas once we have built a building it is there.

11507. *Professor Cairncross*: If you were facing conditions in which your profits fell off and you had a large capital programme in progress, you then might have difficulty in raising the necessary finance. Would you in those circumstances think in terms of some slight cut in your stocks, or would you think a cut of 5 per cent. or even 2 per cent. more than you would be prepared to make?——We are dealing with consumer goods and, if we got stocks below efficiency point, we could do so much damage.

11508. *Mr. Jones*: To reduce working capital by 2 per cent. might be very damaging to the interests of the business?——To say that I am sure that there is not 2 per cent. of waste would be nonsense. I am sure that there is 10 per cent., if I only knew where to look for it; so in one sense if there was 2 per cent. less I do not think it would be much trouble. But how to bring it about I do not know. The operating units would have to change the yardsticks. They work it out, as they claim, scientifically.

11509. *Professor Cairncross*: Are your stocks not held in part to cover not production needs but contingencies? Therefore, if you felt inclined to take a bigger risk would it not be possible to run down stocks a little?——The experts at the centre believe that generally people operating units "feather-bed" themselves too much. We would certainly bed them a little harder if we felt that we should be short of money, but whether it would be effective I do not know. They are pretty tough, these operating chaps; after all, they are responsible for the profits.

The last question is: "How far have changes in interest rates or restrictions of bank credit affected the level of stockholdings?" Well, as I have indicated, very little directly since we normally only borrow money for stocks in one or two countries where we do not like the look of the currency. It is not easy to borrow money in those countries because everyone has the same idea. Even so, we would pay a high rate of interest in those countries rather than send money in. It might be 12 per cent.; but our competitors have to pay the same, and we would rather pay that than send money in.

11510. *Professor Cairncross*: Would you consider financing any of your business in Europe or the Commonwealth outside this country? Do you shift the area from which you are borrowing?——We borrow locally on a long-term basis in America and Canada, and to a lesser extent in Sweden; but for the rest all our borrowing operations have been in the two major markets where capital is drawn from, this country and Holland.

11511. What about short term?——We may borrow elsewhere on short term. We have borrowings according to our view of the currency and the cost of shifting money there and back again.

11512. Would a change in market rates here lead to decisions to shift the country in which you were borrowing on short term?——We think against a background of having cash resources to use for fixed capital or working capital. Clearly there is an advantage in sending the money from here if we think it would save money when the Bank Rate is high in another country.

11513. Do you run a bank overdraft in this country?——*Lord Heyworth*: Yes, we have to; but taking the balance sheets over the last ten years I do not think it was ever continuous throughout a year.—*Mr. Knight*: There has been no overdraft in total for a long time.

11514. *Lord Harcourt*: How do you use cash for which you have no immediate use?——*Lord Heyworth*: First of all, we look at it in terms of what we are going to need in the next twelve months; if there is some left over we buy short-dated investments.

11515. You operate in the short-dated bond and Treasury Bill market?——Yes; we have been buyers of Treasury Bills for twenty to twenty-five years. We also lend money to municipalities for three to six months.

11516. *Professor Cairncross*: So you are much heavier buyers of Treasury Bills at one time than another?——*Lord Heyworth*: Never big enough to make a flutter on the market. The quantities are relatively small.—*Mr. Knight*: The maximum has been £5 or £6 mn. in recent times.

11517. In selecting Treasury Bills did the return on them influence you?——*Lord Heyworth*: We say that the one thing we must never do is to lose any of it; therefore the first thing to do is to be safe. If we can make a bit of money over the period that is all to the good.

11518. *Mr. Jones*: Availability is important?——It is at the top of our minds.

11519. *Lord Harcourt*: Do you make much use of Tax Reserve Certificates?——*Lord Heyworth*: At times—*Mr. Knight*: They are not very interesting now.

Chairman: Thank you very much, Lord Heyworth. You and Mr. Knight have been a very great help to us.

(Adjourned until Thursday, 20th November, 1958, at 10.45 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FORTY-NINTH DAY

Thursday, 20th November, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (Questions 11535 to 11741 only)
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E. (Questions 11520 to 11604 and 11632 to 11741 only)
W. B. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

THE LORD GODBER, Chairman, and MR. F. J. STEPHENS, a Director, Shell Transport and Trading Co. Ltd., called and examined.

11520. *Chairman*: We are very much obliged to you, Lord Godber, for coming to help us with your evidence, and for the clear memorandum* with which you have supplied us. Would you like to add anything by way of introduction?——*Lord Godber*: I do not think so, beyond reminding the members of the Committee of the basis of the group: it is a Dutch and British partnership, and the ownership is divided as to 60 per cent. Dutch and 40 per cent. British. That affects to some extent all our financial arrangements, as you have probably gathered from this memorandum.

11521. I wonder if we might run through your memorandum and see what questions come out of it. You are dealing first of all with the answer to our question: "What are the main considerations which determine the size and content of your organisation's fixed investment programme?" You give us under very general heads four different kinds of expenditure that you are going to think about. The first is (although I know the word is never quite satisfactory) replacement expenditure; the second is progress within the fields that you are in fact working in today; the third is expansion into new fields, petroleum chemicals being an example; and the fourth is general expenditure that will reduce the operational costs of the business in general. Would I be right in thinking that your field of manoeuvre is rather different with regard to the third and fourth from what it is to the first and second, and that decisions as to what you are going to do in the first and second are very much determined by your own history and the nature of your business, whereas with regard to decisions to go into a new field or to find out methods of increasing the operational efficiency you have rather more freedom of manoeuvre as to what you do and when you do it?——*Lord Godber*: I should say not very much. In the first two cases we are also very free to manoeuvre, because often we move into entirely unknown territory. It is solely in our option to go into unknown territory; it is solely in our option to develop our markets or our refining arrangements in our existing territory. It is all based on our own requirements, not always necessarily on what other members of the trade might do. I should say there is very little difference between the four divisions.—*Mr. Stephens*: When it is a question of going into new ventures we can perhaps say: "This is not the time"; whereas if we are going to keep up our trade in a certain place, and our guess is that the trade will go up to such-and-such a level, it may take three or four years of building and ordering equipment to provide the necessary extra capacity. We should probably say: "We want to stay in this market; it is a good market". We think that the sensible thing to do is to keep the business earning, and there is therefore perhaps less manoeuvrability there.

11522. At what point in your costing of new developments does the rate of interest on your capital expenditure come in? Is it when you are actually faced with the problem of raising money from outside?——*Lord Godber*: No, when we are deciding on our approval.

11523. Does the rate of interest you are using for this purpose vary with current conditions, the Bank Rate, for instance?——By and large, yes. When we are calculating the cost of these projects we take in the current rate of interest. If there was any serious difference between that and the actual rate when we were about to go ahead we would then submit a second estimate of revised figures to the board for approval, but it would not affect the carrying out of policy. We merely keep ourselves and our capital expenditure responsibilities up-to-date.

11524. Would the rate of interest you take for the purpose of costing your expenditure be the current short-term rate of interest represented by the Bank Rate, or the long-term rate of interest?——The long-term rate at which we consider we could borrow.

11525. You do vary that, if you find the long-term rate of interest is rising or falling?——*Lord Godber*: If it was going to affect the cost we would vary it. It would be one of the items which would come into a review of the estimate.—*Mr. Stephens*: It might not make any difference to the end result.—*Lord Godber*: It would never be more than a minor difference, and in ninety-nine cases out of a hundred it would have no effect on whether we carried out the project or not.

11526. Although you would take notice of the change up or down, it is very unlikely in your experience that it would actually determine your decision when or what to spend?——No. That would apply in the initial estimate, too. The amount added to the cost to cover interest would not affect our decision.

11527. *Professor Sayers*: It is the rate of return on the project you are thinking about, and not just the interest cost included in the process of construction?——*Mr. Stephens*: It is really both. When looking at the cost of the construction we include an element for interest, even though we may be simply taking money that we have in the bank and applying it to the cost of the project; but in all our calculations on a project we calculate the "payout", which is the other part of your question. We consider how profitable this project is going to be, and whether we shall get our money back in three years' time, in four years' time or in five years' time. Before venturing on projects, unless they are merely what one might call protective projects to permit us to stay in business, we like to have rather a short pay-out time, so that the whole thing is paid off in a reasonably short time, after which we can regard it as generating cash for us again, apart from profit.

11528. So that an adequate rate of return is one which will allow you to pay off the capital within a matter of three or four years?——It depends enormously. Some things, like a refinery, take four years to build, so that we could not expect to get our money back in four years on that. Things vary according to what they are and how long they take to construct.

11529. But when you are thinking of the period over which you want to see your money back, what kind of period of years do you reckon from the date on which

*Memoranda of Evidence Part XI, No. 2.

something comes into operation?——*Mr. Stephens*: It varies enormously on that; there are so many different plants. On some small thing we might get it back very quickly, in perhaps eighteen months; on a big thing it would be a matter of years.—*Lord Godber*: It could vary up to ten, depending on the type of thing.

11530. *Sir John Woods*: Do you take into account the actual life of the asset?——*Mr. Stephens*: We take into account the *useful* life of the asset. A thing can last for ten years, but be completely *demodé* in six.

11531. You get your money back as fast as possible because you are frightened of a long period?——Yes, that is the big feature.

11532. *Professor Cairncross*: Do you vary your expectation of the period of return at different times? Might you at some period decide that you had been rather too optimistic in your estimates of the pay-out periods and revise the rate of recovery expected?——On a certain type of plant, certainly.

11533. Would this have any relationship to the ease with which you could get finance?——No, it would be almost entirely based on profit margin.

11534. *Professor Sayers*: When you get to pay-out periods approaching ten years the interest charge must be an appreciable proportion of the total cost per year of the projects?——Yes.

11535. Do you alter, as market conditions alter, the interest charge in your calculations for those longer-term projects?——Generally speaking not. The things that come to my mind are such things as long-term charters of tankers; there we get no opportunity for revising the interest charge because we make a bargain with the lenders for twenty years. So there is not much point on those long-term things in re-doing the calculation, except as a matter of experience, for when we do it again; even so, it would be very hard, if we went in for this a second time, to say that, because we had a certain experience over a period of ten years, ten years later we should necessarily get the same experience.

11536. *Mr. Woodcock*: The rate of interest you are thinking of all the time is the traditional one?——*Mr. Stephens*: Yes, within we hope a reasonably narrow margin.—*Lord Godber*: We fit into current conditions of interest rates.

11537. If you assume an increase, it is an increase that would follow the traditional pattern?——Yes.

11538. *Professor Sayers*: Long-term rates generally are half as high again, if not nearly double, what they were ten years ago. Do you continue to use the same rate of interest calculations as you did ten years ago?——No.

11539. Would not that make a considerable difference on a ten year project?——Yes. But in many of these cases these estimates are not in a way to decide whether we shall build or not; they are merely to tell us what we think it is going to cost. As Mr. Stephens said just now, in all probability we should be bound to build anyhow.

11540. Your decision whether to go on with your project or not is not likely to change?——No.

11541. Is your decision whether to trim a project at all likely to be affected by rates of interest?——I should say not. The factors which would lead to trimming would be a change in market conditions, a change in market requirements, or something of that kind; often, though not always, that can be done before a project is finished.

11542. *Professor Cairncross*: There must be some projects which come before you which you reject on grounds that they do not offer sufficient return?——Definitely.

11543. If rates of interest were doubled, would not that affect the decisions, and lead to some projects being rejected that previously bad been accepted?——*Lord Godber*: I should say not. I should say the proportion of interest in the cost of most of these projects is comparatively small.—*Mr. Stephens*: It is purely an internal calculation we make which does not have very much, if any, bearing on the decision. If the thing is successful and going to make money or keep us in business, or keep us ahead in competition, like raising the octane level against competition, we would say that regardless of rates of interest we had to be in the forefront and that therefore we must build this thing.

11544. Where you are in doubt whether to accept or reject a project, and the return is the critical factor, that return must be influenced by the rates of interest?——To a very small degree; it is really infinitesimal, I think, because we would expect the profit margin to take care of the situation.

11545. *Mr. Jones*: Amongst many considerations, then, in going forward with a project, the rate of interest would be a minor consideration?——It would be at least at the bottom of the list.

11546. Would you call it a negligible consideration?——No, not negligible; but it would be at the bottom of the list.

11547. Are there any schemes of border-line profitability that it might affect?——*Lord Godber*: Naturally there would be; where the profit margin is tiny it would affect it. On the other hand we could have a case where the profit margin was tiny and we were bound to go on with it regardless of the rate of interest.

11548. Have you any experience of a case where the border-line profitability has been at stake, and the rate of interest has interfered with the scheme or the development of the project?——I cannot think of one

11549. *Chairman*: It is what your experience has left in your minds that we are drawing on, and you do not in fact recall that there have been decisions like that?——I am almost certain that there never has been one.

11550. *Sir Oliver Franks*: You said that the main factor that might cause you to modify a capital programme in some way is if the market alters, if demand falls off. Do you have the impression that among the factors which cause demand among your customers to weaken is the general effect of scarcity or dearness of money? Do you think that it applies to the environment in which you operate to some extent though not to you, or would you think that it applied neither to you nor to the environment of your market, and that it is not one of the market forces that is important?——*Mr. Stephens*: We are vulnerable to the rate of industrial activity, particularly in certain products that we sell, notably fuel oil. If therefore there is a credit squeeze and a general tightening of expansionist schemes for industry in general, new plants and so forth, the chances are that the increase in consumption is going to fall off, and it may be, although we have never seen it outside the United States, that consumption will in fact stay level. I am talking about since the war.

11551. *Sir John Woods*: If you had that situation, that might affect your own view of capital projects?——Yes indeed.

11552. *Professor Cairncross*: Would you let it affect your view of capital projects before you saw demand drop, or would you wait to see whether demand did drop?——*Mr. Stephens*: We would definitely wait to see, because we have been so wrong in our guesses in the past, as I think has everybody else in the industry, regarding the rate of consumption.—*Lord Godber*: Under those conditions the demand for increasing capital projects naturally falls off, so the decision is not necessarily in our hands at all.

11553. *Professor Sayers*: In explaining this effect Mr. Stephens spoke of the credit squeeze and dearer money leading industrialists to contract their capital schemes and so on. You explained that you never behave like this. What is it about other people that makes them behave differently from you?——*Mr. Stephens*: I think it is very largely that only about 5 per cent. of our business is conducted in the United Kingdom, whereas what we are talking about basically are United Kingdom industries. It is partly perhaps also because in a risk industry like ours we have to have a good deal of spare money, and only very much now and again can we rely upon the money markets of the world to give us money for our capital expansion. The bulk of our capital expansion is through retained earnings and depreciation. I should have thought that that was why, when there was a credit squeeze in this country, the impact on us would be very small for our capital projects, but the impact on the steel industry and on various other industries might be substantial.

11554. You think you are really different from other industries?——We are different percentagewise in the amount of business we do here compared, for instance,

with Summers or the Ford Motor Co. in that we operate in every country outside the iron curtain, and we have perforce, like any wasting asset or risk industry, to keep a good deal of money in the till.

11555. *Mr. Jones*: When you talk about a risk industry, are you thinking in terms of being an extractive industry, and that your wells might dry up quicker than might otherwise be the case?——It might even be worse than that; they might be dry to start with.

11556. To what extent would external political considerations upset your plans and create risk?——To a tremendous extent, all over the world.

11557. Would political insecurity to a very large extent affect the development and projects you had in mind and the capital you invest?——*Lord Godber*: As to individual countries, yes. For instance, we would hesitate to spend a great deal of money in any country where their foreign exchange record was not particularly good. Fortunately, however, they are comparatively few. But take the Middle East: we must still go on with our business, even if some risks exist; otherwise we may lose our concessions. That risk is there the whole time. Going back to your point about whether there is a risk of a field not providing any oil at all, there are many cases where an enormous amount of money is spent (for instance, in Tunisia, and Ecuador) without getting anything out. We have spent in Nigeria to date £40mn.; we know now that we have oil there, but we do not know whether it is ever going to give us back our £40mn. We shall have to go on for another five years perhaps before we know that. There we are faced with a position of uncertainty. We have spent so much money; we have got some oil; do we go on, or do we abandon? The chances are that we go on because we think that there may be something we have not found yet which is going to provide us with the cover for the enormous investment we have already made. So many of these new oil-producing areas (the bulk of our capital expenditure is finding the oil) are in untamed jungle country, with no facilities of any kind, no houses, no roads; all that has to be made by us before we can drill our first well. Where the oil is produced from under water we have to create a new set of circumstances with all the risks attached to that. If you compare the risk of the rate of interest with that sort of risk you can see that it is not a consideration that we would think twice about.—*Mr. Stephens*: This Nigerian illustration Lord Godber has given shows why we do have to keep a certain amount of money in the till; we should hate to write a prospectus on Nigeria alone!

11558. *Professor Cairncross*: You have laid quite a lot of stress on the liquid position. Do you have a fixed idea of the money you need to bold in the till in relation to your turnover, or is it a ratio which is allowed to swing pretty widely?——It swings quite widely, but we get very nervous from time to time if we see it approaching what we call the Plimsoll mark.

11559 If that happens you make a fresh issue; you do not necessarily cut down your investments?——We do both. We do not necessarily make a fresh issue; it may not be the time to do so.

11560. Have you in post-war years felt obliged to limit your programme because of the liquidity position?——*Mr. Stephens*: In every year almost we have had to look at it pretty carefully.—*Lord Godber*: I do not think that there is a definite answer to that. We look all the time at whether the cash is up or whether we ought to do something about it. There is a constant study going on all the time in these things. I am not sure whether we have ever been so short of cash that it has really affected to any material degree our capital expenditure.

11561. *Lord Harcourt*: Is it the case that a large part of your capital expenditure is something over which you really have very little control?——Yes.

11562 In your concessions is there an obligation, for instance, to do a certain amount of development per year and so much drilling?——In the early years there certainly is.

11563. That is something which you cannot avoid?——*Lord Godber*: No.—*Mr. Stephens*: Even if there is no obligation in the later years, the Government owns the subsoil and expects a certain amount of revenue; moreover we have to go on drilling to protect our investment, regardless of whether there is a legal obligation to do so or whether it is merely a political or economic assessment of the situation.

11564. *Professor Cairncross*: That would be true particularly of the first and second categories in your investment programme. The third and fourth categories would not necessarily be affected in that way?——No.

11565. And you might delay, I suppose, some entirely new project under the third category if you felt that you were running a bit tight on cash? Would that be done?——*Lord Godber*: Yes, that would be the first one to select.

11566. Have you in recent years held rather less cash in proportion to turnover than you held towards the end of the war when many businesses were pretty liquid. Would that be true in your case?——Yes, I should think that is definitely the case because our turnover, as the result of the weakness in sterling, has definitely gone up in very much greater proportion than our cash.

11567. Then how do you judge what is the normal proportion to hold?——*Mr. Stephens*: We look at our capital programme historically over the past and for the five years in the future. We do not pass a budget for five years; we pass a budget every year. But it is a five-year forward look. We say: "This is what it looks as if we are going to have to spend; this is what we think the trade is going to be; this is what we think the profit margins are going to be; what is our guess about the increase or erosion of our central funds?" Assuming it is an erosion, we have to guess when it will come; if our guess is right, it may look as if we are going to get near the danger mark, whatever we may fix the danger mark at, or the uncomfortable mark where we are really going to be rather short.

11568. *Professor Sayers*: When you have that feeling you do both things: you plan to make an issue and you tend to cut your capital plans?——*Mr. Stephens*: We make inquiries of our financial advisers as to the possibility of raising some money.—*Lord Godber*: And review our plans; I would put it that way. We do not necessarily cut our plans, but we review them.

11569. What kind of project becomes marginal as a result of this review?——*Mr. Stephens*: Going into new areas for exploration, if there really is very little known about the prospects.—*Lord Godber*: Slowing up on marketing; an additional tower or two in the refineries might be held up.—*Mr. Stephens*: Particularly if we think it is going to be accompanied by a recession in the volume of trade.

11570. Over the post-war years the prospect of making a big issue, such as one of yours would be, on any reasonable terms must have varied appreciably from time to time. Have you felt in some years that, because the prospect of such an issue was, as far as you could see, rather worse than it had been, you should become more selective in your new capital projects?——*Lord Godber*: No, it has not made any difference. As an international group we are in the fortunate position that, if by any chance we felt we needed money for projects that we had to build and this market was not a good market, the chances are that some other market would be a good market, for instance, the United States; or the whole of the German business would be financed in Germany, as it is to a large extent, and France the same. We can select our financial market for our requirements within pretty wide margins.

11571. Yes, but you did say that when you felt that in prospect your cash position was becoming rather unusually low you both reviewed the capital projects and thought about an issue?——Yes; but not necessarily an issue here.

11572. It is the review of capital projects I am wanting to know about. Does that review ever lead to any modification of plans? If not, what is the point of it?——*Mr. Stephens*: Postponement would be the big thing.—*Lord Godber*: Certainly postponement; but that postponement could easily be affected by all kinds of other factors besides rates of interest: conditions of the market, a slow-up in consumption, or something like Suez. A crisis of that kind would affect the plans very temporarily.

11573. But your cash position might be one of the factors that would lead to a postponement?——It could be, but very seldom; I do not remember many cases.

11574. Do you remember any such cases where it was a material factor?——*Lord Godber*: After the war we wound up with a lot of cash and a whole lot of assets that had been smashed up by the Japanese. We probably postponed a certain amount of the more glamorous projects in order to get on with the stuff that earns us our bread and butter.—*Mr. Stephens*: If I remember rightly, that was much more because all other members of the industry were occupied in patching up, cleaning up and repairing, and therefore there was no competition from that angle to start building, other than getting right what we had lost and what had been damaged.

11575. *Chairman*: Suppose the capital programme seems to be rather outrunning the available cash and yet you think you should go on with it; have you great freedom to carry over with temporary financing?——*Lord Godber*: Yes. For instance a year ago we did a five-year short loan in America to cover the purchase of additional concessions in Venezuela. That is available all the time. Our credit is so good that in practically any of these countries that has the money and a market we could do that sort of thing.—*Mr. Stephens*: The Treasury have been very kind to us in that regard.

11576. *Mr. Jones*: Have you ever had any difficulty in the last four or five years in raising short-term money from the banks and other institutions to finance tankers and that sort of thing? Have the restrictions on credit had any effect on you at all?——*Lord Godber*: No, not at all.

11577. *Professor Cairncross*: You did mention that you might on occasion make an issue in this country or in some other country, and that you had a fair amount of freedom to make these issues. Would you be influenced in the market in which you made the issue by the price at which your shares were standing, or the rates of interest ruling in this country?——*Mr. Stephens*: If we had a rights issue it would go to all the stockholders anywhere; we would not say that the Swiss or the French were in a particular position where they should have the chance and the others would not. When we raise money in Switzerland and Germany it has always been either short or long-term debentures, or something of that sort, based on the local business.

11578. *Lord Harcourt*: On assets in that country?——Yes.

11579. *Professor Cairncross*: But in those cases you might have raised the money here or in America?——Yes. It is a question of currency as well. We do not want necessarily to push sterling into a place like Germany if Germany can produce the money for the German business. We like them to feel that they have their own shop window and they have to run it.

11580. I wonder whether the cost of raising the money is at any time a factor of importance in the decision?——I think it must be. Now and again we have to consider raising short-term money merely in order to pay excise taxes. If the rate has got really outrageous we give the local company credit on supplies for a month or two instead as a means of alleviating their immediate financial position so that they can pay the excise tax.

11581. If money became very tight in this country and rates of interest were higher even than they are now, might that influence you to look elsewhere for finance in one of the countries in which you are operating rather than here?——For short-term or long-term?

11582. For short-term, or even for long-term if you thought it might be difficult to make an issue in the foreseeable future?——*Lord Godber*: We cannot tell at this stage what we would do under those circumstances. I have no doubt that we should get the money we required, whether it was here or in the United States or elsewhere.—*Mr. Stephens*: We would test the various markets.

11583. If it were a question of raising money on debentures here at 7 or 8 per cent., when you could get it in the United States, or in Germany conceivably in the future, at 5 per cent., would that difference in rates of interest influence you?——*Lord Godber*: Yes, if it was a debenture issue. If it was a debenture we would probably decide, other factors being all right, to go to the United States. The amount we would get from Germany or France would be limited to the asset value of our business in those countries, so it would not have a great effect on our general budget. If we wanted what we call group financing and the rate here was 3 or 4 per cent. above the United States rate, we should probably try for the United States. But we have not experienced that situation; so it is purely a guess as to whether we would or not.

11584. You would not do it if the margin of difference were comparatively small?——No, I do not think we should; besides, the Treasury would have something to say about that as well.

11585. *Chairman*: I think you have covered our second question in what you have told us; and a great many of our questions have been devoted to the third question, and I think we have covered that.—*Sir John Woods*: I was not quite clear on the timing point. You say in effect that changes in interest rates cannot affect the timing at all. My point was this. As so large a proportion of your capital requirements come from depreciation and retained profits, on the face of it you ought to have more margin on timing a public issue than most people. You say that the issue is timed jointly with the Royal Dutch Company, but could you not have a good deal of latitude in timing if you wanted to?——The effect on the timing would be a comparatively short period; we might decide to postpone for three or four months.

11586. *Mr. Woodcock*: That is the issue, not the project itself?——No, not the project.

11587. *Lord Harcourt*: Would it be fair to say that considerations of rates of interest affect the timing of your issues but not the timing of your capital investment?——Yes.

11588. *Sir Reginald Verdon Smith*: Mr. Stephens said a little earlier that, so far at least as concerns marketing activities in this country, you might well be influenced by the fact of a credit squeeze or a downturn in general economic conditions. Would you say that in the case of the ups and downs there have been since the war in the economic conditions in this country your investment programme and marketing programmes have in fact ever been changed by any of those ups and downs?——*Mr. Stephens*: It has been slowed up recently, but before that the curve was going up all the time in this country.

11589. So that it has to be fairly major and significant before it would make any difference to the plans?——Yes, because the progressive percentage increase has been so high.

11590. *Chairman*: Our fourth and fifth questions are on stocks. You point out that you hold stocks for the purposes of your own internal operations and stocks for the purposes of disposal to the public; but in both cases, as I understand it, you have a consistent internal review of the amount of money that is locked up in stocks, and a change in the rate of interest is not relevant to the consideration of the amount that you hold?——*Lord Godber*: Quite.

11591. That records your experience over this period when rates of interest have been changing?——Yes.

11592. *Professor Sayers*: In paragraph 21 you use the phrase: "variations of interest rates within reasonable limits". Would you care to define what you regard as reasonable limits?——*Lord Godber*: I would not.—*Mr. Stephens*: Nor I. So much depends on what the pattern in the country is. You get 8½ per cent. in some countries as the market price for short-term money.

11593. What would you say are the reasonable limits in this country?——*Mr. Stephens*: I do not think that it affects it.—*Lord Godber*: What affects the stocks that we carry is much more the volume of trade than the cost of the stocks. We have to carry enough stock to be sure that we supply the national requirements without any hold-up, and it generally amounts to about three months' supply. A high rate of interest would not affect that three months' supply at all.

11594. Do I now understand you to say that you would rather omit the three words: "within reasonable limits"?——*Lord Godber*: I think that might easily have been done.—*Mr. Stephens*: The thing we had in mind was that, if the rate went up to 25 per cent. or something like that we really would have to look again.

11595. *Chairman*: You mentioned that there may be special conditions in particular countries where the rate of

short-term financing is so high that you in fact provide the finance from elsewhere?——Yes; we give them credit.

11596. *Professor Sayers*: When you say 25 per cent., you mean that, counting in the other carrying costs, that would involve you in 35 per cent.?——*Mr. Stephens*: I would not like to be quoted as saying that at 24 per cent. we would laugh and think it a great joke, and at 25 per cent. we would have to think again. The idea of this was that within reasonable limits it would not be likely to influence the level at all. If they got really out of hand we would have to look at the thing again, and say: "Are we going to take a chance on these stocks, or finance them and keep the stocks going the same, or finance them by other means such as local credit to the company concerned?"—*Lord Godber*: We should review the whole position and decide whether to do that or to let the stocks run down.—*Mr. Stephens*: If we could safely do it without upsetting our customers.—*Lord Godber*: Other companies would be in the same position, and we might cut our supplies temporarily until the financial position of the country was better, as we have done.

11597. Now Mr. Stephens has substituted the phrase "out of hand" for "within reasonable limits". What does "out of hand" mean? Does it mean 15 per cent. in the United Kingdom?——I am not responsible for these words. I do not think they have any bearing whatever on your problem, speaking generally.

11598. *Sir Oliver Franks*: Do you not think that an academic question is being answered in a practical way? The practical answer being given is that if at some point in the ordinary practice of the going concern some particular factor arises, e.g., the interest rates in a given country move so violently that the general balance of things is altered, then you would say this is an unreasonable state of affairs, and you would take action of some sort?——Yes.

11599. You are defining "unreasonable" for practical purposes by an occurrence of that sort which hits you in the eye?——*Mr. Stephens*: Yes.

11600. From the other point of view the nature of the question, if one is asked whether something is reasonable or not, is really not whether an occurrence can take place which makes one revise one's views, but whether there is a criterion, a principle, a rule, which one has in the back of one's mind, by the application of which one would recognise a situation to be unreasonable or reasonable. When I say this is a practical answer to an academic question I think this is what it is about? ——One would have to take the history of interest rates in the market, and see whether this had happened before because of something or other, whether we were able to live with it, or whether it was something which was being imposed upon us because of some special political consideration.

11601. *Lord Harcourt*: There must be countries in which you operate where you are used to paying up to 12 or 13 per cent. for short-term money. If you were suddenly asked to pay 13 per cent. in the United Kingdom, would you think it unreasonable?——I would think it very unreasonable.

11602. *Professor Sayers*: But the 7 per cent. Bank Rate in September 1957 did not hit you in the eye?——No.

11603. *Chairman*: I suppose that one of the questions, when these abnormal circumstances arise, is whether you can identify it as a temporary thing and you can do something to deal with it temporarily, or whether it is a permanent change which you must take into account in your dealings with that country?——Exactly.

11604. You cannot tell in advance for certain which it is going to be?——No.

Chairman: Thank you very much; we are very grateful to you, Lord Godber, and to Mr. Stephens for your help.

(*The witnesses withdrew.*)

F. A. Cockfield, Esq., Finance Director, Boots Pure Drug Co. Ltd., called and examined.

11605. *Chairman*: Thank you for coming this morning, Mr. Cockfield, and for your background summary* of the set-up of Boots Pure Drug Co. Ltd. You have had our general outline of the questions we want to sound you on; would you like to say anything yourself as a general introduction to your response to them?——*Mr. Cockfield*: May I start by talking purely generally? There are two points that I would like to make in addition to what I have already said in the memorandum which I submitted to your Committee. The first is that the company is run as a single entity. The board of the Drug Company, as we call it (that is, the board of Boots Pure Drug Co. Ltd.) is the body which is responsible for the policy of the group as a whole. The boards of the subsidiary companies, the retail companies, meet once a year, and they have very little impact on the policy of the company. The members of those boards are senior officials of the company, but the policy-making body is the board of the Drug Company itself. The day-to-day management of the company is in the hands of an executive committee, the chairman of which is the chairman of the board of the company, and the members of which are themselves directors either of the Drug Company or of the retail companies. This executive committee, which meets every week, is responsible for the management of the whole of the group: for the manufacturing, warehousing and retail side of the business. Below this level there is a tendency for the organisation to branch, and for there to be some departments dealing with the manufacturing and wholesaling side of the company and other departments dealing with the retail side. These points are relevant to what I shall be saying later about the way that our capital programme is managed.

(2) The second general point I would like to make is that although the activities of the company are pretty widespread they are in fact linked together; we are primarily retail chemists, and everything else that we do is governed primarily by that fact. We started as retail chemists; we then went a little further back and started manufacturing the pharmaceuticals that we sold. Then later on, in the first world war, we started manufacturing the basic drugs which are used to make the pharmaceutical preparations. While we now cover a wide field, there is this one single thread that runs through the whole of our activities. The company is an outstanding example of vertical integration in this particular field. In some instances, for example, we control products from the basic raw material stage right down to the point at which they are sold.

(3) Having made those two points, I turn to the schedule which has been submitted to you, which sets out the level of the company's capital expenditure over a period of ten years, and indicates the sources from which the funds were derived. In the year ended 31st March, 1952, you will see that we raised additional capital amounting to about £4mn. At the end of that year we were still overdrawn at the bank by nearly £1mn. That situation had arisen partly because of a high and continuing level of capital expenditure in the years immediately following the war; partly because the stocks had grown steadily, which was in part a reflection of the Korean war, but also because during this period the net profits of the company after tax had not shown any significant growth. We were faced, therefore, early in 1952 with a situation where, having raised a substantial new amount of capital, we were still overdrawn at the bank. In the light of that position two major decisions were taken: it was decided first of all that the level of stocks must be reduced, and the effects of that decision can be seen in the following two years, when there was a reduction of approximately £1mn.; and secondly a standstill was instituted on all new capital projects. We were able in the next twelve months or so to build up our cash reserves again, largely out of the reduction in stocks, and we gradually restarted our capital programme.

(4) The total capital expenditure for the year ended 31st March, 1956, on fixed assets was £2¾mn., which was

* Memorandum of Evidence Part XI No. 1.

the highest figure that had ever been reached in the history of the company, and our stocks had also started increasing quite steeply again. At the end of that year our cash resources were again a debit figure; but we were then in a very different position from the position that existed in 1952. In 1952 we had raised new capital in three successive years, but when we came to 1956 it was five years since the last occasion on which new capital had been raised. Nevertheless we felt at that stage that we wished to avoid raising new capital if we could possibly do so. There were a number of reasons for that: one of them was that the cost of borrowing was rising; and I myself was opposed to the raising of new capital, which would impose an additional charge on our profits, if it could be avoided by any other means.

(5) It was at that point that we took a number of decisions which underlie the method that we now employ for controlling our capital expenditure, and this is why I have gone through this particular history. The board of the company decided in 1956 that in future the level of the company's capital expenditure should be determined by board allocations covering the whole of our capital expenditure, subdivided between the retail side of the business on the one hand and the manufacturing and wholesale side on the other. The figure that we determined at that date for our expenditure on fixed assets was £2½mn. In the following two years, the years ended 31st March 1957 and 1958, the actual capital expenditure was very close to those figures; and the figure is very close indeed to what we expected to be available from our undistributed profits and depreciation charges, and from the increase in our creditors after deducting debtors. The level of our expenditure was not fixed at that figure with the objective of living entirely on our own resources and avoiding raising additional capital at any time in the future. Quite apart from our expenditure on fixed assets we have had and continue to face, taking one year with another, a considerable growth in the level of our stocks, partly due to the rise in the price level, but also because the business itself has been expanding. We cannot plan the level of our stocks in the same way as we can the level of our capital expenditure, but our estimate was that, taking one year with another, it was prudent to assume that we would have to put something like £1mn. a year into additional stocks. At 31st March, 1956, our stocks amounted to about £15mn. The business was growing at a rate of just under 10 per cent. per annum, and an increase of £1mn. per year in stocks represented substantially less *pro rata* than the rate of growth of the business. On the basis of those figures we would have been spending £3½mn. per annum, against internal resources totalling something like £2½mn., so that this level of capital expenditure did carry with it the implication that sooner or later we should need to raise new capital. The exact timing of the raising of the new capital would depend very largely on the changes which took place in the level of stocks. As you will see from these figures, we succeeded in the year ended 31st March, 1957, in reducing the stocks by about £1mn. instead of increasing them by that figure. That is the main reason why we have so far succeeded in going ahead without raising additional capital. I make this point because I do not want to leave the impression that the level of our capital expenditure has been determined solely by the level of our internal funds and without any regard to the possibility of raising new capital.

(6) Now we come to the question how the level of the allocation fixed by the board is determined. It represents a compromise between what we regard as the requirements of the business and what money we think is available to meet those requirements. One of the major jobs that I personally have to do is to try and find a compromise between those two figures. When we first started trying to plan these allocations the figure we started with for the level of our capital expenditure was very considerably higher than the figure which in fact emerged. When one comes down from the question of determining the overall level of expenditure to the question of planning of individual projects in it, the organisation there divides, in the way that I indicated that the organisation of the company itself tends to divide. Below the executive committee the planning of the capital programme on the manufacturing and wholesale side of the business is in the hands of one body, and the planning of the capital expenditure on the retail side of the business is in the hands of another.

(7) On the manufacturing and wholesaling side the detailed work is undertaken by a body that we call the works planning committee, which is under the chairmanship of one of the vice-chairmen of the company. That body deals with all our major new capital developments. It works on the basis of trying to look about four years ahead, so that we can marshal our development in a way which we regard as most satisfactory from the point of view of profitability, and which will not result in a very heavy capital expenditure in one year and a sudden drop in the level of capital expenditure in another. Apart from the major projects, which are dealt with by the works planning committee, there is an enormous volume of day-to-day capital expenditure, mainly on replacement of plant and machinery and small developments, which would be dealt with by the production directors and an organisation that we know as the expense control department.

(8) On the retail side of the business the problem is an entirely different one. We have at present just over 1,300 shops. During the war and in the immediate postwar period it was not possible to undertake any substantial retail development because of building licensing. The only major new shops that we built immediately after the war were replacements of bomb-damaged premises. In 1955 we felt that the time had come for us to push ahead with retail development, and we had the finance available to do it, largely as a result of the reduction we had succeeded in achieving in our stocks. We thought at that time that the amount of work in front of us was comparatively limited, and we tried to dispose of it in a relatively short period of time. That is the explanation for the very large figure of £2,755,000 for capital expenditure in the year ended 31st March, 1956. But the more we did, the more we became convinced that there was much more to be done.

(9) We write off the fittings in our shops over a period of twenty years; we feel, and experience has supported this, that twenty years is really the limit of life of a shopping unit, and that by the time that period has gone, because of changes in shopping habits, methods of service and display methods, we really ought to refit throughout. If we are in a good location and the business has increased, we shall probably want to extend the premises as well. As a result of the virtual cessation of retail development during the war and in the years immediately afterwards we had built new or refitted approximately 250 shops out of a total which was then 1,310. Every one of the thousand or more remaining shops dated back to 1939 or earlier, and therefore, on the criterion that I have mentioned, was either already obsolete or becoming obsolete. This was beginning to become very apparent, because when in 1955 we were looking at a list of, say, fifty shops that required refitting, the more of them we did the more got added on to the other end of the list. The programme originally started at something like £3½mn.; when we had spent £1½mn. of it, and reviewed the programme again, it was up to £4½mn.; when we had spent another £1½mn. it was up to £9mn. At that point we decided that it was no good, with this enormous spread of shops, trying to deal with them on the basis of pressures that might arise in particular quarters. We decided that the only thing to do was to have a programme for refitting the whole 1,300 shops over a maximum period of twenty years. We decided therefore that we must refit 65 shops a year as a minimum. Refitting of course carries with it complete modernisation, and very often an extension of the shop which may double its size or even more than that; for example, the project we are in the middle of carrying out in Oxford entails trebling the size of the branch there. That kind of thing is not uncommon. The time to do that is when we are refitting the shop anyway. It is no good extending it first and then coming round to try and refit it afterwards.

(10) We were then faced with the problem of which 65 to do each year; we decided that the right thing to do was to take a *pro rata* selection of them every year. If we did not do this we should find that the appeal or the glamour associated with the big store would tend to funnel all the money into the very big developments at the expense of the smaller ones. Our experience, which is contrary to what had been anticipated some years ago, is that our most profitable expenditure has been not in the very big shops but in those taking between £1,000 and

£2,000 a week. So we classified all the shops in takings ranges, found out the number in each range and split it down by twenty, and so arrived at an allocation of so many shops in each range each year. We then estimated the cost of refitting or extending each of those shops, and that gave us a total figure for our expenditure each year.

(11) We found that, working on this minimum basis we could finance the programme within the limits that I have mentioned. The question then immediately arose whether we ought not to try and go ahead faster than we were. We have always wanted to do so, but we have found that hitherto limitations have emerged, not financial limitations but rather physical limitations. We have tended to do most of our work ourselves; we make and fit all our own shop fittings; we have our own architects who design the shops; and so on. The rate at which we can go ahead is no greater in fact than the amount of money that we have allocated to this purpose at present; indeed in the year ended 31st March, 1957, less money was spent than was allocated to that purpose. We have taken steps to try to remove these internal bottlenecks, of which the most important one was the physical capacity of our own shop fitting works, which we have now increased by something like 60 per cent. and we have also appointed a retail development officer whose job it is to co-ordinate the whole of this retail development programme.

(12) We envisage that over a period of years by these means we shall gradually be able to lift the level of expenditure particularly on the retail side of the business. In the year ended 31st March, 1957, we were estimating to spend £2½mn. and we spent £2,400,000; for the year which has just ended we again hoped to spend about £2½mn., and have again spent about £2,400,000; for the current year we are budgeting to spend about £2¾mn.; and next year and for the two succeeding years we hope that the figure will go up to nearer £3mn. We believe that a programme of that nature is within the physical capacity of the company, and also within its financial capacity. We must also find more money for stocks, on the assumption that the stocks go up, as they will do in the long run. This programme represents spending more money than is immediately available inside the business; but it represents spending only at the rate probably of between £1mn. and £1½mn. a year more than we have, which means that if we raised on the market about £5mn. every four years it would meet our requirements. That figure is one which we regard as reasonable in relation to the size of the business, and also reasonable in relation to the profit-earning capacity of the business. If we raise new capital we are in the unfortunate position of having to pay interest or a dividend on it; one endeavours therefore to avoid raising new capital as long as one can!

11606. I was not clear whether the conditioning factor which has led to expenditure in recent years of about £2,400,000 on total fixed assets has been the limitations of the physical capacity or a policy decision earlier on to spend, realising that the stocks were the joker in the pack, only as much as the business generated, on the ground that you did not want, owing to the current conditions in the market, to raise more capital outside. Or was it that the two things coincided and produced roughly the same result?——The original decision was to spend £2½mn. on fixed assets, because we felt that that was all at that stage that we could afford to spend. When we took that decision we concurrently decided to try and reduce the levels of our stock. If we could reduce the levels of our stocks we could finance the programme without going into the market for money; if we could not reduce the levels of our stock we would have had to have gone into the market. I took the pessimistic view at that stage, and I was perfectly prepared to go into the market and raise new capital twelve or eighteen months ago. I have no doubt that we could have done it perfectly easily, and it would not have put an undue strain on the business. We did not in fact have to do so because the effort to reduce our stocks proved to be much more successful than we had ever anticipated. At the time the best estimate we could get was that we might get £400,000 out of stocks. This was a year in which the business was expanding, so it was a question not just of reducing our stock in relation to turnover but of doing a bigger turnover on a smaller physical volume of stock. In fact stocks were reduced by £1mn. and not £400,000, and at the same time the profits went up, which is always a very helpful thing, particularly as we do not pay our tax until the following year, which means that for some period we can live on our tax reserves, so long as we can keep our profits going up. The success of the stock reduction programme has in fact removed the immediate necessity for raising new capital, and the lifting of the Chancellor's directive has meant that there is no date that I have in mind when I think we shall require to raise new capital. We obviously shall require to, but it is not at this moment an immediate necessity.

That was what was going through our minds at the time we took the decision, but subsequent experience has shown that we could not in fact have gone very much faster on the retail side of the business than we did. Our hope was to spend two-thirds of our money on the retail development; in fact we have spent about 60 per cent. We tried in the year ended 31st March, 1956, to put a lot of work outside. It proved very uneconomic; the cost of shopfitting done by outside companies was between 50 and 100 per cent. higher than our own costs. We now propose looking at that particular aspect again, because I am not satisfied that we are developing as fast as the opportunities exist. There is no point whatever in trying to develop faster than the organisation will stand; but equally, if we could get effective help from outside at the right level of cost it would be wrong to cut off that opportunity.

11607 *Professor Sayers*: You spoke of the effort to reduce stocks, and the fact that that effort was more successful than you had hoped; what was the reason for making that effort? Was there any circumstance in that particular year or group of years that led you to make this apparently extraordinary effort to cut stocks?——Some of us felt that the levels of stocks had got too high; not very much too high, but we felt that they were going the wrong way. This was almost inherent in the general economic state of the country during this period, which was one of boom, when business was going ahead very rapidly. Against that background, where people can see the possibility of big increases in their sales, it is very difficult to get them to be economically minded on their stocks. By the time we reached March 1956 we had had two years in which together the stocks had gone up by £2½mn. On the 31st March, 1956, we had an overdraft at the bank; this does not, I am afraid, appear on these figures, which merely have the variations in cash from one year to another. But you will see that over the two years the cash went down by £1½mn., and that left us on the 31st March, 1956, with an overdraft of just under £400,000. The decision we had to face at that time was whether to raise new capital or whether to get the money from internal sources. We decided that the first step must be to try and get it from the inside, because one never earns any money on a surplus of stocks; if stocks are higher than the absolute minimum needed to operate they are a positive embarrassment, because they need room to house them, and people to trundle them about; they are in the way and people fall over them. It costs money to hold them; we do not want a penny more in our stocks than we really require for the needs of the business. We made a real effort to get the finance from that quarter rather than going into the market. We had no doubt whatever that we could go into the market; it was a question of deciding that this was the economic way of doing the job. We were in some measure influenced by the fact that rates of interest were going up, but only to a marginal degree.

11608. Were you under any pressure from your bank to reduce that overdraft?——None whatever. Our bankers have only been too happy and willing to meet our financial requirements. Perhaps I should say a little more about our cash. You get very little indication from our year-end figures of what our true cash position is. There are enormous fluctuations in our cash holdings from one period of the year to another. The difference between our minimum cash balance and our maximum may be as high as £8mn. There are three regular periodical cycles which affect our cash holdings. The first is that we pay our trade bills monthly. This produces a heavy outflow of cash at the beginning of each month; then of course it comes in very rapidly over the counter every day. Secondly, the purchase tax is payable every quarter. Our biggest purchase tax cheque reaches £3mn. The tax is

payable in the first week of May, the first week of August, the first week of November and the first week of February. Thirdly, there is a very distinct seasonal pattern in the business. In Christmas week, for example, we take two and a half times the average weekly takings for the rest of the year. The most difficult period in our finances is the four weeks following about the 8th November. On or about the 8th November we have to pay purchase tax, which may vary between £2½mn. and £3mn., and the September bills, which include the very heavy Christmas supplies; but the Christmas takings do not begin to come in until December. So for a very short period everything is going out and the incomings are relatively light. During that period we may run a very heavy bank overdraft; by the time we reach the 31st December we may be back in credit by £5mn. I gather that that is the sort of business that the average banker likes: a very big overdraft, which is corrected in a very short period indeed, with the money coming in automatically, with nothing to stop it. I gather that the bankers begin to get worried when the account is merely fluctuating entirely in the red. We can be quite a long way in the red on the 31st March, and heavily in credit for quite a lot of the rest of the year.

We have never at any time been under any pressure from our bankers since I joined the company in 1952. I am not prepared to say what the position was before then; but the fact that we raised three successive lots of additional capital in 1950, 1951 and 1952 would indicate, as I believe to have been the position, that our bankers felt that the level of our borrowings had reached the stage when an addition of permanent capital was required in the business. Since that date we have never been under any sort of pressure from them at all.

11609. Do the ins and outs of your business through the year allow you to be influenced by the rate of accommodation which you have to pay your bankers?——Obviously the higher the rate of interest the more anxious we are that we should not go too far in the red. But the extent to which we go into the red is dictated almost entirely by the level of our capital programme and the level of our stocks. We can influence the figure in other ways to a certain extent, and we have done it. On two occasions we succeeded in shifting liabilities very considerably from one period of the year when we had no money to a period when we had a lot. We did it first of all by ensuring that the maximum amount of supplies to the shops were sent after the 1st October instead of before, thereby paying the purchase tax in February instead of November (we have plenty of money in February, and none whatever in November). We shifted well over £1½mn. of purchase tax; but that was a "once for all" operation. Secondly, we did the same with certain of our Christmas supplies; by rephasing the buying programme we shifted some of the payments into December instead of in November when our cash position is difficult.

11610. *Professor Cairncross*: Over ten years you have added about £1mn. net to your cash, while your turnover must have come near to doubling. That would imply that you are under more pressure on liquidity than you used to be. Would you regard the kind of financial position in which you have been over the past two or three years as a natural and normal one, or one where you are really waiting to make a public issue as soon as possible and improve your liquidity?——I see no point whatever in making a public issue of capital at this moment; we simply do not need it. If we have surplus liquid funds, we are faced with the problem of trying to employ them. Last year, when the Bank Rate was 7 per cent., I had a man working a great deal of his time peddling out money at different times of the year to all sorts of people who were prepared to pay 7 or 7½ per cent. on it. There is no reason whatever why we should raise new capital from the public in order to employ somebody on trying to make a return on it; it is not part of our business at all.

11611. Business as a whole in this country is clearly much less liquid than it was ten years ago; you are therefore in a fairly characteristic position in that you have about the same cash position as, or slightly better than, you had ten years ago, but your turnover has gone up very markedly. Yet you are saying to us that you are quite reasonably comfortable, and you see little point in being more liquid. How is it that you can be as comfortable today in effect as you were ten years ago, with far less money in relation to your turnover?——There is one other important change which has occurred over this ten year period; the increase in stocks is nothing like as big as the increase in the business. The volume of the business over this ten year period has gone up comfortably over double. The stocks have not increased by more than about 50 per cent. That has a distinct bearing I think on the amount of money we hold and need.

11612. That goes part of the way, but it still leaves you with 50 per cent. more stock and no more money?——In 1949 industry generally was very liquid because of the cessation of a great deal of capital development during the war. We were particularly in that position, because on the retail side of the business we were allowed to spend virtually nothing at all, and, because money goes out later than the physical execution of the work, the major schemes that we started on the manufacturing side did not seriously affect our capital expenditure until 1949.

11613. You did however go to the market in 1951 and 1952, in a position where, as I should judge from what you have told us, you were not very much less liquid in relation to turnover than you are now?——Before the last issue of ordinary capital was raised, very early in 1952, we were very heavily overdrawn. After raising that new money our cash position at the end of the year was about £600,000 worse than it is now. We are therefore more liquid today than we were after we had raised that £4mn. If one makes a comparison between the period immediately before we raised that £4mn. and the position now, we are more liquid to the extent of £4½mn.

11614. *Professor Sayers*: You made a very big economy in stocks between 1952 and 1953. Was that operation on stocks again associated with your illiquidity?——Directly, because having raised £4mn. we were still overdrawn by nearly £1mn. The reduction in stocks started just before the end of the year 31st March, 1952, but it does not show in the figures until the following year; in other words, the increase in stock in the early part of the year 1951-52 was so big that the reduction made in the latter part of the year still left us with an increase for the year as a whole.

11615. Do you know why stocks went up so much in 1950-51?——There were three reasons: (1) the Korean war, and of course we are substantial manufacturers as well as retailers, and part of this was to protect our manufacturing position; (2) consumer goods began to be very freely available during this period, and the time when the customer was prepared to buy what we had to sell was disappearing, and we were moving to the position where we had to supply what the customer wanted; (3) in each of the three years from 1950 to 1952 there was quite a considerable increase in the level of the business: it went up by approximately 11 per cent. each year.

11616. *Chairman*: Mr. Cockfield, would it now be convenient if we just went through our particular questions, so far as you have not covered them already, and asked you to concentrate your replies on them?——Yes, Sir. The answer to the first question is that the size and content of our fixed investment programme is determined by a review of our requirements and of our available cash resources, and represents what we regard as a reasonable compromise between the two.

On the second question, on the wholesale and manufacturing side of the business the works planning committee endeavours to plan our major developments approximately four years ahead. We try and take a general view of development over approximately ten years, but we begin to crystallise our plans by looking at the individual projects about four years ahead of their occurring. The smaller capital expenditure, on replacement of particular items of plant and machinery and so on, tends to be much shorter term matter. In addition we very often find quite unexpected requirements emerging on the manufacturing side of the business; for example, if a new product emerges we may have to spend a very large amount of money that we never foresaw a year or two before. This is true, for example, of the company's investment in the production of the cortico-steroids: cortisone, hydrocortisone, delta-hydrocortisone and so on. Our investment in plant and buildings for this venture something like £250,000 which was incurred over a very short period of time. These are entirely new drugs, where the market develops very rapidly and very quickly. It is no good trying to fit that into a capital programme; if we are

going to take advantage of the opportunity we have to do it here and now, and if necessary we have to make room for it. If we have not got the money we have to take it from something else. On the retail side of the business we have endeavoured to take a long-term view of the level of our capital expenditure, the rate at which we ought to be modernising and extending our shops, and the groups in which we ought to plan the expenditure. As far as the detailed planning is concerned, with the larger branches each of which may involve expenditure of £200,000 or £250,000, we have on hand at present enough projects to cover the next five years, and I think that we shall be permanently in that position. It takes a long time to carry out one of these major projects, because they often involve buying additional premises or pieces of land, getting planning permission, and so on, quite apart from the job of actually designing the shops. If we want to carry out a major development somewhere, we have to start acquiring the land or the premises a long time in advance. As far as the smaller jobs are concerned, our objective is to try and plan them about two years ahead; but here it is a question of fitting individual shops into a general programme, and whether we put in this branch here or this one there is a decision which we need not take until a year, possibly two years, before the work actually starts. It is quite short term work. You ask: "How quickly can we expand or contract?" We can of course stop anything at any time if we are prepared to stand the loss which is involved in so doing. But our policy, which we have been successful in maintaining, is never to stop anything that we have actually started.

11617. That means once contracts are out?——Yes. We have never stopped anything that we have actually started. Subject to that, as far as large projects are concerned, if we decided here and now that we would not authorise any large new ones it would begin to have a noticeable effect in something like six to twelve months. By stopping small ones we could get an almost immediate result. So far as expansion is concerned, the problem there is one of physical capacity. We have found ourselves right up against it this year, when the level of expenditure during the current year has been below the level that the board allocations would have permitted, and it has proved very difficult indeed to get the level up, because merely putting additional jobs into the programme only slows down all those we have in it already.

11618. That may be a transitional situation, from what you have said; you may be able to develop a situation in which you can use outside contracting?——My own guess is that to some extent it would be a permanent problem. The amount of work in front of us on the retail side of the business, and the opportunities open to us, are so immense that we could almost go on at any rate, if we could do it economically. During the years in which we were deliberately going slow on capital development, particularly after 1952 when we had a standstill on new projects, our capacity was under-employed, and it proved much quicker to get it up than it would do now.

The answer to the third question on the effect of changes in interest rates is that they have had effects to a very limited extent only. That is tied up with the fact that since 1952 we have succeeded in financing our development out of our internal resources.

11619. You have had your bank borrowings?——During a great deal of this period our credit balances brought in very little income indeed; it was not until about 1956 that the rate on bank deposits became a significant figure. The drawings, when we were overdrawn, tended during this period to last for a relatively short period, and the cost of our bank borrowing was very small in relation to the profitability of the projects that we wanted to undertake.

11620. *Professor Sayers*: What other uses have you found for your credit balances besides the bank deposit account?——Because of the very big fluctuations in our balances, weekly, monthly, quarterly and yearly, the periods that we have money available are usually very short. When the Bank Rate was 7 per cent., and we were in possession for periods of very large amounts of money, we were lending sums to local authorities.

11621. Do you buy Treasury Bills?——We bought Treasury Bills at one period, and we had £1mn. in Tax Reserve Certificates. We had to stop buying Tax Reserve Certificates, because once we start going in the red to any appreciable extent it is much cheaper to avoid borrowing at the bank. At present levels it is uneconomic to buy Tax Reserve Certificates and finance them by bank borrowing.

11622. *Sir John Woods*: For what period do you lend to local authorities?——Normally for seven days, but very often we are able to negotiate fixed term money. For instance, one year when we wanted money to pay the purchase tax, which in that year we paid on the 7th November, we lent £500,000 to somebody on the basis that it was repaid on the 6th November. But the amount of money we have ever made in this way is not a significant figure in relation to our profits. In the peak year when the Bank Rate was 7 per cent. and we had for us a very large amount of liquid money, we made £60,000 in the course of the year. It is worth putting somebody on to do it, but as a means of making a profit it is not as good as investing money in shops. Normally if we invest money in a shop we expect after its teething period that it will produce about 15 per cent. On the good ones we do better than that.

11623. *Professor Sayers*: Have you ever revised that figure of 15 per cent. since the war?——When I first started talking to my colleagues of 15 per cent. they thought I was setting the target very high. As the Bank Rate has gone up they have come more and more to the view that 15 per cent. is really the minimum we should go for.

11624. *Chairman*: Is it 15 per cent. after making all allowances for depreciation?——Yes; but we must bear in mind that a lot of our depreciation is not allowable for tax.

11625. Then your answer in general to our third question is that you have been so placed that consideration of the actual rate of interest, apart from your accommodation from the bank, has not been within your experience in this period, because you have kept away from raising money?——We have. It has had some influence on our thinking. When we found that our stocks were rising faster than we wanted them to in 1955 and 1956, the fact that money was short and expensive was a very valuable talking point, both to one's colleagues and to the people who were actually operating the business. When money is cheap and easy to come by it is very difficult to convince other people that they have got to economise in the use of it.

11626. *Sir Oliver Franks*: Is there not a point of substance behind the talking point which gives it some force, or would you disagree?——No, I entirely agree with you that there is a point of substance. The point I am making is that until the Bank Rate went up to 7 per cent. the amount of substance in it was limited. In fact I might almost say that we succeeded in getting more effect from the talk than the substance warranted.

11627. Would you say as a general observation that most people with whom you have to deal in this sort of context are fairly habituated to Bank Rates up to 5 per cent. or a bit over, and it is difficult to make them take notice, and that it is only when money rates move beyond that that notice is taken and people are therefore willing to modify action?——I think that there is a great deal in that point, particularly as the rate on bank borrowing is not affected by changes in the Bank Rate when the Bank Rate is very low. It would not have been until 1955 that the changes in the Bank Rate had any effect on the cost of borrowing to us at all.

11628. *Sir John Woods*: Because there is a minimum rate?——Yes.

11629. *Professor Cairncross*: Would you have found, in the years before 1957 particularly, when you were discussing the level of stocks, that there was a tendency to say that stocks were already at the minimum compatible with the efficient running of the business?——In some quarters, but the degree of willingness on the part of the board and the senior executives of the company to make every possible effort to get the level of the stocks down was quite remarkable. There was, and still is, some difference of opinion as to what the right figure was, but there was general and complete acceptance at that level of the business that the stocks were too high and ought to come down. There is throughout the business a general acceptance of the proposition that we must operate the

business at the minimum level of stock that is compatible both with efficiency and with the general policy of the company to try, within the range of merchandise it sells, to have the article the customer wants available at the shop. As far as we are concerned going out of stock is a much more serious matter than it is with a purely manufacturing organisation. One can demonstrate on paper that the level of stocks we hold in our retail branches is more than is theoretically necessary; but in practice once we get below a particular level the human error begins to become important, and we start going out of stock of lines that ought to be in stock.

There is one other point I want to make here. During this latter period stocks were going up rapidly, our capital expenditure had deliberately been put up, and we found ourselves once more overdrawn at the bank. There was a very keen realisation throughout the business that the amount of money we could afford to spend on our capital development was very closely associated with the amount of money we were required to keep in our stocks. When we came to consider raising new capital, there was no difficulty whatever in getting the point over to people that, if we raise £5mn. and pay 6 per cent. on it, our profits are down by £300,000 a year immediately, and it is a very long haul to try and get that figure back again and show the same profit as we did before we started.

11630. So you think that, even when you have had more experience of the minimum to which stocks can be driven, there will still be some room for manoeuvre if access to bank finance or rates of interest were to alter? You can in fact at any given time be a little tougher or a little more lax in stock control, depending on your access to finance?——I would like to put it in quite a different way. I am satisfied that long term there is abundant room for reducing the level of stock in the business. That can only be done by increasing the level of efficiency of the business. We have the whole operation under our own control; we have our own warehouses, and to a large extent our own distribution system. The only stocks which are of any use to us are the stocks which appear on the counter, at the point where we sell them to the customer. Every item of stock which is in the line behind that, whether it is in the shop stockroom, in a lorry, or in the warehouse, has value only in so far as it is ultimately going to get on to the counter. The opportunity for improvement and efficiency in that is immense. We are in the course at present of programming an electronic computer which is going to cost us the best part of £250,000, due for delivery this coming spring, the main part of the operation of which is directed specifically to this problem. On paper I could show you a system which would theoretically cut our shop stocks by one-third; but we cannot do it until we have lifted the efficiency with which we carry out the operations behind the shop. That is the job we are now embarking upon. We propose doing this irrespective of what money costs; it is still worth doing if money only costs $2\frac{1}{2}$ per cent.

11631. At that more efficient level of stockholding would you become immune from financial influences?——No. We shall always be faced at some point with the fact that we can either have our money in one place or in another, and we have to make up our minds which is the most remunerative place. Stocks are not unremunerative in the sense that if the stock is not there available to sell we have lost our business and our profit. On the other hand, if we have more stock than we require, that money could be put into a new shop or a development somewhere else in the business.

Chairman: Thank you very much, Mr. Cockfield; your evidence has been very helpful to us.

(*The witness withdrew*)

(*Adjourned until* 2.15 *p.m.*)

SIR IVAN STEDEFORD, K.B.E., Chairman and Managing Director, Tube Investments Ltd., called and examined.

11632. *Chairman*: We are much obliged to you for coming, Sir Ivan. You have had a chance of seeing our questions; I was wondering whether you would like, before we get on to any detailed questions which arise on them with regard to your own business matters, to say anything in general about the subject of capital expenditure and investment programmes, and the effects of changes in the interest rate and tightness or expansion of money, in relation to the decisions which have to be taken?——*Sir Ivan Stedeford*: The varying of interest rates has a very important effect, I think, in two principal directions. On the smaller companies I think it would affect their programme, and hurt them quite substantially in raising finance, and so on; on the bigger companies it does not make a great deal of difference.

11633. As far as your own experience goes, drawing on your connection with Tube Investments, would you say you had observed its effect or not?——More by the impact it has on the general demand; we have not ourselves allowed it to have any impact on our own capital investment programme.

11634. Could you say why you have not allowed it to determine your own decisions?——For two main reasons, I think: first, that the circumstances which led us into the position which requires high interest rates seem to me to make it even more important than otherwise to have the most modern and the best equipment we can; and secondly, one can most advisedly proceed with capital investment programmes, if one has the resources to do so, in times of the weakened demand which these high interest rates create. That is the policy we have always endeavoured to follow.

11635. It is inherent in your answer that you have been in possession of resources which did not lead you to consider the terms upon which you went for money to the capital market?——Yes. We have always assumed that we shall always want money. It is a continuing process to satisfy that want. Therefore we have endeavoured, since the war, always to raise money when money has been cheap, and use it when we exhausted the lot we then had. Generally that policy has paid.

11636. You get money in like a store which you take in and draw upon when the need comes?——Exactly.

11637. Does that policy not involve you in having stores of unusable merchandise from time to time?——You might think it did, and certainly that is an argument; but the advantages of doing it our way, I think, outweigh that one simple and relatively small disadvantage. We find that when we have enough money for our existing and our forseeable requirements, then we can proceed with our plans, and all down the line they go forward. We think there is more enthusiasm and determination there than if people had to say: "What will the powers that be say to this if we go forward and we have not got the cash?"

11638. *Lord Harcourt*: When you have large sums of cash, how do you employ them?——We have large sums at the moment. We have quite a lot in Tax Reserve Certificates, more than enough to pay our tax. We have other arrangements for the balance that reduce the cost of having this money to a minimum. We arrange with our banks to our satisfaction.

11639. Do you ever go into the gilt-edged market?——Not now. We used to, and we will re-enter it later on, no doubt. It is not really speculation in gilt-edged, I know, but it has been at least a bit speculative during the last few years, and we do not speculate.

11640. Do you buy Treasury Bills?——We have done, but we are not doing so at present. We are not experts in that, and we do not like to do it unless we are pretty sure that we shall be safe.

11641. *Chairman*: What determines your decision to go to the capital market for further funds?——A projected capital expenditure programme, developments of other kinds involving capital, such as the acquisition of other companies or investments in companies overseas; those are the main considerations.

11642. You relate your expected expenditure under those heads to your current store of money?——Yes. We know roughly what we are spending each year; we know what we shall have to spend, and we know what we shall retain in our business.

11643. What proportion of your total capital expenditure do you plan to finance from funds retained in the business?——Not so much now as used to be the case. Since the war we have drawn on between £35 and £40mn. of our own resources, those that were accumulated at the end of the war and the accretions of the lean years immediately afterwards. Since then from our own resources we have met something like one-half to one-third of our capital expenditure out of retained profits and depreciation funds.

11644. *Professor Cairncross*: Does that imply that one-half to two-thirds of your gross investment is financed by borrowing?——Yes; I should think half.

11645. *Sir John Woods*: Do you include in borrowing the issue of shares?——A half would be on the high side, perhaps. We raised £20mn. that way during the last ten years, and we have spent about £35 or £40mn. of our own resources.

11646. *Professor Cairncross*: Have you a fairly definite target for liquidity? Is there some point at which you can say categorically that you are short of money, or is it something rather elastic?——We always see when we think we shall be short of money, but we do not work to a formula. It would not worry us if we were running lower in our cash resources, because we should not feel that we should be encountering difficulties because of it; but as soon as the time became propitious we should raise the money.

11647. It would follow from what you said earlier that you probably now hold a good deal less cash in relation to the volume of business you transact than at the end of the war, when presumably you were much more liquid. In running down the cash that you then held, were you doing that quite deliberately, because you had no wish to retain the liquid assets you had at that time?——Yes; we had more than we needed.

11648. *Chairman*: It is assumed in what you have said to us that in effect money will always be available for your planned programmes?——We have never suffered any handicap for want of it.

11649. But I think you linked that up with being a big business, because you were distinguishing between the big and the small firms. Why is it that, as a business on the scale and of the kind that you are, you have this confidence that the money will always be available, that the capital programme can go on unshadowed by tightness?——I meant to convey that we had not ever been embarrassed in the carrying out of any of our plans for want of money. We have been careful in observing the best times when to raise it, and therefore we have never had any difficulty about it.

11650. Would it follow from that that if, at any time, you felt that you must raise it, and you found that the current rate of interest seemed relatively high in relation to an earlier period, you would not be altered in your decision by that?——I do not think that we would be altered very much. These rates of interest have been changing so fast that it is a job to keep in touch with them; if we thought they were going to come down very soon we might defer it, but I do not think interest rates would make a serious difference. We should hope to raise the money, as we have done before, either before they went too high or after they came down.

11651. *Sir John Woods*: You might advance the time at which you went to the market, within reasonable limits?——We have advanced the time when we went to the market for money, as we did the last time.

11652. But it would not make much difference to your actual plans for capital investment?——We have never had to delay them, because we have always been in time in getting the money.

11653. *Professor Sayers*: This experience of always being in hand with money is during a period which began with your having more money than you felt you needed?——Yes, but we spent all that.

11654. That means that during the last ten or twelve years you have not had to raise as much money as you wanted to spend, even allowing for the fact that you spent more than depreciation funds and so on. Have you faced the possibility that over the next ten years, if you are to develop as fast, you will have to raise a larger proportion by borrowing?——We may have to, but we hope we will be earning much more profit in the next ten years than we did in the first ten.

11655. So you anticipate still being in the position of always being able to get all the money you need for your programmes?——I would think so.

11656. *Professor Cairncross*: Has your business been expanding continuously throughout this period, even in the last year or two?——Yes; this last twelve months just finished was one of our biggest years.

11657. And you look forward to a continuing expansion in your business?——I should like to think so.

11658. *Chairman*: You indicated earlier that one of the principles of your company was that you should expand at a time when the general run of trade was rather in recession. Is that based on social considerations?——The time when we hate doing a thing, when it costs us most, is when the demand on our plants is a robust one; and therefore we like to use these so-called recessions to do our spring cleaning.

11659. The fact that your customers are reducing their orders upon you in a sense acts as a stimulus for you to increase your capital expenditure?——It is a very troublesome thing to have happen; but we do accelerate our plans as fast as we can during those periods.

11660. *Professor Sayers*: Did you decelerate them in 1955-56, during the busy time?——Certainly; plans were held down sometimes because of the strong demand which we should not have been able to satisfy if we had started carrying out some of the schemes.

11661. Were they held up in 1955-56?——Yes; some were never started.

11662. *Sir Reginald Verdon Smith*: This is because of the technical character of the particular plants?——Some plants would have to be completely closed down.

11663. *Sir John Woods*: It is physical dislocation that you are talking about?——Yes.

11664. *Chairman*: You were speaking at the beginning of what you thought you had observed of the influence of interest rates or tight money upon the smaller firms?——The two main things which spring to my mind are these. There is immediately a weakening of demand, resulting from the smaller companies going on the defensive; they do not quite know what is in store for them. There is also a running down of inventory stocks. We also notice that debtors tend to jump up at once in the smaller companies. For the time being stocks increase, because orders are cancelled and so on. They may remain at a high level for quite a little time, because people order from hand to mouth. In the export trade it probably has an illusory effect of devaluation, because the pound weakens and they can buy for the time being cheaper. We have noticed that the export side does not weaken but, for the time being strengthens a bit; but that is not lasting.

11665. *Professor Sayers*: Have your customers cancelled orders, and given you the reason, or indicated in some way, that this is because of tighter monetary conditions?——They do not give a reason quite like that, but it is rather like a freemasonry; we are all in the same boat. It may not be that the orders are cancelled; but they are suspended as often as not, or deliveries are prolonged over a longer period.

11666. You are speaking now of what has happened within your own firm? Customers' orders have been suspended or deliveries prolonged during the period of tight money in circumstances which led you to believe that that was the reason for it?——Mainly in circumstances of a general weakening of demand.

11667. *Professor Cairncross*: Which period have you particularly in mind?——Last year it was very evident.

11668. Would you say that it happened in earlier years when the Bank Rate went up, or that it was only when the Bank Rate got above 5 per cent. or 6 per cent.?——It was more last year, because last year there was the effect of all that had been going on, and that was most severely felt. It takes a long time for it to get right through. I do not think that it was necessarily that the 7 per cent. last September did it when earlier measures did not; I think that it was a cumulative effect.

11669. *Professor Sayers*: Was it possibly the effect of the news of the American recession?——I think we talked ourselves a bit into it, yes; but I do not think that it was

mainly that; mainly it was the credit squeeze and the high interest rates.

11670. *Professor Cairncross*: Interest rates went up, if you remember, in the first months of 1955. You did not notice this then?——No, I do not think I did. I do not think that it existed in 1955 to anything like such a notable extent.

11671. *Professor Sayers*: Did you not in fact mention 1955-56 as one of the years when your customers' orders were exceptionally pressing?——That is right.

11672. *Chairman*: You began to notice the suspension of orders, which is a form of cancellation *pro tem.*, about a year ago?——About eighteen months ago, in the spring of 1957.

11673. *Professor Sayers*: Did these cancellations come from any particular directions, by trade or by country, or by area in this country?——I do not think any one section of industry was conspicuous. Broadly speaking it was general over the whole lot.

11674. *Chairman*: Is the inference that the recession of orders was caused by higher interest rates and the credit squeeze from your own deductions rather than what you have learned from the people responsible for altering their orders, or do you find that is the common reason given? ——The effect is most felt, and felt very strongly, in the consumer end; the companies engaged in those fields feel it very seriously. That is where we first get the cancellations and prolongations of delivery. We cannot help associating those rather widespread moves with the fact that there is a credit squeeze and high interest rates. I think the two go together.

11675. *Professor Sayers*: They also go together with the American recession, if you are talking about the last twelve or fifteen months?——Yes. There have been a lot of expressions of surprise that the American recession has not had the effect over here that other recessions have had.

11676. Has it had the effect of making people ponder whether such good times are after all ahead?——It may make people wonder whether we are going to get a recession. There has been psychologically quite a habit of looking over our shoulder to see whether the recession in America is coming our way.

11677. Have you any idea why the monetary changes should have made your customers defer their purchases? ——Yes. Cars are not selling, and everything that goes into a car is not wanted in such great volume. Those people, whether car manufacturers or component manufacturers, extend their periods of delivery. There was a very significant alteration that took place in a plant on which we had spent £2 or £3 mn. in putting down equipment for ball-bearing tubes.

11678. Was not this a trade which was affected most perhaps by the hire purchase restrictions, and not by credit becoming dearer?——I am not very familiar with the retail arrangements. You may be right.

11679. *Chairman*: You said earlier on that one of the things you noticed was that your trade customers were asking you for extended credit in the last eighteen months?——They did not ask us for it; they took it.

11680. Was that noticeable on a large scale?——Yes; our total of debtors about doubled.

11681. If they take extended credit do you ask them to pay interest on the outstanding account, or raise the charge for interest?——No, we do not.

11682. In that sense they were borrowing from you when they found they could not borrow from somebody else?——Yes. We were rather slow there, I think.

11683. *Professor Sayers*: Can you give us any idea of the proportion in which your outstanding credit to customers has gone up?——Debtors and creditors used to be very nearly the same. If debtors started going up too far above our creditors our secretary would be beginning to ask questions about this. At the end of last year they were £8mn. and debtors were £18mn. The creditors the previous year were £11mn. and debtors were £21mn. Before then they would have been very close together.

11684. So that the debtors have gone down?——There is a special reason for that; in the previous year one of our subsidiaries' accounts was consolidated in the groups accounts, and this year it has been taken out.

11685. *Professor Cairncross*: If you want to restrict credit to your customers, are you in a position to do so? ——If we wanted to restrict credit, if we were being taken advantage of, we would be in a position to do so, and we would do so.

11686. How could you do it?——Only by stopping delivery. We have never had the experience yet.

11687. You would not introduce an interest charge or a penalty of some kind for non-payment before a certain date?——Before the following delivery, for instance? I would not like to suggest that they could not have a bit longer. We do not wish to do this. We would try to accommodate a good customer. We have not made a practice of it; indeed I do not know of any case where we have done it.

11688. *Chairman*: This big change in the balance between your debtors and your creditors involved in extending credit to them must put a big strain upon your own capital resources. You are able to carry this?——It would have been a strain if we had not had the cash, but we have had the money. We have not noticed any difficulty about that.

11689. *Professor Cairncross*: This means that you have two simultaneous pressures on you in a period such as this: in the first place the fact that you are trying to carry out more investment puts pressure on you, and at the same time your customers tend to take advantage of what credit they can get from you, and that puts pressure upon you. Do you find it possible to sustain both of these pressures?——When I say that we carry out more investment, all we can do (and it is not much) is to accelerate as much as we can the investment plans which have already been put in hand. That always takes a bit of time to get going. I should be giving a wrong impression if I led you to believe that we said to ourselves: "Here is a recession; let us turn on the tap and get it out faster", because we cannot do that. It is a matter of whether we have started it or not. We have been perhaps fortunate that we have been able to carry the financial liability of that and the increasing debtors at one and the same time; it has not troubled us. I believe that that is one of the advantages of raising money when we can get it under favourable circumstances. I am a firm believer in raising money when we can get it and keeping it, because we shall always need it sooner or later, and it is a very good thing to have. Money is power; if you have money you can do anything you want to.

11690. But you have to pay interest or dividends on it?——Yes. We had to pay interest on our last amount at 5¼ per cent., not 7 per cent. or 8 per cent. as we might have done if we had had to wait until later on. I do not know what we would get now; we were getting 5 per cent. on Tax Reserve Certificates at one time. But it did not really cost us very much.

11691. *Professor Sayers*. You have speculated successfully?——I do not like the word "speculation"; but we managed to get it quite successfully.

11692. *Chairman*: Why is the small company, as opposed to the big company, more vulnerable to the movement in the rate of interest and the tightness of money? It is not because they are nearer the consuming end, because the distinction does not fall that way; yet I think it is your view that they are more vulnerable?——Yes, definitely. In this country there is an enormous number of small companies. 80 per cent. of industrial companies are very small, employing 100 or 200 people, and their financial resources and their financial arrangements are quite different from those which the larger companies have; and their relations with their bank managers and so on are different. It puts them right on the defensive; they have to conserve their resources. They are afraid to spend; they take a long time to pay. All those things start off as a sort of chain reaction with the small companies, and it creates a mood in the market, a mood in their spending; they go carefully. Then it affects demand; it spreads right the way through the economy. Because there are so many of them, a little bit from everyone makes a big difference in the end. A lot may be psychological. I have not had to argue from the point of view of the small man, so I do not know, but I imagine that when they see the bank manager they may not feel they can get all they want.

11693. Do you find that your own policies about your expenditure on investments are affected by budgetary concessions in the form of initial allowances or investment allowances?——Not at all. We like the investment allowance, because we get an extra 10 per cent. for nothing; but the ordinary deferred depreciation allowance is not so interesting. I do not think it matters very much.

11694. Would the investment allowance lead you to accelerate your programme of investment in the year when it was offered?——No, but it would give us even greater satisfaction.

11695. *Professor Cairncross*: If you had to pay an investment allowance instead of being paid one, that presumably would have a damping effect on you?——Yes, I think it would; but as it is we are the receivers, and it is very satisfactory.

11696. *Sir Oliver Franks*: It is always difficult to distinguish between things which one expects to be the case and things which, by direct experience or immediate hearsay from people one trusts, one has reason to believe to be the case. The description which you gave of the response of small companies to tight money was better than the description given in a great many textbooks, but it was on the lines of the textbooks. It is very important for us to know whether your description is of what you expect to happen or whether it is a description of what you have reason to believe actually does happen. Are you speaking from factual experience, in relation to the experience and behaviour of small firms?——I was speaking from the point of view of the effect it has on our particular company. It is the delaying of or prolongation or cancellation of orders. That is what we live by, and that is what bits us first and troubles us most. It is purely on those grounds that I form my conclusions.

11697. *Professor Cairncross*: You cited by way of example the motor car industry as one which might be affected, because the demand for motor cars had fallen in the period you are talking about. Does the motor car industry represent, indirectly at least, a substantial part of your market?——Yes, in various ways.

11698. And would another part go into other durable consumer goods of various types that would also be sold on hire purchase?——Yes.

11699. In that sense your market is particularly vulnerable to the restrictions on hire purchase which may be imposed from time to time?——That is not true of the group as a whole; consumer goods which lend themselves to hire purchase arrangements are important, but do not account for more than about 15 or 20 per cent. of our business, I should think; motor cars, bicycles, electric cookers and things like that. You are probably thinking that I am grouping the effects of hire purchase and high interest rates together. I think perhaps I am, because they generally come together. I do not think that I am able to separate them, except to the extent that the removal of the hire purchase restrictions which took place recently certainly had a very big effect on the motor car trade and on other trades in which we are interested, such as bicycles and electrical equipment and domestic equipment.

11700. *Sir John Woods*: But other things have happened; the credit squeeze has come off, interest rates are lower, there is more money to spend, the removal of the restrictions on hire purchase, and the lowering of the purchase tax. I do not know whether in all that complex you feel you can isolate the rate and say that is a significant influence?——It is very difficult to segregate the effects and apply them to one particular thing, because they all went on so closely together, and they all came off so closely together; I must confess I may well have been grouping hire purchase and high interest rates together.

11701. *Chairman*: We all find it difficult to isolate them. We were trying to enter into detail with you to see whether, in your contacts with your customers, accepting the fact that your industry had shrunk, they had expressed anything like a common view that this or that was the cause of the shrinkage?——No, I do not think they have.

11702. *Professor Cairncross*: If you take the movement of stocks in your group, are financial factors of any importance, or are your stocks dictated exclusively by technical considerations?——They are dictated almost exclusively, but not entirely, by the level of activity and demand. They are not dictated very much by possible price fluctuations.

11703. *Chairman*: Do you think that attention to the internal control of stocks has markedly developed in recent periods in industry?——During the period of financial stringency and all that follows in its train, I think it has done so very considerably. I think there has been a sustained running down of stocks.

11704. Has not scientific attention to the control of stocks been very much developed in industry in comparatively recent years, with the introduction of cost accounting and all the necessary equipment of a big company?——Yes, it has. Now we are even using computers to give us even quicker information on such matters.

11705. *Professor Cairncross*: Do you think that the financial stringency of the last few years gave a considerable impulse toward the better control of stocks?——I should like to say yes, but I think that until this recession took place we were doing a bit of stock piling in a quiet way all over the place. I do not think there is anything very scientific about it. Again I come back to the small company, which represents such a high proportion of British industry: they use a lot of common sense, but I do not think that they have come to the scientific ways of life yet.

11706. You do not feel that scientific control of stocks was resorted to to a greater extent because of the difficulty in getting money?——I would not think that, no.

11707. *Chairman*: Does the reference to the small companies in this connection mean that, because they do not, as a normal practice, go in for scientific control of stocks, when tightness of money comes they are the people who can look around and take notice, because they have got a margin there which they can look into?——Yes, they would have more opportunity to look into their stocks to make adjustments. I would think they did, and that it would be of much more importance to them that they should than it would be for the bigger companies, whether the big companies used scientific methods of stock control or not. I think that they are forced to do it, where the bigger companies would not bother.

Chairman: I think that covers all the questions we have to put, Sir Ivan. We are very much obliged to you for coming.

(The witness withdrew)

THE RT. HON. THOMAS JOHNSTON, C.H., Chairman, and A. N. FERRIER, ESQ., O.B.E., Chief Accountant, North of Scotland Hydro-Electric Board, called and examined.

11708. *Chairman*: Good afternoon, gentlemen. You have been good enough to supply us with a memorandum* covering the main lines of the questions on which we are wanting your help, which we have all been able to read. I wonder if I could just ask you a question in order to get your background approach about your answer to our first question on the considerations which govern your fixed investment planning. You say that your main responsibility is to exploit to the full the water power resources of the North of Scotland district to produce electricity, and that what governs your main approach is the course of demand for your product over the years ahead of you. Having decided how much electricity is to be provided you then come to the form of generation that is to be chosen, and there a number of alternatives arise, hydro-electric, diesel, steam or nuclear, upon the choice between which the rate of interest taken may have an important bearing. Do they all lie within the range of activity of your own Board?——*Mr. Johnston*: Yes; for our area which covers 74 per cent. of the land area in Scotland, all these obligations are upon us.

11709. So "hydro-electric" in your title is only a general phrase; you are able to make a choice between these various other forms of generation?——Preferably we would go in for hydro-electricity because it is cheaper than steam coal electricity.

* Memoranda of Evidence Part X No. 4.

11710. *Sir John Woods*: You say that the rate of interest is very important in hydro-electric schemes because of the high capital cost. Are not the maintenance costs of hydro-electric generation very much less than any other known form?——Yes. While our capital costs are higher on hydro-electric schemes, for dams and so on, our maintenance costs are very much lower. We have no fuel costs. The ultimate result is that our unit cost, the final result to the consumer, is lower than that of either coal-produced, diesel oil-produced, or as far as we can gather, nuclear power-produced generation.

11711. *Professor Cairncross*: That is at current rates of interest?——At current rates.

11712. But at higher rates of interest the choice might fall in a different direction?——Higher rates might drive us on to coal.

11713. As the least capital-expensive method of producing electricity?——Yes.

11714. Have you not other possibilities of some importance? I should have thought you were interested in the possibility of pumped storage, for instance. Have you any schemes of that kind?——Yes. The next big scheme that we are promoting is at Loch Awe, where in conjunction with the nuclear power station at Hunterston being operated by the South of Scotland Board, we are going to have a pumped storage scheme. Hunterston will pump the water up to a high level dam which we shall build at Loch Awe, and then we will pour that down during peak periods. We reckon that between us we shall have a reduction of one-third in kilowatt cost.

11715. In the economies of building pumped storage will not interest rates again be quite an important factor?——Yes. Part of the cost will be borne by the nuclear power station at Hunterston outwith our orbit. If I may confine myself to the costs of the water power side of it at Loch Awe, there undoubtedly very high interest charges would make our profits less.

11716. Apart from its repercussions on your own operations presumably pumped storage is particularly suitable to be combined with nuclear power?——Undoubtedly; probably the best form of power that we can get.

11717. The cost of nuclear power generation in turn rests very much on rates of interest, so that your operations too are being tied to nuclear power generation that way, and would respond to a reduction in interest rates very much?——Yes.

11718. Do you also in some of the schemes which you are preparing intend to use the South of Scotland as a market or are we to regard the market as almost exclusively the North of Scotland?——Our first obligation, of course, is to supply power and light to the inhabitants of the North of Scotland. But we have also obligations to them which involve our supplying blocks of power to the South Board. We make a profit on what we sell to the South Board and use that profit to distribute to non-economic areas. If we did not do so, there are vast areas in our country which could get no electricity at all.

11719. A scheme like Loch Sloy, for instance, would be geared a good deal to what is happening in the South of Scotland?——Yes.

11720. *Chairman*: How does the bearing of the interest rate actually express itself in your programmes? Is it the rate that you assume in charging yourself with the capital expenditure, or is it the rate at which you expect to be able to get your money for the purpose from those who finance you?——We borrow for thirty years, but our schemes last for very much longer than thirty years. Some parts of our schemes, dams and purchase of land and all the rest of it, we hope will last for ever. Therefore after the first thirty years it is impossible for us to make any calculations whatever about interest rates; but for the first thirty years we take the current interest rate as a basis.

11721. *Professor Cairncross*: Have you ever been in the position where you have felt compelled to reject some of the possible projects because they did not offer a return greater than the rate of interest you would have to pay?——We have large numbers of possible schemes. Naturally we have eliminated, or put well down the list, schemes which are less economic than the others.

11722. But if you take the total size of your programme, is that limited by interest costs or is it limited by more technical considerations as to what you can take in in any one year?——It is limited by both. We have statutory obligations to provide electricity to the North of Scotland as far as practicable (we are not compelled to go to St. Kilda, or incur extraordinary costs of that kind), and we are under obligations to balance our budgets taking one year with another. But subject to that it is our duty to take the most economical schemes we can think of and get them into operation.

11723. That does not give you much guidance as to the total scale of operations. If you have a large number of schemes all of which you expect eventually to yield an adequate return, what determines how many you carry through this year and how many you defer to next year?——The total volume of capital and labour availability and also our contracts with the South of Scotland Board. We enter into negotiations with the South of Scotland Board engineers as to what they expect to take, over a period of years, and provided that we can sell them that quantity as surplus to our estimated demand in the North of Scotland we then go ahead with our scheme. Our estimated demands in the North of Scotland are increasing by nearly 11 per cent. per annum, and the volume of exports to the South of Scotland has risen from 56 million units in 1949 to 466 million units in 1957.

11724. *Mr. Jones*: You say that under the statutes you have to balance your accounts taking one year with another. To what extent are you able to do self-financing?——There are only two ways in which we can go in for self-financing. One is to raise our tariffs. That was ruled out by the Select Committee on Nationalised Industries, and indeed by the Herbert Committee, on the ground of its social difficulties. It is impossible for us to raise tariffs 68 per cent. to raise £6mn., which is what the figure amounts to. The other method is that we should be allowed to use our redemption fund monies to finance capital expenditure instead of, as now, using these redemption fund monies to go into the market and buy up stocks. We have to borrow money from the Treasury now at 5½ per cent., and we are earning 5¼ per cent. on our redemption fund money; so we lose on the deal £5,000 a year by this method; as we have to borrow for thirty years we lose £150,000 on this year's redemption fund contributions alone.

11725. There is a very wide difference between the nationalised hydro-electricity authority and private business, in that you are seeking to render a public service rather than work for commercial gain. As you pursue your capital development plans, at the time you want capital to finance those plans you have to make arrangements for raising the capital through the Treasury on the basis of repayment of capital and interest on a thirty year annuity basis?——That is right.

11726. *Professor Cairncross*: In our third question you were asked how far changes in interest rates affected the volume, the pattern or the timing of your fixed investment programme; you mention that changes in interest rates have had some effect, but that the effect has been to contribute to revenue deficits and apparently in consequence of that to slow down the rate of investment on future distribution capital. Could you enlarge on that?——Undoubtedly a rise in the rate of interest slows down our distribution programme. We can only spend a limited amount on non-economic distribution work to isolated areas, farming areas and so on. If we have to pay more in interest for our money then we can afford less to spend in distribution work. That leads to a vast amount of criticism from people who have wired their houses waiting for electricity, from Members of Parliament who complain that such and such an area has it, so why not their area and so on. Our particular area is largely agricultural, apart from Aberdeen and Dundee, and it is difficult for us to meet complaints when some farming areas have no electricity and others have it. So a rise in the rate of interest does detrimentally affect us in distribution. As for generation, a considerable increase in interest rates might drive us on to coal.

11727. But it has not yet had an effect on the total size of your generating programme?——Not yet.

11728. I ask that because the picture you have given us is that you tend to exhaust the more favourable opportunities of construction one by one. At the same time you are facing a rate of interest which has been rising fairly steadily throughout the post-war period. One

would imagine that the scissors were closing, so to speak; there must be fewer and fewer projects which would clear the higher hurdle of interest rates?——The Loch Awe project will be an exceedingly cheap scheme for us, because of its conjunction with nuclear power. I am not a technologist in this matter, but as I envisage it the cheapest way in which electricity can be produced now is by water power in conjunction with nuclear power. Instead of prices rising against us we envisage that, if we can develop nuclear power plus hydro power, we can reduce prices per kilowatt.

11729. In all this you have made no reference to any decision by the Government communicated to you in the form of a ceiling in your investment programme; you are making it turn on interest rates. I assume that you have been under pressure at times to limit the scale on which you have been constructing?——Yes. The appendix deals with that. The Government have for several years told us that money was scarce, that we would have to cut our programmes or delay them or postpone them; and we do that. But that has not yet affected generation finance. It has only delayed such schemes as the Chliostair and Gisla schemes in the Hebrides where people have had to go without hydro-electricity at all.

11730. *Chairman*: When you say in your answer to our first question that a very high interest rate might divert expenditure to steam from hydro-electric works, could you give me any idea of what range of rates of interest you have in mind where the change might be likely to come?——I have not seen it yet. I would hesitate to put a figure on that, particularly if we can go ahead with more schemes which link water power and nuclear power. We could stand an increase in interest rates, although, as I say, the social effects of that on distribution might be serious.

11731. *Professor Cairncross*: Do you not at present generate electricity in the North of Scotland by steam power and diesel power as well as by hydro-electric power?——Yes.

11732. You have therefore in use currently different techniques, some of which must offer higher returns than the others. Is it possible to see one of these techniques expanding and replacing the others at current rates of interest?——Yes. We are doing our utmost to eliminate diesel production. Production of diesel oil stations is much more costly to us, and as we extend our hydro-electric stations we close down our diesel stations or sell the plant.

11733. If you are under pressure to limit your capital expenditure you can presumably keep these stations going a little longer. Have you had to do so?——Yes, we are doing that now. In some areas in the extreme North of Scotland and in the Islands we are keeping some of these diesel stations going, and we are losing money on them; our preference is always for hydro stations.

11734. If you had been free during the last few years to determine the scale of your capital expenditure without the Government attempting to lay down a ceiling, would the scale of expenditure have been much different from what it was?——I do not know. We had one bad year, with a serious drought which cost us about £1mn. in loss of sales to the South of Scotland, and we had to buy electricity from the South to meet our ordinary obligations, and we had to set going old coal burning stations in Aberdeen, keeping them going full time at considerable cost. But I should not say that without Government inhibitions or prohibitions we would have accelerated greatly our production. Here and there we would have.

11735. It has been marginal in fact?——Yes.

11736. *Chairman*: Is it largely the distribution expenditure that has had to bear the result of the Government cuts?——Largely.

11737. *Sir John Woods*: In the appendix, in reference to 1956, you say that the effect of the Government's restrictions on capital expenditure was reflected in a drop of some £2,600,000 in expenditure on capital account, half of this being in distribution. That would seem to imply that but for the restrictions you would have spent nearly £1½mn. more on generation schemes?——Yes.

11738. *Chairman*: If we turn to the question of stocks and the influence of interest rates or tightness of money I think your answer is that those are not the relevant influences that control the volume of your stocks?——No. We do not burn much coal; we therefore do not stock much coal. We do not burn any more oil than we can help; so therefore we do not stock much. So it is not a very serious matter.

11739. Do you find these Government cuts very difficult to adjust yourself to?——In distribution, yes.

11740. It means a lot of replanning at short notice?——*Mr. Johnston*: Yes. We send canvassers round an area to ask how many people would take electricity if it was brought; then we arrange for that distribution scheme there. Then these people go and wire their homes to have electricity; if there is a serious delay, then the trouble begins. These people have spent money on wiring their houses, and they want to get it. In our 1953 Report it was said that because of the small growth in the hydro-electric power production in that year, the steam power stations at Dundee and Aberdeen had to be run in 1953 at an even higher rate than previously, generating some 363 million units, an increase of 68 million units over 1952. As a result the Board had to buy 243,000 tons of coal costing £881,000, compared with 204,000 tons costing £689,000 in 1952. Nevertheless the production of hydro-electric power was equivalent to a saving of about 617,000 tons of coal in the year, which is about two-thirds of the year's export of coal to foreign countries. That is the saving in actual coal used.—*Mr. Ferrier*: The Aberdeen steam station is a relatively old and inefficient one, and we avoid as far as possible using it at all. It has to be run to a small extent.—*Mr. Johnston*: We keep it as a reserve.

11741. *Sir Reginald Verdon Smith*: Going back to the distribution side, has that reached a point now at which social considerations rather than economic are the only or the main considerations which determine its extension?——I should say that it will take six years yet at the present rate of distribution progress to cover our distribution areas, barring a major war or an extreme increase in the rates of interest or some cataclysmic upheaval like that. That is always excluding extreme cases like St. Kilda. What we have been doing is to take on these extreme outer islands, and offer the people subsidised bottled gas to give them some encouragement to stay in these islands. That is what it amounts to; unless they get some kind of encouragement to stay in these islands they will move. We have come to terms with steamship companies and with the bottled gas people, and the three of us collaborate in trying to keep these people in these remote islands, by guaranteeing them bottled gas at mainland prices. In other words, between us we carry their transport charges, and we think that we are performing a great social duty in doing that.

Chairman: Thank you very much, Mr. Johnston; we are very much obliged to you and Mr. Ferrier for your help.

(Adjourned until Friday, 21st November, 1958, at 10.45 a.m.)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTIETH DAY

Friday, 21st November, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. B. JONES, ESQ., O.B.E. (Questions 11809 to 11907 only)
PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH (Questions 11742 to 11853 only)
SIR JOHN WOODS, G.C.B., M.V.O. (Questions 11742 to 11889 only)

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

DR. M. W. HOLTROP, President, De Nederlandsche Bank N.V., and Chairman of the Board of Directors and President of the Bank for International Settlements, called and examined.

11742. *Chairman*: We are most grateful to you for coming here today, Dr. Holtrop, and for the memorandum* you have very kindly prepared for us. I think it would be easiest if we started at the beginning and worked our way through your answers to the questions. Might we take you up first on your answer to question 1, taking question 3 with it, since they are both dealing with different aspects of the same subject? Under your Bank Act there is a definition of the appointed task of the Bank in Article 9. Do you think that in the work of a central bank it is important that one should attempt to define its tasks or its objectives?——*Dr. Holtrop:* It is very difficult to give a definition; any definition is always somewhat awkward. Yet I feel that the fact that we have a definition is of some help to us, because it clearly recognises the task of the central bank. After all I base part of my thesis on the responsibilities of the Bank on the fact that there is a definition, and if there were none people could just start wondering what the thing is all about. I think that the existence of a definition is more important than what exactly is in that definition, because I believe that it is almost impossible to give a perfect definition.

11743. You are familiar no doubt with the statutes and governing acts of a number of other central banks? Would it be common practice to try to define the task or the object of the central bank?——I have not sufficiently mastered the other Bank Acts to be able to say, but I think that it is rather more the exception than the rule to have this type of definition.

11744. *Sir Oliver Franks*: How far in your view is it a necessary condition of a central bank itself possessing some degree of initiative and responsibility that it should have some definition of its functions within which its action can therefore be spontaneous and responsible?——That is indeed one of the main points. The fact that we have a definition of our tasks makes it possible for the Managing Board of the Bank to say: "By law we have been entrusted with this task"; it is for that reason in a way that we can have a difference of opinion with the government, and certainly have a right of initiative. It is more than initiative, I would say. We have a certain field where we have a recognised right to be on our own and to act; not only to take the initiative in suggesting something, but to do it. On the other hand the initiative of preventing us from doing or steering us to do something would have to come from the other side, and would have to be based on other parts of the Act than the Article in which our task has been circumscribed.

11745. *Lord Harcourt*: Was the Bank Act, 1948, a reorganisation consequent on the war?——Yes; it was the consequence of the taking over of the shares.

11746. Was there a direction as to the functions of the Bank before 1948, or was this attempt to define the task of the Bank inserted for the first time then?——Yes, it was.

11747. *Professor Cairncross*: You mentioned that you had in certain directions the power to act independently. Would that be true in any direction where monetary policy was involved rather than technical supervision of the banking system: in the regulation of the note issue as distinct from the money supply and so on?——Yes. In our practice there has never been any doubt, for example, that discount rate policy and open market policy are the concern of the Bank and that the Bank acts on its own initiative and its own judgment. That we keep in contact about these things also with the Treasury is another matter; that is because in the end Article 26 gives the Minister of Finance the possibility of giving directions. At a certain moment he might have a quite different view about the situation and say that be wanted us to do this or that. Given that situation it is only natural that one should have some contact about the ideas one has and about what one is likely to do. But that does not alter the fact that it is recognised that the Bank has a special field of responsibility and of judgment.

11748. If you were about to alter your Bank Rate you would certainly acquaint the Minister of your intention. Would you need his concurrence?——Technically not. Our practice is that I inform the Treasury that we are going to discuss the possibility of changing the Bank Rate at our next meeting, and whether they have any ideas about it. That would be the formal position. In practice we may have been discussing it for a long time, but always on the basis that this is a responsibility of the Bank. Our practice is such that it has never been doubted that this is the field of banking. This is a natural outcome of history. The Bank Rate was nothing else but the rate at which the old limited liability company with a charter was willing to give loans to other people; it was no concern of the government at all. Now, having become somewhat more sophisticated, we may agree that Bank Rate goes farther than a private contract and is important for general policy, but I would say the tradition has been built up on that historical basis.

11749. Since the nationalisation of the Bank you do not find that the Minister of Finance may be subject to attack in your Parliament because Bank Rate has been moved in a direction that some Members might not wish to see? He does not have to answer for you?——He does not have to answer for me; he would no doubt answer that this was a matter for the Bank and that he had no reason to disagree.

11750. *Sir John Woods*: Does it follow from what you said that movement of the Bank Rate is not one of the matters to be co-ordinated between the government and the Bank where, as you say in your memorandum, the

*Memoranda of Evidence Part V No. 4.

Minister of Finance, having heard the Bank Council, can issue directions to the Governing Board?——There is not the slightest doubt that Bank Rate falls into that category.

11751. In other words, formally he could give you the direction?——Definitely; but he would have to make use of that power of giving direction.

11752. *Chairman*: Has the power in the Bank, with the approval of the Minister of Finance, to give directions to the credit institutions, or the power of the Minister after hearing the Bank Council to give directions to the Bank, ever been exercised?——Never.*

11753. What is the part played by the Bank Council in practice, not just on paper, in the relations between the Bank on the one hand and the Minister of Finance on the other?——It is difficult to give an answer to this question otherwise than on the relationship on paper, because that is how it has really worked. In those cases where it is necessary for the Minister of Finance to ask the opinion of the Bank Council he has done so, and there have been other cases, where it was not explicitly necessary, where he has also asked the Bank Council's advice on monetary matters.

11754. How often in a year would there be a request for advice from the Minister, and on what specific things?——In practice he has only asked for advice on new legislation. The matter of a directive has never come up, so he has never asked the Bank Council's opinion for that reason. We have had some minor changes in legislation; also provision about the cover for the bank note issue was legislated. But it does not happen once a year; it is very occasional, only when there is some special reason.

11755. The other functions of the Bank Council cover reports by you to them from time to time?——Yes. The Bank Council meets at least six times a year, and I make a report about the situation and about the Bank's policies and there is a general discussion.

11756. *Sir Oliver Franks*: When you make your report to the Council, no doubt that will contain reflections on the broad trends of the economy and, in the light of that, on what the practice and decisions of the Bank has been. Does a lively discussion then sometimes occur, with people contributing views which are argued around the table, or are the proceedings of the Council always more formal, so that if anyone had anything to say it would be rather brief and not much developed; the sort of thing which would happen in a meeting which met because the statute required it, rather than a meeting where people were really trying to get to the bottom of views on a controversial subject?——This type of discussion sometimes takes place, but not regularly. There are members in the Council who are very well versed in this subject and who will come with observations on policy which give rise to discussion. But I must say that we have not so far had any lively differences of opinion in the Bank Council. I would not say that everybody always agreed; that is natural in a body like this, because it is a body drawn on a very wide political basis, apart from anything else. But we have never had in the Bank Council so far any strong criticism of the Bank's policy, nor consequentially a very lively discussion of that difference. It is more on the lines of general observations and discussion on the general state of the economy.

11757. *Chairman*: How is the Bank Council made up?——It is presided over by the Royal Commissioner. The last Royal Commissioner, Professor de Vries, recently died. He was at the same time the Chairman of the Social Economic Council, but there is no necessary relationship between these two. The body is further constituted of sixteen other members, four of which are appointed by and from the Board of Commissaries; four are representatives from the employers' side of trade and industry, two represent agriculture, three the trade unions and three others respectively banking, the stock exchange and economic science. It was tried to create a body which would represent more or less the community, not only on an economic basis but also on the basis of ideas; for example our Economic Society, the equivalent of your Royal Economic Society, has the right to make a nomination for the Bank Council, so that economic science would be represented. The Stock Exchange also make a nomination. A number of members of the Bank Council are also on the Social Economic Council. It is more or less the same type of people as the Social Economic Council.

11758. These various bodies are given a statutory right to appoint their members?——Yes; The various bodies, mentioned in the Act, have the statutory right to make a nomination.

11759. And you add to them on the Bank Council four permanent heads of government departments?——Yes; they are not members though, but have the right to attend meetings and have an advisory vote.

11760. They are advisory to advisers?——Yes indeed.

11761. *Lord Harcourt*: When you talk about the Governing Board, you mean yourself and four other executive directors?——Yes; myself, the Secretary, and three to five managing directors. The total body is five to seven. At the present moment we have by chance a body of six, and we are going to a body of five.

11762. *Professor Cairncross*: Are any of the members of the Board drawn from the banking community *ex officio*?——Not *ex officio*. One of my colleagues was a managing director of one of the commercial banks before, so it is certainly not excluded; but it is not necessary.

11763. *Chairman*: I know you draw your executive directors primarily from the staff of the Bank; but do you think it valuable that they should add to their experience in the Bank some outside experience?——I personally do.

11764. *Sir Oliver Franks*: You would not regard the fact that a man had been a professor in such a subject as economics as debarring him from a directorship in the Bank?——Certainly not; though it has never occurred. It has generally been the other way round. My colleague, Professor Posthuma, for example, is a professor at the Rotterdam School of Economics; but he became one when he was a banker, though before he entered the Nederlandsche Bank. My colleague de Jong was a Professor at the same institution. He was appointed a Professor when he had already a high position in the Bank.

11765. So members in high positions in the Bank, whether actually directors on the Board or their deputies, may simultaneously be carrying out professorial duties at schools or universities and therefore lecturing on the broad subjects about which they are currently taking decisions, and no doubt conducting discussions at seminars on the broad subjects they are concerned with from day to day?——Yes.

11766. Would you consider this as a valuable element of cross-fertilisation?——We feel that. That is why we have made it possible for them to take the time; it may mean a full day a week when they are not available for the work of the Bank. They have always been Extraordinary Professors; that means that they are less taken up by their duties as Professors. We have always found the cross-fertilisation very useful; on the one hand it is useful to have one or two of the directors occupying themselves with the literature on the subject, and well versed in the theoretical approach to monetary problems; and on the other hand the contact with science is very important because it enables us to influence the thinking of others.

11767. Would it be fair to assume that in your view the contribution of reflective scientific thinking and investigation of economic matters, in addition to the contribution which the experience, habit and flair which come only from practice in making right decisions, is of significant importance in running a central bank well? Do you want a marriage, so to speak, between reflective analysis and scientific investigation on the one hand and practical experience and flair and knowledge on the other hand? Or is that taking it too far?——No, it is not taking it too far, in so far as we like to have at least one member of our Board well versed in the theoretical approach to the problems and the literature. Contact with the scientific field is also important. I could not say whether a pure theoretician would be good on the board. Questions of that sort are unanswerable in general; they are only answerable in particular when one thinks of certain persons.

11768. *Chairman*: May I just ask you how far you would go on this? In order that a man should be an effective executive director of the Bank, you would expect him to spend the great bulk of his time in service to the Bank?——Yes.

* See Appendix to Minutes of Evidence.

11769. But that is not inconsistent in your view with some kind of outside responsibility, such as a professorship, which allows a day a week in the outside world?——No.

11770. Could you apply that to somebody who had a different kind of outside capacity, if he were in business or a credit institution? Would that be compatible?——No, it would not. We only have full-time directors in the Bank. We had part-time directors under the old Bank Act, but that was discontinued as early as 1919.

11771. Would that have been discontinued as a matter of policy because it was thought undesirable, or because it made it difficult for the man?——In the nineteenth century the work of the central bank was quite different; but I would say that it was contrary to Dutch company law. With us managing directors are always full-time; the board of directors, which is the policy making body in British company law, in our company law is more a controlling and supervising than a policy making body. This of course merges up to a point; very important decisions will always be discussed with, and may have to be approved by, the Board of Commissioners. But generally we do not have this position of being a full and responsible director, and yet only spending part-time work on the responsibilities of the company.

11772. With the work of the central bank and its necessity for contacts with the credit system as a whole, do you find it a disadvantage that your managing directors are virtually full-time employed?——No, we do not; but perhaps for that reason we very much appreciate having colleagues who have been private bankers, or who have had a long experience in the private side of business.

11773. When they come in from outside activity to the Bank, what tenure do you offer them?——Formerly the President and Secretary were appointed for seven years and the other directors for five years, but a few years ago that was changed and now we are all appointed for seven years.

11774. Would there be a reasonable expectation of renewal after seven years?——It almost never happens that an appointment is not renewed. The normal thing is to continue.

11775. A man's expectation would be, when he came in, that he was giving up his other career for the future?——Yes.

11776. *Professor Sayers*: Do you have recruits into the Bank from the Ministry of Finance, and do the Bank men move into the Ministry of Finance? Is there cross-fertilisation in that direction?——Some Bank men did move into the Ministry of Finance; the present Treasurer-General, for example, was with the Bank. It is rare for Ministry of Finance men to move into the Bank.

11777. It happens, but is not specifically cultivated?——No, it is not specifically cultivated. There is no regular exchange.

11778. *Sir Oliver Franks*: Before we get too far away from the subject illustrated by the position of Professor Posthuma, would it be possible for a director in his position to be conducting a seminar on current economic problems in Holland, discussing the relative importance of present inflationary or deflationary trends, saying nothing about the immediate decisions of the Bank of which he is an executive director but nonetheless willing to share his analyses of the contemporary structure of the economy with students? Would that sort of thing happen, or would it not?——That could very well happen.

11779. *Professor Sayers*: I was impressed, in your description of the Bank Council, by the apparent absence of great and prolonged differences of opinion. It was not a picture of a body in which there was constant bickering and argument of an intense character where different points of view were being put forward and they were constantly at loggerheads with each other?——That is right. That may be due to the fact that so far monetary policy has not been a political issue in our country.

11780. You also said that it would not be considered necessary for the Minister of Finance to answer in Parliament for a change in Bank Rate; but you took the view that Bank Rate was a subject on which the Minister of Finance might issue a direction to the Bank, so that it would seem perfectly reasonable for Members of Parliament to question the Minister of Finance as to why he did not issue a direction to the Bank. Is the absence of any incident of this kind again evidence of a lack of disagreement about monetary policy, or it is due to some deeper constitutional reason?——I would say that it was fundamentally the lack of disagreement, though it may also be the consequence of an ingrained feeling that this is, after all, the Bank's business. You might say that, if a Member of Parliament should violently disagree, he might ask the Minister of Finance why he has not given any directions to the Bank to stop their silly policies, if that was his opinion; but, as I say, that has never happened; the question has never come up.

11781. In the Bank Council is there any general view that this is all the business of the central bank, and that therefore if things seem to go reasonably well there is no cause for great discussion? Or is the Bank Council uninhibited in its attitude towards the Governing Board of the Bank?——I find it difficult to answer about the opinions of the members of the Bank Council. They no doubt in many respects hold different opinions, but, as I say, there has been no case of very strong differences on actual policy problems.

11782. *Chairman*: Do you think that from the point of view of your carrying out your functions as a central bank the existence of the Bank Council with its wide representation of different social points is important to you?——Yes, it is important to us, both because it brings us somewhat nearer, not purely politically but generally, to other spheres of interest and thinking than our own, and because it has the great advantage that we can convey monetary thinking to those spheres. I look upon my own membership of the Social Economic Council in the same way. It gives me the opportunity to know the way of thinking in very important parts of the community and it gives me the opportunity to explain and to defend monetary policies; so both ways it is important.

11783. *Professor Sayers*: Would you say that this machinery, because it works like this in the two directions, is an important factor in an explanation of why there has been comparatively little difference of opinion?——I would not dare to be so bold. Perhaps I underestimate my own influence or the influence of the Bank Council in this interchange, but I certainly could not be sure that it has worked that way.

11784. The scene you have just described is a scene very unlike anything one can conceive at this moment, or at any time in the last twenty-five years, in this country. Very strong differences of opinion going quite deeply would be apparent in any such body appointed in this country. We have very different ideas on all hands about the monetary policy of the Government. But we have not known machinery such as you describe. Do you think that the comparative quietness with which the Dutch machine works is the result or cause of the difference in the state of opinion?——Probably more the result than the cause. Our political set-up is completely different from the one in your country.

11785. I was thinking of differences within parties, and differences between people with no strong political views. This not a matter of politics in this country.——I had the impression it was. In my country, since the war we have had very wide coalitions, so that practically every party was represented in the government. Since the war we have only had Labour Ministers of Finance in these coalitions; so the man who was, next to the Bank, responsible for monetary policy and has had the power of giving directions, has been a man from the Leftist parties. I have always wondered whether this has not helped to prevent the discussion about monetary policy from going, as it sometimes does elsewhere, in the direction of violent difference between liberal and leftist monetary thinking which sometimes occurs. Anyway it is a fact that in our country differences of opinion in this subject do not go very deep and occur within the parties. These parties being all in the same government and taking part in the responsibility for government it is less likely that a technical issue like monetary policy becomes a strong political issue than in a two-party system, where I would expect a subject like this more easily to be brought into politics.

11786. *Professor Cairncross*: You mention in paragraph 9 that co-operation between the Bank and the government has always been possible by consultation and mutual

agreement. Has this always been so? How are differences resolved? You are through monetary policy exerting pressure on the level of demand, and the Minister of Finance through fiscal policy is also exerting pressure on the level of demand. Would it not be unthinkable that these pressures should be exercised in different directions?——It is definitely not unthinkable; but so far we have come out well. This striving for monetary equilibrium has also been so far a programme of the government; the government has always denied any willingness to follow inflationary policies. We had inflationary policies at the very beginning after the liberation, but that was based on very special circumstances also. They did not touch the field of central banking, so it did not lead to controversy. It was completely in the field of the Ministry of Finance. The inflationary financing which took place in the years after the liberation, say up to 1949, was the consequence of the monetary reform; the monetary reform of 1946 brought an enormous amount of money into the hands of the Treasury, which they have gradually spent. That was completely out of the control of the central bank. Monetary policy is of course not only central bank policy but also government policy. In so far as a government can inflate without making use of the central bank it is the government's responsibility; since the central bank cannot give directives to the Minister of Finance, there is no reason for clash. There may be a reason for differences of opinion, but not a clash. One thinks of the possibilities of a clash when inflationary financing takes place in the private sector where the Bank is supposed to have control, or when the government has to make use of the central bank in order to indulge in inflationary financing. But happily the government has never had the intention of doing so.

11787. What machinery exists through which you can convey to the government any anxieties you feel about their financing policy?——We have a lively correspondence, if there is anything important in this field. Apart from being in touch continually, the Bank may also take the initiative to open certain subjects and give its advice or opinion.

11788. *Chairman*: Could we list the possibilities? There is correspondence, you say, which is fairly constant, and lively?——Occasionally.

11789. Then the President of the Bank attends meetings of the Economic Council of the Cabinet. Would that be an avenue by which you could make your views known?——Yes. It has of late tapered off somewhat, because the meetings have not been as frequent as they were in the previous period. For the rest, contact is with the Ministry of Finance itself. There it is up to the Bank to give its advice and to warn the Minister of Finance when the Bank fears that certain government policies might lead to monetary disequilibrium. The Budget might be the subject of discussion. We have no knowledge beforehand, but we can have our opinions about the possibilities. We have exchanges about the capital market, about how much can be borrowed, what is likely to happen, how income is likely to change. All these are the kinds of subjects in which an exchange of opinion can take place. A lively subject in Holland has been, for example, municipal finance. Municipal finance went wrong in 1956 and 1957. That was a great preoccupation for the Bank and also for the Minister of Finance. We could not completely control that. That is a subject where we had many exchanges and which gave rise to correspondence to clarify and put on record exchanges of opinion that had taken place.

11790. *Chairman*: Apart from that, the President of the Bank has his annual report, in which he is able to address the public and is not prevented from making any comments about the course of government action bearing on the monetary field, that he thinks right?——Yes.

11791. *Professor Sayers*: It would seem to follow from your appointed task as defined in the Bank Act that you must make such comments in your report if you feel them?—*Professor Cairncross*: Even though they may be very critical of the government?——Our first line of contact of course is with the Minister of Finance himself, but certainly I would conclude from the Bank Act that it is our responsibility to warn the government if we see that certain government policies or municipal policies contain an inflationary threat.

11792. *Chairman*: Would it be within the field of your reports to the Bank Council to draw attention to what you thought?——Yes, and we always have.

11793. *Sir Reginald Verdon Smith*: Do your reports to the Bank Council receive any publicity outside?——None whatever. We give the Bank Council a lot of information that is not published. We make them a full report and give them financial statistics, and generally represent the financial approach to the whole problem, but none of that is published.

11794. *Chairman*: Would it be outside the proper field of a member of the Bank Council for him to convey in outside conversations to his own contacts the effect of what you had been saying?——Yes.

11795. *Sir John Woods*: Do you tell the Bank Council anything of your future intentions?——I would very much hesitate to do that except in general terms. I could not tell the Bank Council what we are going to do next week. On the other hand I might in a general way discuss a situation which may indicate that we might at some future date consider this or that, but it would be in sufficiently general terms not to give too explicit an indication of our plans.

11796. *Chairman*: Information that you give to the members of the Bank Council they must treat as confidential; but would they be precluded from representing the Bank's point of view in criticisms in their outside contacts?——No, it is left to them. The only thing that is explicitly mentioned in the law is that the chairman may impose upon the members the obligation of keeping secret anything they have learned by reason of their function. The general opinions they get they can certainly make use of.

11797. *Lord Harcourt*: Apart from your attendance at the Economic Committee of the Cabinet, do you have any formal meetings with the Minister of Finance?——Our meetings have gradually grown into informal meetings which are fairly regular. We might have formal meetings; that happens when the Minister wants the formal advice of the Bank on a certain subject, or if the Bank asks to partake in certain discussions. I have been involved at periods in a lot of discussions in the Ministry of Finance, but there have been other periods when I have hardly set foot in the Ministry because the Minister and I have had lunch together outside.

11798. *Professor Cairncross*: How far do contacts take place at a lower level? Is there contact between members of your staff and members of the Minister of Finance's staff?——On explicit subjects. Take, for example, the subject of open market policy. Especially since the conclusion of the agreement of June, 1952, there has been a constant exchange of opinion about open market policy, and there is a close contact between the people handling this policy, including the agent of the Ministry of Finance in Amsterdam who is charged with the technical execution of the government tenders.

11799. Would there also be some interchange in assessment of economic trends?——Occasionally, when opinions have to be prepared for outside bodies, and also when important decisions have to be taken internally; before the Budget, and before the Planning Bureau makes or publishes its plan for the next year. These plans are sent to the departments, who make comments, and there will be consultations about the finished state of that report between the Ministry of Finance and our people.

11800. Not always at your level?——Not necessarily. The same is true, for example, with the many international organisations we have nowadays, in which a member of our delegation may come from the Ministry of Finance, or in which we ourselves may be represented on the committees. Then we consult with one another about the data.

11801. *Sir John Woods*: Would you be consulted before the Budget? You would naturally talk about the state of the market and so on; would you be consulted as to whether there should be relief of taxation or tighter taxation?——I would not consider that formally to belong to the Bank's responsibilities, though they might informally discuss these problems with me. By chance I happen to

be on an advisory committee to the Minister of Finance on taxation questions, so that the fact that things have been discussed there may, when we meet, very easily lead to a discussion on the subject. But as President of the central bank I would not expect the Minister of Finance formally to consult me about taxation.

11802. *Professor Sayers*: Would you not consider it covered by Article 9?——No.

11803. But somebody else might take the view that it was covered?——Somebody might.

11804. In talking of relations with the Ministry of Finance you have assumed that the Bank is confining its activities to what has been conventionally the field of the central bank, plus an interest in what is going on in the long term capital market. A central bank Governor with this appointed task might take the view that he ought to be doing many other things that are not within the conventional boundaries; if he did, would there not be room for very substantial disagreement?——That is a hypothetical question; the matter has not occurred. It is outside my experience. My approach to the problem is that taxation is not very much the concern of monetary policy. Taxation is one of the very proper ways of paying for the expenditure of the State, and it is up to Parliament whether they want to spend a lot and tax a lot, or spend less and tax less. It has fundamentally nothing to do with monetary policy.

11805. *Professor Cairncross*: But you agree, I think, that monetary policy is important because it affects the level of demand. A change in the size of the Budget surplus clearly has a very direct influence on the level of demand; might it not in practice be very difficult to separate the impact of the change in the Budget surplus from a change in interest rates?——My approach to the problem is that taxation is simply a matter of a shift of demand. When the government pays for its expenditure by taxation it takes away demand from the people who are taxed and adds to its own expenditure; from the monetary point of view this is a completely neutral procedure. Disequilibrium and monetary problems arise when the government cannot pay for its expenditure by taxation of demand and from real savings, and starts what I call inflationary financing. There the central bank starts to play a role.

11806. I gathered from what you said earlier that this is not theoretical or speculative, but that there had been an experience of a large floating debt to which the government might at any moment make additions without first consulting you. If that did happen it would, from your point of view, be inflationary; it would add to the monetary flow. Would you not be consulted?——I would certainly discuss this.

11807. Would you feel free to be highly critical in your annual report of any government policy that did add to the floating debt at a time when you thought nothing like that should be done?——Yes.

11808. Without embarrassment?——Yes. I would no doubt give my opinions to the Minister of Finance first, but in the end it would crop up in the annual report. I would not agree if I thought that it was a dangerous policy.

11809. May I take the opposite case? It might happen that you were reluctant to exert pressure on the money supply, and upward pressure on interest rates, because you felt that there would have to be a very large movement before that change in monetary policy took effect, but you might at the same time feel that if the government were to repay debt, particularly floating debt, through appropriate budgetary policy, that would be a much more effective method of handling things. If you were unable to persuade the Minister of Finance that this was the appropriate line of action, would you again feel free to say so in your annual report?——I have always felt free—and I am basing myself on a long tradition of Governors before the nationalisation—to say anything in the annual report which in the monetary field I think necessary; so I would not hesitate in the annual report of the bank to show a disagreement with the government's policy in that monetary field.

11810. Why do you draw a line of distinction between the monetary field in this sense and any other action calculated to affect the level of demand?——What is the difficulty? In any Government policy that might actually or potentially lead to disequilibrium in the monetary field, I would consider it to be part of my responsibility to give my opinion about it.

11811. But not to act upon it?——It is conceivable but not likely that I should want to act upon it, if there were a government policy that could be executed without the help of the Bank.

11812. Restrictions on hire purchase may affect the level of demand in a very direct way. Do you regard these as coming clearly within the field of monetary policy?——No, I do not. I would only consider, and have only considered, the field of hire purchase to come within the field of monetary policy insofar as hire purchase was being financed by the banking system. Insofar as hire purchase has been financed by the capital market I consider it to be outside the field of monetary policy; then it is just a choice of spending somebody else's savings on consumption goods or on investment goods.

11813. You are taking the view that the banks alone have the power to create credit?——That is correct. Insofar as it has come into the banks' field of financing we have acted. On the other hand it is the Ministry of Economic Affairs and not the Ministry of Finance which has taken the initiative in hire purchase regulations which restricted the terms of hire purchase, apart from the question of how hire purchase was being financed. Insofar as hire purchase is being financed by the capital market, and insofar as hire purchase finance companies get their money out of the capital market, my attitude would be that this is not so much the business of the central bank or of the Minister of Finance as of the Minister of Economic Affairs, because he might take a very strong attitude about the lack of supply in the capital market, and about the large amount of consumption financed out of savings. We might be interested, and we might say that in the future this might also lead to great pressures for inflationary financing, but so far we have said that this is not our business. As soon as hire purchase is being financed by the creation of liquidity, then I think it comes into the purely monetary field and we take, and have taken, an attitude to it. This is comparable with what I say about taxation. Insofar as the government finances itself by taxation, for all practical purposes I would say that this is outside the field of monetary disturbance. It is only when the government starts to finance itself by the creation of money or the creation of liquidities or short-term financing, that it comes into the monetary field.

11814. Would you disinterest yourself in the insurance companies' operations, pension funds and other agencies in the capital market, and almost all financial intermediaries other than banks, because you would not regard them as creating credit?——We have. This field is not completely outside our interest from the statistical point of view, but we would consider it outside the field of our policy.

11815. *Professor Sayers*: Then your definition of the field in which you have an appointed task under Article 9, turns on your definition of a bank?——Of a credit institution. This is a very deep subject. I would like to clarify it in this way. The definition of Article 9 gives me the right to bother about anything which I might think could in the end disturb monetary equilibrium, or could endanger the task which has been given to the Bank. Major disturbances on the capital market will no doubt add to monetary pressures at a certain moment, so that one can from that point of view say that the Bank is not disinterested in the capital market. If the capital market goes completely haywire I know that monetary pressures will occur. On the other hand we feel that it is necessary to set a proper limit to the field of activity of the central bank, and to its direct responsibilities. You might say that anything that might lead to monetary pressures would be in the province of the central bank. I might be concerned with the amount of military expenditure, or of any spending by the government, because I might say that, if they are going to spend that much money on that subject, in the end monetary pressures will come. I have tried not to follow that kind of reasoning, because that would lead the central bank into every policy issue. I admit that my line of division is somewhat technical, but I think that this is a proper definition of the position of the Netherlands Bank. The Bank should have the widest possible

public confidence, whatever people's private interests and whatever their political opinions are. I therefore want to draw the line at the financing, and not at the decision to spend; I do not want to concern myself about whether the government wants to spend or not on military things or on social policies. If it is properly financed, all right; if it is improperly financed, then it comes into the province of the central bank.

11816. On that basis why do you bother about Bank Rate?——Because I do believe that Bank Rate is one of the important factors in the decisions and the policies of the banking system.

11817. Does it affect the volume of bank deposits? Is it not rather directed towards its influence on spending?——We work on the hypothesis that changes in the Bank Rate will affect both the demand for bank loans and the willingness of the banks to give loans. That depends on what the decision of the banks on their lending rate is. We see the Bank Rate as one of the important factors in the increase or decrease in the volume of bank loans. I am not so much interested in bank deposits; I am interested in bank loans.

11818. Is not the same equally true of other financial intermediaries besides the banks?——I do not think so, because I know that those are capital market institutions, and the capital market institutions are institutions that transfer actual savings from one party to another. In so far as I have to deal with the capital market institutions, like the big institutional savers, I know that they redistribute the saved income of other people, and there is no initial reason to believe that there will be a monetary disturbance.

11819. But are not the banks doing the same thing, receiving people's savings and transforming them into loans?——This brings us to the question of the character of the deposits with the banks; but at any rate I think we both believe that the banks have the possibility of creating their own deposits.

11820. I also have the belief that financial intermediaries have the possibility of adding to liquidity.——I do not know of what intermediaries you are thinking. They may add to their own liquidity.

11821. Do they not add to the liquidity of business?——That is a question of tradition and of the situation of the market. I would say that the debts of the other financial institutions in our country cannot be considered by anybody to be liquidity in his own hands.

11822. I am trying to find out why you bother about what the banks are doing, and yet do not bother about what the financial intermediaries are doing in the same way; and why in explaining why you bother about Bank Rate you explain it by reference to its effect on the banks and nobody else. Are you really not concerned with its effect on the capital market generally?——I think that that effect is very indirect, and not the essential effect. I find it difficult to follow exactly what you mean without an example of the intermediaries you are thinking of. In Holland we have a sharp distinction between registered credit institutions, which are subject to the control of the central bank, and others. I know that you have financial institutions which can take deposits and are not considered banks. We think that that is a potentially dangerous situation, because it leaves people who create liquidity outside the control of the central bank. In my opinion these institutions are to be considered banks. According to the Netherlands law everybody who in the course of his ordinary business takes deposits and at the same time grants credits is a bank. The savings banks too are credit institutions, but I do not consider them money-creating institutions. I am safe in considering deposits with the savings banks as having no virulent liquidity. This is a matter of actual conditions, of course. On the other hand, the banking system in Holland has very little savings deposits. In practice deposits with the banking system in Holland are corporate and business deposits, and are therefore liquid.

11823. *Professor Cairncross*: You laid a lot of stress in your answer just now on bank loans. That made me wonder how you thought monetary policy took effect. Bank loans are clearly short-term credit, rather than for long-term investment, though they are used for that purpose. Do you think of monetary policy as taking effect chiefly in the short market, affecting credit and, through the effect on credit, real operations in the economy, or do you think of it chiefly in its effect on long-term fixed capital investment?——I think that the central bank's part of monetary policy has its main object in influencing the volume of active business done by the banking system. Indirectly, it may have a further influence, but only through the influence we can exert on the banking system.

11824. Do you find in the Netherlands an indication of the immediate influence of changes in the rediscount rate on the volume of bank lending?——This is always a very difficult question to answer. The data are never clear enough to prove the case. There have been increases in the rediscount rate, especially at the end of 1955 and in 1956, where we have complained in our annual reports about the lack of reaction, but the fact that the rediscount rate was not very effective can be explained by the fact that the banks were not in a position to depend upon the Bank. I do not believe that in a full boom a moderate increase in the Bank Rate is going to influence the demand for short-term loans or bank loans. On the other hand, if by the circumstances of the market the banks get into a tighter situation in which they have to fall back on the central bank, then the Bank Rate is much more effective in influencing the banks in their policies. I am generally inclined to believe that the influence is likely to be more on the policy of the banks in making the loans than on the policy of the public in trade and industry in demanding the loans. This leads to the whole subject of motivation of trade and industry, insofar as stocks are being financed by short term loans. There an increase in the Bank Rate is much more important, and the effect of an increase in the Bank Rate, as a threat of the possible non-availability of credit, may very much affect trade and industry in its inventory policies.

11825. Do you think that that threat is a real one nowadays? Your own country has policies very similar to ours about full employment. Do you find that business men are scared about the difficulty of financing their stocks when the Bank Rate goes up?——I would put it more this way: that, in a certain phase of the boom, when the Bank Rate goes up and financing difficulties increase it is brought home to them that all the money which they want will not be there, and that will influence their policies.

11826. In that sense, you are laying stress on the availability of finance, rather than on the cost of it?——That is so.

11827. In the same way, I think, the indications in your paper are that you have come to lay more stress on methods of acting directly on the liquidity of the banking system than on using the rediscount rate. You do not use it so invariably now?——Yes. I am inclined to think that the rate by itself is an insufficient deterrent; but the increase of the rate is and should be a warning sign of a lack of availability, and that lack of availability is the important point in business decisions.

11828. *Professor Sayers*: Why should it be a warning? If your stress is on the availability of bank loans, could you not get the whole of the effect you want most directly by altering the power of the banks to lend, by altering their cash reserves, for instance, and by putting up the reserve ratio? What is the point of changing the rate if you believe that the important thing is the readiness with which the banks will lend?——The increase of the rate has many other functions at the same time. It also has its functions in our relationship with foreign countries, or in the short-term movements of capital abroad. Theoretically, in a market economy, even though I do not believe that the price is the only decisive factor, I am still of the opinion that the price should work in the direction of the market to convey the situation properly to the public. You might conceive a kind of rationing arrangement, I suppose. Just as you might say: "Why increase rents when houses are scarce? Let us freeze the rents and ration the houses", so you might say with credit: "Why increase the price? Let us freeze the price and ration the credit." But then you would put yourself to an awful strain; the thing would be unmanageable. The method of rationing the credit is to increase the price as well, and let the market decide on the price, if there is not sufficient reaction by itself.

11829. You are assuming that the price works?——To a certain extent I am assuming that the price works.

11830. Where does it work? Does it work on demand?——When I say that the price works, I mean on demand. To a certain extent it works on demand. The whole policy will also influence the supply, because the banks will be more reluctant to give credit.

11831. It is the business man's demand for credit that you are thinking of. Have you any evidence that the business man is less willing to borrow when the price goes up?——In the sense of evidence, not other than the evidence given by the experience of the bankers themselves.

11832. Is that experience still the same as it always was?——The bankers will tell you that in a period of increasing rates their customers will think twice over their demands. I cannot say that those customers, in those circumstances, are influenced by the pure fact of the price or by the knowledge that this increase in rates presages a turn of the tide. It would all be individual decisions. I definitely believe that there will be some influence on demand, but I would not rely on the influence on demand only; I would also rely on pressure from the banks to get their loans down.

11833. Can you not get them down in other more direct ways?——It is very difficult to get it if the market does not move in the right direction. If the bankers are always lending money at 5 per cent., and want to get loans down, it is very difficult to get that over to their customers.

11834. I notice that you confine your argument entirely to what happens in the short market?——I should say the same thing in the long term market. The textbooks tell you that there is a supply and demand in the long term market. The demand is from the entrepreneurs who want to invest, and the supply is from the savers. The textbook argument is that there are some entrepreneurs who say: "I am not going to do this if the money costs me more than 4½ per cent.", and others say: "I will do it when the rate is 5 or 6 per cent." I think that entrepreneurs are led much more by direct expectation of profit on the one hand, and by the possibilities of finance on the other, than by whether under present conditions they will get the money at 5 or 5½ per cent. A business man of good standing borrows at the market rate; when the market gets extremely thin, because there is not very much supply, there is a tendency for the market rate to increase. Then demand gets frightened, and people think over their plans again and drop off.

11835. So that whether you are looking at the short-term or the long-term market, your answer as to why interest rates affect the situation is that a rise in interest rates is interpreted as a threat that money will not be available later on?——As an indication that money is scarce and is going to be scarcer. I was in industry for a long time, and I do not remember that we were ever bothered in our plans about whether the rate of interest was 3½ or 4 per cent. We were bothered by the question of whether we could get the money. The rate of interest is a very important indication of whether one is going to get the money. When the rate of interest tends to go down, everybody thinks he can get the money; then, when the rate of interest goes up, everybody rightly concludes that maybe he is not going to be able to get the money. That is the way the market influences the position of the entrepreneurs. If everything was rigid, there could never be equilibrium; and yet we succeed in getting equilibrium, even if with fluctuations.

11836. *Mr. Jones*: Are you not arguing in favour of credit restriction and control, rather than in favour of an increased Bank Rate?——No, I am not. Control and restriction involve the element of judgment by the central authority; the reaction to market movements presumes a decision by the individual and the market. I do not believe that it is possible for a central authority to make all these judgments centrally, and to say that one man should do this, another man should do that, and someone else should not be allowed to do this or that. One needs the market fluctuations to get these decisions taken by the people concerned.

11837. As I see it, it is a question of the limitation of credit in certain circumstances?——It is more than that. In the sense of short-term credit it mainly is, but in long-term credit it is market forces aiding in the control of capital movements.

11838. To the extent that credit is available only at a high rate of interest, how does taxation enter into it, in view of the fact that the increased burden of the rate would be allowed for tax purposes at a cost of running the undertaking?——In so far as we are assuming that the rate by itself has an influence on demand, there is no doubt that taxation weakens that influence, because the incidence on the company is smaller because of the taxation, as interest is a deductible expense. In so far as we recognise that the movement of the rate by itself indicates a scarcity or an abundance of funds, and thereby influences entrepreneurial decisions, taxation to my mind does not enter into the picture. That is then a given situation that has no influence on this decision.

11839. To the extent that there is relief from taxation in consequence of that additional burden, has not that a tendency to undermine the limitation of credit which the first movement of the rate was intended to secure?——It is not impossible that high rates of taxation will tend to widen the fluctuations of the rate of interest, because more fluctuation will be necessary to influence decisions. The high rate of taxation has a definite influence on the proportion of borrowing as compared with the raising of equity capital. There is a tendency to go in for more borrowing by bond issues, to finance by that sort of borrowing instead of by issuing equity. But this does not make any fundamental difference to the total demand on the market. That may be presumed to be the same. So far as the rate of interest is a factor in the calculation, an increase of 1 per cent. in the cost of borrowing may mean only ½ per cent. difference in net profits after taxation, and that can have a certain influence. It may, as a consequence, lead to wider fluctuations, because people will be willing to pay higher rates just to go on with their plans.

11840. Would you think that an increase in the re-discount rate is a good thing for the economy of the country, having regard to the fact that it affects the government, the running of local services, and the whole of the social services? Do you think it is a good thing for the economy of the country to raise the Bank Rate, if there are other instruments available?——This is too hypothetical a question to answer. Under certain circumstances I think that it is necessary to use the Bank Rate to get results. As to whether it is good for the country, what do we really mean by that? In the first place, we must ask ourselves how far Bank Rate influences long-term rates, and in what direction. I am not of the opinion that the Bank Rate has a very strong influence on the long-term rate. I see only a very indirect influence. In so far as the Bank Rate influences the amount of inflationary financing, that may have an indirect influence on capital market rates; but in our country the influences are indirect. It also depends upon the traditions of the banking system. Our banks, for example, generally do not go into the long-term market at all, so that the direct connection does not exist already. On the other hand in England, and especially in the United States, the banks are accustomed to operate in the long term market, and Bank Rate decisions may influence their buying and selling in the long-term market, and so directly affect the long-term rate. With us it is not so. I think that the influence of the Bank Rate on the long-term rate is very doubtful. I can only see that the creation of a supply of capital created by inflation will tend to bring the long-term rate somewhat lower than it would have been, or, *vice versa*, deflation will tend to bring the long-term rate somewhat higher than it would have been without that. I would say that, as we preclude as a matter of faith the existence of a deflationary or inflationary situation over a long period, the Bank Rate cannot have very much of an influence on the long-term rate. The reverse is the case: it is the long-term rate which exists and has its own life, and which therefore determines the range within which the Bank Rate will fluctuate. In a country with high long-term rates of interest you will find higher short-term rates of interest than in a country with low long-term rates of interest.

11841. *Professor Sayers*: Are there ever circumstances in your country in which you think it appropriate that the long-term rate should be moved?——No. I personally take a rather indifferent attitude to the long-term rate; that is to say, I generally believe that the lowest possible long-term rate is the nicest position for a country to be in. In conditions of monetary equilibrium, it is nice to have a low rate of interest. It is generally a sign of a proper supply of savings in proportion to the demand for capital. I do not believe that it is possible

much to influence the long-term rate, and if one does it by monetary policies then I think that one is in a very dangerous field.

11842. You take it, therefore, as one of the facts of life?——In a way, yes. I think that the philosophy of the long-term rate is a very difficult one.

11843. Therefore the range within which you can influence the long rate by moving the short rate is a fact of life that you have to accept?——Indeed. The long-term rate is one of the remarkably stable things, if one looks over centuries. In a country like ours, we knew the same rates of interest two hundred years ago as we know now, and even lower ones. There is nothing so stable as long-term rates of interest. One wonders how it works out, but it does.

11844. In fulfilling your appointed task, you do not consider that any manipulation of the long-term rate is a useful weapon?——No. We have never worked on the long-term rate, because we never have been in the position to do so. I might say that we have never sinned enough to be able to influence the long-term rate! To influence the long-term rate one must have a portfolio of long-term paper. A central bank cannot get a portfolio of long-term paper without inflationary financing, for all practical purposes. It would have to create money to buy long-term bonds. I admit that, in a period of depression, there might occur the situation where such action could be defended by the central bank as being for proper equilibrium policies, but it would under such circumstances be more easy for the government to act than for the central bank. It is conceivable that one could create a long-term portfolio for purposes of monetary policy, but it is more conceivable that one would do it for wrong reasons.

11845. *Sir Oliver Franks*: You said that for a central bank to seek to intervene in matters of the long-term rate was for it to go into a dangerous field. Would you expand on the thoughts which were in your mind which led you to use the phrase "dangerous field"?——Yes. Apart from the fact that the Netherlands Bank has never been in a situation to consider this as a practical problem, because we have never had a long-term portfolio and so we could never have influenced the long-term rate in an upward direction, I think that the purpose of establishing a certain long-term rate is completely outside the field of the proper purpose of the central bank. The proper purpose of the central bank is, in my opinion, to maintain as well as possible monetary equilibrium. For reasons of maintaining monetary equilibrium, I admit that it may be proper to influence the long-term market, and that if I do operate on the market I influence the rate; but that movement of the rate is not the purpose. The purpose of the policy is the buying and selling, as a method of compensating deflationary or inflationary developments elsewhere in the economy. If at a certain moment we thought that the economy should be inflated, if we were in a deflationary situation comparable with the thirties, I could very well conceive a policy whereby the central bank would go into the capital market, supply money and buy long-term bonds in the capital market, and thereby bring the long-term rate of interest down. That might not perhaps be the best policy conceivable under those conditions, but it is a conceivable policy. But I do not believe that the purpose is to bring the rate down, but to supply funds to the market, unless one then said: "I want to bring the rate down, in order to give an incentive to demand."

11846. *Professor Sayers*: Why did you use the word "dangerous"*?——Because I thought of the other purposes which are known to have occurred in central bank policy, where maintaining the long-term rate was at a certain moment conceived to be the proper purpose of government policy. When the central bank under such conditions has been willing to try to maintain the rate, was mostly in the direction of preventing it from going . Central banks have been buying government bonds the market, thus going in for inflationary financing and eation of an excess supply of money just for the purpose of maintaining the long-term rate of interest. In my opinion that is totally contrary to the proper purposes of central banking, because there the central bank would knowingly have disturbed monetary equilibrium instead of maintaining it.

11847. But if the central bank keeps firmly before it its duty to maintain monetary equilibrium, or promote monetary equilibrium, is there any danger in long-term market policy?——No. I was thinking of the danger of getting away from proper purposes to side purposes, which are purposes of government policy, to borrow cheaply and all that. It is not dangerous of itself. As a matter of fact, we have often discussed amongst ourselves the possibility of the Netherlands Bank acting under certain circumstances in the long-term market, and how we would have to create a portfolio for that purpose.

11848. So you rule out a long-term interest rate policy not on the grounds that it is technically impossible, or technically dangerous, or even generally dangerous, but simply on the ground that you do not believe that it promotes monetary equilibrium?——I can very well conceive of market operations by the central bank in the long-term market, for proper purposes of monetary policy; but I know of dangers in operating on the long-term market with the purpose of maintaining a certain preconceived rate on that market, because that might so easily lead one away from proper monetary policies.

11849. If it could lead you away from proper monetary objectives, must it not be because the level of the long-term rate matters in monetary equilibrium?——No. In my view, trying to influence the long-term rate by creating or cancelling liquidity would influence the monetary equilibrium, but by itself the long-term rate if left alone does not influence monetary equilibrium.

11850. Even if the money created in support of the long-term market were completely idle?——It cannot be expected that anybody who borrows on the long-term market would leave the money idle.

11851. *Sir Oliver Franks*: You are saying that, because in your view the long-term rate is a product of nature at the time, it is therefore not something which as it moves alters monetary equilibrium, because it itself, at any given level, is the result of an achieved monetary equilibrium between saving and capital expenditure; and it is because it is the expression of an achievement of equilibrium that it does not either add to or detract from it. Is this correct?——That is perfectly correct.

11852. *Professor Sayers*: You say that people do not borrow in the long-term market if they do not want to use the money; but may they not prefer to hold money idle rather than invest in long-term securities at the low rate of interest? The idle money can be increased, because people prefer to hold idle money rather than hold long-term securities at their present prices? Is that not a possibility?——Yes.

11853. So that the increase in liquidity which results from the intervention in the long-term market may have no direct bearing on spending at all. Is that so?——I do not think that that is stated quite correctly. I agree with you that one can very well conceive of a situation in which long-term savings are not flowing into the capital market, because the rate of interest is considered to be too low by those who have money to invest. That situation will be the expression of a deflationary development, because these people have been saving money without passing it on to the capital market, and so without any possibility of investment to take up that money. Under those conditions, you are right to say that it might be in favour of monetary equilibrium to compensate this deflationary hoarding by a supply of money to the capital market, which would then be absorbed by investment. That new supply would not add to the hoarding; it would compensate in a way the existing hoarding. That situation is potentially dangerous in the future, because that mass of liquidity might loosen up at a certain moment; but in itself this would be more or less a condition of equilibrium; I can follow you so far.

Chairman: I think that we ought to break off for lunch now.

* See answer to Qn. 11841 above.

(*Adjourned until* 2.15 *p.m.*)

Dr. M. W. Holtrop further examined.

11854. *Sir Oliver Franks*: I would like, if I may, to go back to one general question. This morning you were describing a situation in which there were three agents: the Bank of the Netherlands, the Ministry of Finance and the Ministry of Economic Affairs. In our own country we have a central bank, but the Treasury combines the responsibilities of the nation's housekeeper with those of being responsible for the general lines of economic policy. I have in front of me another paper* which was put into us, from which I would like to read two sentences:

"Monetary management is predominantly an instrument of general economic policy, though it might be of use to assist in securing some particular result. For example, credit might be made relatively easy or difficult, to encourage or discourage an individual industry or group. Thus, in order to give an account of our experience with monetary policy in recent years, it is necessary to state the broad purposes which have been sought by the Government."

If one has to state the broad purposes of government in order to give an account of experience of monetary policy, it must be because these broad purposes of government have entered into the purpose or intention of those who were making decisions on monetary policy. The broad purposes of government would be, for example, trying to maintain an equilibrium between demand and the production capacity of the country, with a correspondingly high level of employment; trying to attain a balance between consumption and investment, and therefore a provision for growth in the economy. If it were true that in order to make decisions on monetary matters one had to take account of all these things, one would be bringing monetary decisions of all kinds, if they were important, under the umbrella of economic affairs. You were making distinctions between the role of the central bank concerned with credit, the role of the Treasury concerned with raising taxes and the spending of the money raised, and the role of the Ministry of Economic Affairs dealing with the general equilibrium between supply and demand in the economy. The two sentences which I have read suggest to me that the only way in which one can arrive at satisfactory decisions on monetary policy is if one takes the three responsibilities which you have described all together. You want to take them separately, for very good reasons, which I understood as you explained them; but I should be very grateful if you would talk for a little on how you find it possible to reconcile the distinctions which you draw with these broad objectives to which all monetary decisions seem to be related. Is your distinction a real separation?——*Dr. Holtrop*: I only mentioned the Ministry of Economic Affairs in connection with hire purchase restrictions, where in general the lead has been taken by the Minister of Economic Affairs. All purely financial matters are the responsibility of the Minister of Finance. General economic affairs, that is to say in the physical field, are the responsibility of the Minister of Economic Affairs. Co-ordination takes place in the Cabinet. The division is slightly different from here, because your Economic Secretary in the Treasury plays a part in the affairs which with us would belong to the Minister of Economic Affairs.

I admit that I, from my own point of view, have a tendency to see the problems of monetary policy in a slightly narrower frame than as simply a part of general economic policy. I am of the opinion that the general economic aims of government, in the sense of the distribution of income, the increase of investment, and so on, are outside the field of monetary policy. With any sort of government, and within any proper aims of economic policy, one thing should be clear: that one should always try to maintain monetary equilibrium. One should have sound monetary policies whatever further aims one strives for. For that reason I can separate the problem of monetary equilibrium from the rest of the problems, and can take the position that I do not admit that monetary policy can rightly be used for other aims of government policy than the maintaining, as far as possible, of monetary equilibrium. In so far as the general economic policy of a country might be to redistribute incomes in the country, I would say: "That is all right with us; that has nothing to do with monetary policy." If the Government tried to make use of monetary policy for this purpose, I would be very hesitant. The instruments of monetary policy should be used to maintain the general position of equilibrium which we should have under all circumstances. Instruments of taxation and price subsidies and price policy and wages policy and everything else can be used for other economic purposes, but monetary policy should not be used for this purpose.

This kind of division turns on the question of what one calls "monetary equilibrium". A situation of under-employment can be and will mostly be a consequence of disequilibrium from the monetary point of view, and will then constitute a break in monetary equilibrium. But there are conceivable circumstances where unemployment might be created by wage policies or policies in other fields, where I would not recognise monetary policy as the real cause. The question can easily arise whether the disequilibrium condition in a certain sector of the economy is of a monetary or non-monetary nature, and whether the methods of monetary policy should be used to correct it or not. My decision would always be that, if it is of a monetary nature, then monetary means should be used, but if it is of another nature, one must look for other means to correct it.

To sum up, I would say that it is not correct that monetary policy is only one of the instrumental possibilities of general economic policy. I think that monetary policy is a thing of its own, which strives for a purpose which should be the purpose of good government under all circumstances, namely, the maintenance of monetary equilibrium, in whatever sense this may be defined, as, for instance, price stability, maintenance of the value of money or the prevention of monetary causes for disequilibrium in the economy. Other purposes of economic policy should be pursued by the use of other instruments than monetary ones.

11855. It seems to me to follow from that that the aim of monetary policy, in the sense in which a central bank is interested in monetary policy, is relatively, or even perhaps absolutely, autonomous: its aim is monetary equilibrium which it is ever seeking to restore, if it becomes disturbed; and that this is an aim which, so to speak, is valuable in its own right?——Yes.

11856. But then you go on to say that the actions which other bodies, for example the ministries of the government might take may impinge on and alter the monetary equilibrium. These decisions are taken by the departments of government in their own right and in their own authority, but the effects of them may be, and must be in some cases, to modify the equilibrium and introduce distorting factors. In that case, as I understand it, the job of the central bank will be, not bothering about the decisions which have given rise to these effects and distortions but bothering about the purely monetary disturbance, to seek to bring the monetary system back into equilibrium again?——Yes.

11857. So that on this argument I find that what began as an autonomous activity, directed at an aim which had its own justification, becomes at second remove an eternal trying to catch up with disturbances which other organisations create in the monetary system, so that, instead of being a king it becomes a hand-maiden; it becomes subservient to the other departments. I deliberately put this as a paradox; what do you make of it?——I see that activities of other departments of government can affect monetary equilibrium. I would say that it is then the responsibility of the central bank to try to correct these disequilibria, both negatively, by not itself co-operating in the causes of monetary disequilibrium and positively, by advising the government to adapt its policies in such a way that these disequilibria are not continued. Perhaps we need examples to be clear what one is thinking of. I could very well imagine that the Minister of Economic Affairs might think it important for some reason or other that he should do everything possible to increase or facilitate hire purchase. What is the central bank to do about it? In my opinion, the central bank would simply have to take care that hire purchase was not financed either by the central bank or by the banking system. It would say to the banks: "It is the government's policy to facilitate this, but they should go out on the capital market, and we do not think that you should co-operate in this financing." This might create certain controversies, but everybody in his own field should try to keep things as straight as possible.

* *Monetary Policy and the Control of Economic Conditions* submitted by H.M. Treasury (Memoranda of Evidence Pt II. no. 6, para. 2).

In the field of the Ministry of Finance which, as I say, is the field of expenditure and taxation, I see no monetary problem. There might be very indirectly, of course; there have been in the past many arguments about it. It is argued, for example, that if the Minister of Finance goes in for new expenditure and tries to cover this expenditure by new taxation, that taxation will reduce the available savings in the capital market and might, in that way, very indirectly lead to the emergence of stronger monetary pressures. I would say: "Well, that may be. My task, as the central bank, is to prevent or check this inflationary tendency, and for the rest I am not very much interested. It is out of my field whether the sovereign power of Parliament does or does not want to tax somebody out of existence. If they increase company tax to 90 per cent. and the companies have no reserves, that is not a monetary problem, that is a problem of distribution of income." The entrepreneurs might then say to me: "You should lend us the money." There the duty of the central bank would be, in my opinion, to say: "No; that would threaten monetary equilibrium. I can understand that when the government takes away your money you cannot get enough to continue, but that is the government's business."

So I still feel these fields are separate. I, as a central bank concerned with monetary policy, have to do my very best to take care that no inflationary dangers emerge. It is true that I also have to keep an eye open for deflationary dangers, but there I am less powerful in the first place, and historically the dangers are less, so let us mostly talk about the inflationary dangers. It remains the duty of the monetary authorities to prevent the use of inflationary methods of finance. It can very well be the duty of other authorities to redistribute the national income, or to do things that will stimulate or slacken investment, and that will have all sorts of consequences for the whole economy; but that by itself is not a monetary problem. It would only become a monetary problem if someone tried to create money to take the place of the real means that are taken away for other purposes. So, as far as I can see, one can make this practical division between these two fields, and, as far as that goes, one can keep the policy of the central bank completely out of political controversy about the aims of government policy in other fields. I have never heard anybody saying that it should be the aim of government to inflate the economy; nobody goes that far. But there are people who go so far as to say that the aim of investment is so important that we might even accept some inflation. To them I say: "My business is to try and prevent that. That is the duty which has been given by law to the central bank." I am strengthened by this provision of the law, which clearly says that it is the responsibility of the central bank to stabilise as much as possible the value of the monetary unit. If other policies lead to endangering that purpose, it is my duty to try and prevent that being done.

11858. *Professor Sayers*: The ability to stabilise the position would seem to depend upon a belief that the actions of the central bank have comparatively quick effects on the economy. Is that your belief?——My belief is that one cannot have any long period of inflating the economy without the co-operation of the central bank. I know there are always escape valves in the system which can be used, and then the central bank cannot do anything about it. We lived through that period in 1955 in Holland; we saw a tendency to inflationary financing, but at that moment we could not do much about it. But we knew that in the end there would come the point where the central bank would have an influence, and that was the case in 1956 and 1957. Here we come to the very important problem of the relationship between the internal and external economy; because, as I say, inflation cannot go on without the co-operation of the central bank, which therefore gets in the end into a position of having an influence. That may not be true if the whole world inflates. Then the technical position may be such that the central bank cannot get a grip on the situation.

11859. So you see the central bank not as continually pitting its weight against other forces in the economy, which may or may not include the policy of the government, but as exercising its influence only from time to time, when it believes that influence will be effective?——I do not think that we continually live in a situation where the central bank's policy has an active influence on the economy.

11860. And yet you think a Bank Rate is a very powerful weapon?——Yes, but in some periods Bank Rate may not even be close to market rate and under such circumstances may not have any influence whatever.

11861. But you can always make it close?——We could; but I think that we could have fairly long periods in which that would be rather indifferent, where bank policy would be neutral. We might have years of no change in the Bank Rate, and then suddenly things might being to move out of equilibrium, and then we should have to do something about it. I really conceive central bank policy as a policy of trying to retain equilibrium. We have only to balance the threat to equilibrium, to keep financing "on an even keel", to use the Macmillan Committee's phrase. If there is no threat to that, there is nothing to do about it; the central bank does its usual business, but has no real policy decisions to make.

11862. *Lord Harcourt*: We talked about the Bank Council and the Governing Body, but there appears to be a third body, the Board of Commissaries; what is their function?——The Board of Commissaries formerly had more powers than it has now. There are certain things that the Board of Commissaries has to do. They have, for example, to approve the balance sheet. According to Dutch company law, a company's balance sheet has to be approved by a meeting of shareholders. That meant that the shareholders could have withheld approval of the balance sheet because they did not agree with the policies of the Governing Board, because they did not make enough profit and things like that. Even when the Netherlands Bank was just a privately owned limited liability company, the power to approve the balance sheet had been taken out of the hands of the general assembly of shareholders and vested by a special Bank law in the hands of the Board of Commissaries. So the Board of Commissaries are really the representatives of the shareholders, who control the Managing Directors. Generally under Dutch company law, there is between a board of directors and the shareholders a board of commissaries which controls the management.

11863. It approximates to the outside directors under English company law?——To a certain extent.

11864. *Chairman*: What, if any, influence on monetary policy does the Board of Commissaries have?——None; neither under the old nor under the new set-up was there any provision for consultation. We use the Board of Commissaries very much to get informed ourselves. We have meetings with the Board of Commissaries and with the Bank Council. In a way they sometimes duplicate because the same developments may be discussed; so in the Board of Commissaries we concentrate more on the actual transactions of the Bank: the business aspects, the questions of whether to buy gold, and how much gold, or not to buy gold, the choice of investments, etc. We exchange views and discuss these problems. They have to control us, and they have to approve the balance sheet, which is the final approving of the actual management of the managing directors under our company law.

For the new Bank Act, which was made in 1948, it was considered whether the Board of Commissaries should be retained or replaced by a Bank Council, or whether we should have the two. It was finally decided to have the two, the Bank Council being considered then as the representatives of the community in the affairs of the Bank, which would make it possible to have an exchange of views about the general policy matters, and the Board of Commissaries as the people who actually supervise the management of the Bank in the daily course of its affairs, to make sure that we keep within the Bank Act. That is also the special duty of the Royal Commissioner; there is a direct link there to the Minister of Finance, because he is appointed by the Crown and reports to the Minister of Finance.

11865. *Lord Harcourt*: In paragraph 7, where you are discussing the Minister's power under Article 26 of the Bank Act to issue any direction, there is a sentence which says: "If the Governing Board of the Bank objects to the given directions it can within three days appeal to the Crown. The Crown decides whether the direction has to be followed." What is "the Crown" in that sense?——The Crown is constitutionally the Queen with her Council of Ministers. In practice it means that the whole

matter has to be brought to the Council of Ministers, so that it is no longer a matter for the Minister of Finance to decide but a Cabinet matter; the Cabinet has to decide and will formulate the Royal decree which the Queen, as a constitutional Queen, will sign. It is important because it brings it to the Cabinet level; and there is also this provision of publication, which even brings it open to parliamentary questions.

11866. Because the Royal decree is something which can be debated in Parliament?——Yes, but also because the considerations have to be published in the Official Gazette.

11867. *Chairman*: It is clear that an appeal to the Crown means an appeal to the Ministers of the Cabinet who are responsible to Parliament; it is not like our Privy Council?——The Council of Ministers, yes.

11868. Then can we turn to your answers to our second question, on the instruments of policy? Is there any more on discount rate policy?—*Sir Oliver Franks*: In paragraph 22 you say (and I think most of the witnesses with whom we have discussed the matter would agree with you) that in certain circumstances the use of the discount rate by itself cannot be very effective. In Britain in these circumstances in the last few years it has become almost habitual to decide upon what is called a "package deal"; a rise in the Bank Rate is accompanied by other, synchronous government measures, in relation to hire-purchase, or in relation to public expenditure. September 1957 was the last and clearest example of such a package; there were a rise in the Bank Rate, restrictions on bank lending and reductions of public expenditure all at the same time. These package deals flow from the view that monetary policy is something which is directed to accomplishing ends of general economic policy. If one leg is not strong enough to stand upon, they make it a tripod, and hope it will be strong enough. Given the rather different view which you have been explaining to us of the duties and responsibilities of a central bank, would it follow that in circumstances where a movement of the Bank Rate by itself would be insufficient you would nevertheless not expect to become involved in a package deal with other government departments?——That is correct. As a matter of fact, the question has never yet arisen that way. We have always acted on our own. Generally decisions are more easily and quickly taken in the central bank than in the government; even if the central bank's action became a part of general policy we might have been the first to act. There have been periods in which, as in 1951 and again in 1956 and early 1957, the increases or decreases in the discount rate have coincided with measures of government policy, but they have never been presented as belonging to a package deal. The change in the Bank Rate would have happened at an earlier moment, because we have always been able to consider changes in the Bank Rate in our country as more or less technical matters decided by the Bank itself.

11869. *Professor Sayers*: They are technical matters in the nature of the decision, and perhaps most of the considerations which go to the making of the decisions are technical; but their effects may be broader than that?——You must also take into consideration that there are changes in Bank Rate which are of a purely technical character, and do not involve general monetary policy at all. If the rates in London and other European centres go up at a certain moment, one may not want to see a drop in the visible reserves, or may not like to have pressure on the money market which would bring the Treasury into difficulties, having to repay short-term money to the market. We may also have to adapt the rate in Holland to a change in New York, as we have done occasionally. That would be a purely superficial adaptation to movements abroad, which would not affect internal monetary policy at all. Yet there may be a deeper meaning, because although at that moment it may be only a technical adaptation, such a change may be conforming to general world policy. If important institutions like the Federal Reserve System and the Bank of England move in a certain direction, and that is an expression of general economic trends in the world, then the decision to follow may be only a technical one, but it would bring our position into line with general developments in economic policy all over the world.

11870. When you say it would be purely technical, do you mean that the situation in the Dutch economy would be the same whether you took that step or not?——Yes. I mean that I would not expect that change in the rate to affect in any important way the actual amount of lending by the banks, but only short-term foreign investment and the movement of short-term funds.

11871. Then why would you expect a movement of Bank Rate not in such circumstances to have effects on the internal situation?——We can lose reserves just because of money market fluctuations or because of a balance of payments deficit on current account. When we have a balance of payments deficit on current account for any lengthy period, we may come to the conclusion that it is due to inflationary financing within the country, which we must put a stop to. We might then increase the rate to put pressure on the banks to reduce the expansion of their lending; equally one might reduce the rate so as to have an influence on internal monetary policy. On the other hand, if there is a movement of short-term funds towards New York and this reduces reserves within the country and also reduces banks' holdings of Treasury Bills, one might say: "We had better reduce somewhat this outward flow of short-term funds."

11872. But why would you expect a rise in Bank Rate to have deflationary effects in one case and not in the other?——The difference might be that in one case we would only increase the Bank Rate by ½ per cent. and in another case by a full 1 per cent. When I say here that the Bank Rate has not always been effective by itself, I have in mind that, if I really wanted to exert an influence on the amount of credit given by the banks, I would also talk to the Banks and make use of moral suasion and the other possibilities we have to get a hold on the situation.

11873. Are we not back at the point where the rise in Bank Rate is just a signal, if you say that when you want to have deflationary effects you will do other things as well?——You are inclined to draw these lines so sharply. My point is this. I believe that a rise in Bank Rate, if it is sufficiently large, will have by itself a certain effect on demand for credit, but not too much. If it is the Bank's policy that the banks should be very careful about their lending policies, apart from raising the Bank Rate we will also talk with the banks and try to influence their operations. One might even say to the banks: "This is a credit ceiling, and you must not go beyond." If I used the Bank Rate as a means of influencing monetary policy I should also look to other means. If, however, I was using the Bank Rate only to affect the movement of short-term funds, I should only move the Bank Rate and nothing else, in order to make it a little more or less attractive to invest short-term funds on the Dutch market instead of on other markets.

11874. It is when you move the Bank Rate only and do not do other things that you say that the movement is a technical operation?——That is what I mean.

11875. *Professor Cairncross*: Would it be your experience in the last few years that there has been substantial movement of funds in response to interest differentials?——It depends what you call substantial. It has fluctuated by hundreds of millions of guilders.

11876. Sufficient to embarrass you?——That depends upon circumstances. If our reserves were low, we should not like it; when reserves were high, we might not care or might even like them to go down. It might make problems easier inside the country. I have explained in the memorandum that there are definite limits to these movements, because the banks will not take positions of their own, not at any rate too large positions, and if they wanted to cover on the forward market it might be difficult. Owing to a technical position we moved our rate down last week. We now have a market rate which is below the New York rate. The forward dollar has hitherto always been at a premium to the guilder; it is now slightly at a discount, which clearly shows that there is a movement and that people want to cover. The banks will move to the higher rate; they will look for cover in the market. If there is a discount we may get to the point where importing businesses which do not generally buy forward dollars say: "I cannot lose by buying now the dollars I need six months hence." Then the banks will be able to move funds out.

11877. If we raise interest rates in this country, do you think that that, in itself and without any reaction on confidence in sterling, has much effect on the movement of banking funds through covered interest arbitrage, or do you think that it has a substantial effect on the movement of covered credit in dealings between this country and Amsterdam?——I find that any increase in the margin of difference between short-term interest rates in London and Amsterdam has an influence on the movement in the market. Of late, interest rates in London have continually been higher than in Holland. As a consequence that would naturally lead the banks to move into the London market; when they have reached the limit to which they are willing to take positions of their own, they will only do so when they can cover. This they can do by selling sterling to Dutch importers who have bought in England for later delivery; they can only sell by offering these people a discount. It all depends upon the discount. As sterling has been at a discount anyway we may long have exhausted the market; but there may be people left who have not already covered their sterling when it was cheap to do it. As in the case of the dollar it depends on exact market conditions. Even a marginal difference is important for the market and for the reaction of importers and customers in going into forward deals, and there may be some movement of importance; but it is always limited because the number of importers who know that they have to make definite payments for these six months ahead is always limited.

11878. In the last few years would you say the predominating factor has been the interest differential, or would you agree that in general the view of future exchange rates or lack of confidence in one currency as against another has been the most important factor at work?——It would be impossible to answer that question without a very thorough analysis of the figures to see whether one could find the motivation from the figures. There is no doubt that there have been periods where sterling was very weak, and nobody would dream of having funds in London without being covered. As a matter of principle, the banks do not do it very much any way, so they certainly would not. On the other hand, at the present moment, when confidence in sterling has improved so much, there will be a certain inclination to take a small position, and funds will move. As to exporters and importers, there are certain types of people who cover and others who do not. Some people get excited; that is what happened in September last year, when people who do not usually cover suddenly started to cover German marks and American dollars.

11879. We are interested in forming an opinion about sterling fluctuations. It is clear that sterling has been a much stronger currency in the last six months than, say, in 1957. What do you think made the difference? It was not presumably the difference in the balance of payments?——This is a difficult question, because again you ask me about the motivation of other people. I can only judge from what I know of general talk; and general talk might concentrate at one time on the world's problems and at another time might concentrate on government policies. Those, I think, are the two main problems; the third problem is whether your reserves are actually moving up or moving down. People always expect things to go on as they are. If reserves move up they are optimistic and when they move down they start to be pessimistic.

11880. We were rather hoping to hear from you something about the movement of Bank Rate. Have you an opinion of how sterling is influenced by a rise or fall in the London Bank Rate?——Bank Rate would only influence rate differentials between two markets, and so play a role in the interest preference. Commercial interests would not be interested in Bank Rate as such. They would not start to cover forward exchange just because the Bank Rate rose 2 per cent. However, the policy of the central bank as part and as an expression of the total policy of government can be considered to be very important. The move to raise the Bank Rate as high as 7 per cent. was interpreted outside England as a very clear indication that the Government and the Bank of England would stop at nothing in defending the position of sterling. If under such adverse conditions as then existed a country did not move the rate, and the authorities explained that they would not move the rate because it would be bad for industry to have to pay higher rates of interest, people would say that this was a foolish policy, and that to refuse to move the rate for such weak reasons would be a sign that Government policy was not very strong. It is clear that if a country is in a weak position and there is no sign of a policy which grips the disequilibrium, then the expectation outside the country is that the situation will worsen. On the other hand, if there is a clear indication of a policy which people interpret to be in the right direction, then it will strengthen confidence.

11881. The interesting point for us is the importance of a movement of Bank Rate as an ingredient and symptom of Government policy. Would you think that, if in September 1957 no change had taken place in the Bank Rate but the other measures of policy had been taken, the effect on opinion abroad would have been as pronounced as it was?——I would think not; the movement of Bank Rate certainly played a role in the judgment of the whole situation.

11882. *Professor Sayers*: When you say that you thought the rise in Bank Rate to 7 per cent. showed that the British authorities would stop at nothing, there would seem to be an implication that people outside this country thought that a 7 per cent. Bank Rate, or a Bank Rate at whatever level to which the authorities would eventually push it, would hurt and would make a difference in the economy. Was it believed that 7 per cent. would make a difference by itself?——I really cannot answer these questions, because you are really asking not my opinion but other people's. I could not sum up general opinion about a controversial subject like that.

11883. Could you sum up Amsterdam financial opinion?——I think that the increase in Bank Rate was interpreted in our market as a clear sign of a positive policy of curbing inflationary development internally.

11884. As a sign?——Yes, that would be interpreted as a positive sign giving more confidence. I do not remember that it was ever interpreted as a kind of despair which showed how bad the situation was.

11885. It was as a sign of action, nothing more than a sign? Not as something that would itself have effects internally?——I do not think that people bothered so much about that. They have no opinion about that. They see that action commences; they know the Bank Rate moves up, which is anti-inflationary, and that is a move in the right direction.

11886. Why were not the 1955 and 1956 moves of Bank Rate equally impressive outside?——I do not know. I do not remember that there was any particular speculative movement at that time. There has been much talk also about "leads and lags", we saw very clearly the "leads and lags" in 1957 but not in 1955 and 1956. I do not remember any clear movement of funds out of Holland or into Holland in those years.

11887. So that the sign argument is important when there is an obviously speculative movement, but not otherwise?——I would say so.

11888. *Professor Cairncross*: It has been put to us on occasion that a central bank raising its rate rather sharply might frighten public opinion rather than reassure it, and that a small rise in Bank Rate may be preferable to a rather large rise. Have you, in your own country and in your own policy, ever been conscious of that problem?——Yes, we have; it is a very difficult problem. We put up the Bank Rate in April 1951 by 1 per cent. as a clear warning sign; we jumped from 3 to 4 per cent. We considered that quite an increase. I must say that your increase to 7 per cent. was quite exceptional. I was a bit stunned, and much admired your courage to make a big jump like that. That is a big decision, to increase by 2 per cent. On the other hand we increased Bank Rate in February 1956 by ½ per cent. That was also a kind of warning, because we felt that internal developments were not in the right direction. I have always wondered since whether we should perhaps have done better to increase it by 1 per cent.; perhaps more notice would have been taken of that. One cannot know the answer; next time we might try other things and see whether we get sufficient response.

You must be clear that an increase in the Bank Rate in Holland under normal conditions will only affect the rates the banks charge to their customers. These rates are largely based on the Bank Rate, so that it will be brought home to trade and industry that money is becoming more

expensive. That may be a warning; or they may be so optimistic that they do not care a bit. In the early stage of a business boom in our country the banks are mostly so liquid that they are not worrying about liquidity and having to heed the influence of the central bank. That is so far off that one could not expect it to work that way. It is only in the later stages, as the banking system gets nearer to the limits of its liquidity, that we could expect reaction in the policies of the banks themselves.

11889. *Chairman*: In paragraph 25 you stress the point that access to the resources of your Bank is a privilege. I suppose it follows from that view that, if your influence is to be effective, the wider the circle of people who resort to you the better?——The Netherlands Bank has powers to give loans to everybody. Even between the wars there was quite a general public taking loans from the Bank. We have discontinued that completely. We have purposely tried to be only a bankers' bank, and we have left other fields to the banks; so though legally we can make loans to private persons, we very rarely do it.

11890. *Professor Sayers*: I wonder whether, on paragraph 43, you want to insist on the difference between U.K. and Dutch practice as to what happens when there is a loss of foreign exchange? Is not the effect in both cases that the liquidity of the commercial banks declines automatically?——General liquidity yes, not cash liquidity. With you the liquidity ratio must be affected; with us the difference is in the cash liquidity of the banks.

11891. The governing liquidity is affected in the same way in both countries?——Yes, only with us it has so far played only a small rôle because it was anyway rather high.

11892. On paragraph 56, when the Netherlands Bank operates in the forward foreign exchange market, does it have any particular consistent policy on the rates at which it deals, or does it move its rates according to circumstances?——This is so exceptional that we would have to make our policy at the moment according to circumstances.

11893. *Professor Cairncross*: You give an indication here of the scale on which you enter the foreign exchange market; do you publish figures of your foreign exchange dealings in your weekly returns?——No, we do not; but we may afterwards in the annual report give an indication of the scale on which we have operated, as we did in the annual report of last year. The market would know, of course, that we were in the market, but we would not give figures. We do not show these forward obligations on our balance sheet as the National Bank of Belgium does.

11894. At what interval does it do so?——In its weekly statements.

11895. *Chairman*: In paragraph 62, where you are dealing with qualitative credit restrictions, you make the point that this type of control worked relatively satisfactorily during the very first years of the reconstruction period, but became more and more difficult to apply when normal conditions returned. I wonder if you could enlarge on the difficulty of working these qualitative restrictions?——I would say that the answer lies in the simplicity of purpose of general economic policy and the willingness of people to put up with controls, which is also a function of the stresses in the economy. Under a war economy everybody is willing to accept governmental controls which are aimed at winning the war. Even in a reconstruction period governments can control and people will put up with a refusal. But the more the singleness of purpose disappears, the more difficult it gets for a government to judge whether one thing or another is more important; and also the willingness of the people to put up with their decisions disappears.

11896. The range of choice gets much larger?——Yes; and it becomes very difficult to say what is the purpose of economy anyway. The general wealth of the people: what is that? Sweets are also part of the general wealth, so why should you not put up a plant for making chocolates, or a cinema or whatever it is?

11897. Would you think that simple distinctions like "essential" and "non-essential" are almost incapable of application?——I would think that they are worthless, and very dangerous in so far as they strongly encourage the tendency to become completely protectionist; "essential" is everything which replaces imports or which furthers exports, and "non-essential" is the other things, and one gets farther and farther away from a real market economy. It only happens because people look at this foreign exchange business as if it were a thing by itself: but one could never really get it right in the long run by that sort of decision. I think that the foreign exchange aspect, which has often entered into these kinds of consideration, is a thing which is bound to be applied wrongly and mistakenly; and the other decisions of "essential" and "non-essential" have no basis in a free economy.

11898. *Professor Cairncross*: Do you have any restrictions on the flotation of long-term capital issues for abroad?——Yes, as part of our exchange control. Foreign exchange control applied by the central bank, as it is here by the Bank of England, tends to be a completely different thing from monetary policy, though at moments people slip in the foreign exchange control arguments in dealing with internal monetary problems. The Bank has no responsibility of its own in the field of foreign exchange policy at all; it is purely and solely government policy and we are nothing but agents of the government in the execution of that policy. In execution we may take a lot of decisions on the spot and they are left to us, but the general lines should be given to us by the government. It is the policy of the government that we cannot afford the export of capital and we have only had one short period since the war, from July 1954 to August 1955, when we allowed foreign capital issues on the Dutch market. I would say that purely from the point of view of exchange reserves we should not at this moment worry too much about export of capital, but as a matter of equilibrium of the capital market we should. Demand for capital within the country and also from the government is very large, and supply is limited; so we do not feel at the present moment we can afford export of finance capital.

11899. The exercise of that control is through the Minister of Finance?——No, it is exercised by us, as agents for the government in foreign exchange control. People could not transfer the proceeds of issues without a foreign exchange licence; so they would have to apply for a licence before floating an issue, and they would not get a licence.

11900 Who decides which issues shall be permitted and which shall not?——We have not discriminated; no one gets a licence. There have been no foreign issues; the international finance institutions are the only people who have been allowed to issue during the time of embargo on foreign issues. This is a very important difference between England and Holland; you have to cope with the demand for capital in the Commonwealth, with which you have no foreign exchange control, and where fundamentally it is a matter of market policy. You have to leave it to the Capital Issues Committee to judge things like that.

11901 In the final sentence of paragraph 83 you talk about the increase in the general state of liquidity which must be the consequence of simultaneous hoarding by the public and inflationary financing by the government. You feel that attention should be given to this, but you do not give us any indication of the action which you feel is called for?——I have just indicated the dilemma; it will depend on all sorts of special circumstances what choice is made. At the present moment one might say that the private sector in Holland is probably slightly deflationary, and the government tries to remain neutral and not to compensate the deflationary tendencies, because after all they do not give rise to very big unemployment. Unemployment is slightly higher than in this country but not really serious. This is a controversial problem, of course, and people may have different opinions; but there is this danger of a compensatory policy by the government building up an inflationary potential for the future. It is not necessary that a compensatory policy by the government should be a policy of short-term financing. It may very well be that the situation is such that they can do it by long-term finance. If there is a supply of savings which the private sector

will not take because they are not investing and the government will take it, there is no inflationary danger whatever in a compensatory policy.

11902. *Professor Sayers*: Does it not leave the private sector abnormally liquid?——In that case the government could come into the market.

11903. You mean by floating long-term securities?——Yes; if investment in the private sector goes down but savings still flow into the market, and the government replaces the private sector as the taker of the savings and in the end as the investor, the effect is neutral.

11904. Suppose that the public is not willing to buy the long-term securities, but prefers to hold money because it thinks that the present price of securities is rather high; then surely it is in the interests of equilibrium at the moment that the government should go on spending, and that that spending should compensate for hoarding in the private sector?——In your case I think that the government ought to pay a higher rate of interest. I could improve on your example. If those responsible for the deflationary tendency are entrepreneurs who will not invest in long-term securities, then you have your pure case and you have your dilemma.

11905. *Professor Cairncross*: It is rather difficult to visualise monetary authorities putting up interest rates in a period of recession; it would be unusual to react in that way; would it not also be rather difficult at the outset to dispose of bonds, especially if the gilt-edged market was weak?——I must correct a mistaken impression. What I said about increasing rates of interest was in reply to Professor Sayers's hypothetical question which assumed that private people were holding funds which they were unwilling to lend to the government at the prevailing rate of interest. I said that it would be better to pay a higher rate of interest than to inflate the currency because people did not want to invest at the existing rate. But I think this is a rather unlikely situation. It is only when money is in the hands of entrepreneurs that the government cannot get hold of it. Private people will bring their money to the savings banks, and the savings banks never refuse to invest just because they think the rate of interest is low. They may have slight fluctuations in their liquidity, but there is no savings bank that can afford for any length of time not to invest the money it gets. The whole situation is hypothetical and unlikely. More likely is that the money is not in the hands of private people, but in the hands of entrepreneurs. If the deflationary tendency gets bad enough the government may then have to go in for inflationary financing to create a compensation. But they will then also build up liquidity which may at a later stage give trouble.

11906. If the government was anxious to finance increased expenditure by borrowing, and found, as it might well find in the conditions of an incipient slump, that it was difficult to make large issues of bonds, would there be much alternative to borrowing short?——No.

11907. *Professor Sayers*: Would you regard it as dangerous?——At that moment it would be in conformity with maintaining monetary equilibrium, but one would be conscious of the future danger.

11908. You suggested that, if the money were in private hands, the solution would be that the long-term rate of interest should be put up. Do you think that there are ever situations in which the government cannot, by raising the rate of interest it offers on its securities, get its securities taken up?——Yes, definitely. The question is how much of the liquidity is in private hands and how much in entrepreneurial hands. If it is in entrepreneurial hands, it is fundamentally not open to consolidation; and it also constitutes a potential threat in the future because the entrepreneurs are going to spend their money some day.

11909. What is the solution that the central banks should adopt in that situation?——One has to choose between evils. Under economic conditions and unemployment like those that exist at the present moment, I think that one should not try to compensate too much, and I think it is wise to keep government policy neutral. If on the other hand the economy was really spiralling down, then I would personally agree that it would be better for the government to step in, even if they could not finance it long-term, and try to compensate. Then contrary action is left to the future; but the trouble is that contrary action is often practically impossible. That is what we have lived through in 1956, and in the period of the activation of the over-liquidity of the war; once the private sector starts to activate its liquidity and to spend, there is no way of getting the government to reduce its expenditure.

11910. What should the central bank do in such a situation? The obvious fiscal reaction is to have a series of budget surpluses; but you were supposing that the government is unwilling to go as far as it should in that compensatory direction, so that the private activation of money is not fully compensated by government surpluses. In that situation how should the central bank behave?——In my opinion the central bank is for all practical purposes powerless. Theoretically it might try to force the banks to reduce their loans, but that is almost impossible in a generally inflationary atmosphere. Here is a clear case where monetary policy has to be done by the government; it cannot be done by the central bank. It would be useless to increase the Bank Rate against that situation.

11911. What about your long-term rate? Should you try to do anything about that?——I do not think that the central bank can really do anything about the situation. It is not possible to prevent people spending their own money, and if they draw on their surplus liquidity the only way to compensate is for the government to have a surplus or to get some outside aid.

11912. *Chairman*: You spoke of two periods when it was impossible to sell long-term government securities. What are the conditions which create that impossibility, because theoretically the government can bid up its offer to an unlimited extent?——This is a situation where the government would have to outbid the private sector in trying to get hold of the savings of the people. That is extremely difficult, because the private sector is more likely to outbid the government.

11913. *Professor Sayers*: But in the situation we were considering it is not a matter of outbidding the private sector; it is bidding a sufficient price to induce people to move out of idle money into securities?——That would be a state of over-liquidity created, for example, by war financing. We knew that situation and you have known it. We made our monetary reform to try to get away from it; then the government was sitting on the same money and even so spent it. But let us suppose that this liquidity is in the hands of the public, and the public is trying to spend it. I can theoretically conceive of two ways of getting hold of this money: for the government to place long-term loans on the market and use them to repay debt to the banking system, or for the government to create a budgetary surplus by taxation. The essential point is in whose hands is this money. If it is in the hands of the entrepreneurs, there is no method of getting it out of their hands except by taxation. Entrepreneurs are not going to invest their money in government bonds because that is not their business. If however it is really in the hands of private people (which is rather unlikely, because it would then be in the hands of the savings banks and it would have long been consolidated) it would be conceivable to sell long-term bonds and get away from the problem.

11914. You do not believe that there is any price the government can pay on its long-term money that will have any influence at all in checking the pace at which entrepreneurs are spending?——I do not know; we have never tried, so I think the question is too hypothetical. The government might raise the rate of interest in that situation, but that would not prevent the entrepreneurs from spending their own money. They would not invest it in long-term bonds, I think; but there your traditions may be somewhat different from ours. I have the impression that in England entrepreneurs are more inclined to go into long-term investment than they are in the Netherlands. With us it is extremely rare for liquid reserves to be invested in long-term bonds by entrepreneurs. Here you have more of that; there is a larger and easier market even for long-term bonds, so that they might take the risk. With us they will not, because they know that they cannot easily sell them.

11915. We have been talking in all this about the private sector being abnormally liquid. I notice that in your last annual report you take the view that 30 per cent. is a normal degree of liquidity of the private sector. Do you

think that there is a point at which the reduction in liquidity of the private sector fairly quickly changes the aspect from one of abnormally high liquidity to one of abnormally low liquidity? In this country we have had a gradual fall in the proportion of the money supply to the money national income, and this fall seems to be continuing. Do you think that there is a point at which we can expect people to begin to feel so uncomfortably short of money that they begin to alter their course of action in spending on capital and on consumption?——Yes, I do. We have been working on the hypothesis that the liquidity which we reached during the peak of the Korean crisis was a kind of minimum liquidity. At that moment we had a rather open economy. Trade liberalisation had proceeded quite far; people could buy what they wanted; prices were going up. There was every incentive to spend money that an entrepreneur could have. At that moment the total mass of primary liquidity was little over 30 per cent. of the national income, and we have been working on that as a minimum. This is never absolute; as we know from the history of inflation in Germany in 1922, if you inflate fast enough people will bring down liquidity to practically nothing; people will not hold money any more. But for normal conditions where there is still sufficient confidence in the value of money, and liquidity preference is determined only by outside circumstances, such as expectations of price increases, holding larger stocks and so on, we come to a minimum figure. We have now reached a stable level of liquidity, which has no strong tendency to drop any more. In a recession, of course, it goes up, which is the normal thing to expect. So we believe that for practical purposes one can say that this is probably the normal minimum amount of liquid resources that people will want to hold. It is their own choice to hold this liquidity; we cannot force them to hold less. They will simply not go into long-term investments, given this general state of liquidity. And if they want to go in for new investment they will not be able to reduce liquidity further, but will have to borrow funds in the long-term market.

11916. If you have a gradually spreading opinion that the value of money is going to go on going down, would you not expect the ratio to go on falling?——I would, yes.

11917. Is there any bottom to it?——We know too little about this whole thing. As I say, in the German conditions of 1922 the real value of the monetary circulation neared zero. If governments get to extremes the people will also go to extremes. On the other hand, we also know from the history of liquidity that in the last few centuries (in my own thesis on the velocity of circulation I quoted William Petty's figures about the amount of circulation in Britain in relation to the national income) the proportion of liquidity to national income has continually increased, and that it is much higher in more highly developed countries than in less highly developed countries generally. In America and Britain and countries like Holland one gets to normal figures which have a tendency to maintain themselves, and which one can count upon for all practical purposes.

11918. If I were examining your thesis I might argue! ——There is no doubt that the amount of liquid holdings in proportion to national income has gone up.

Chairman: I think that brings us to an end of our questions, Dr. Holtrop, with very great gratitude to you. Thank you very much for the great help you have given us.——*Dr. Holtrop*: It has been a pleasure, Mr. Chairman.

(*Adjourned until Thursday, 27th November*, 1958, *at* 10.45 *a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-FIRST DAY

Thursday, 27th November, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E. (Questions 11972 to 12065 and 12074 to 12188 only).
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.

PROFESSOR R. S. SAYERS, F.B.A.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser* (Questions 11919 to 12065 only)

L. K. O'BRIEN, ESQ., Chief Cashier, Bank of England, and W. H. J. DE W. MULLENS, ESQ., D.S.O., T.D., the Government Broker, called and examined.

11919. *Chairman*: Good morning, gentlemen. We have given advance notice of the questions in which we are interested. Would you like to say anything before we start?——*Mr. O'Brien*: I should like with your permission to make a statement which the Governor has asked me to make to the Committee in relation to Issue Department policy.

It is over a year since the Governors gave the Bank's main evidence on Issue Department policy and debt management—the primary reference is Q.1762 on the 25th October, 1957. Before the Committee examine the Government broker and myself on operating aspects of these questions, I am authorised by the Governors to confirm in the following statement the general aims of policy as then put forward.

Put briefly, we stated the general aims of Issue Department policy as to maintain an orderly market, not to resist a definite trend, and not to intervene on any continuing or large scale with the object of shifting prices one way or the other. The functions within these limits of the Issue Department were explained in connection with new Government borrowing and refinancing: and the continuous need to fund short-term debt.

During the past twelve months there has been a progressive restoration of confidence in sterling and Bank Rate has been reduced from 7 per cent. to 4 per cent. As a result there has been a definite trend towards a rise in gilt-edged prices and a distinct rise has in fact occurred.

During this period the policy stated earlier has been maintained, in that the Bank have not sought to halt or reverse this trend: but funding has gone on almost continuously, and this has restrained the rise in prices, although to an extent which cannot be accurately determined. (See Q.1796.) If there is a footnote to add to the previous evidence—which was concentrated on those aspects in which the Committee were particularly interested—it is perhaps that this restraint may have been more consciously exercised than in some earlier periods. It would still not be true to say that the Bank were aiming at any particular range of rates: but four points may be made:—

(1) Fairly high levels of long-term rates were appropriate in view of the continuing need to attract a very considerable volume of funds into long-term gilt-edged securities, confidence in which had only recently revived.

(2) More specifically, when Bank Rate was at 7 per cent. and just below, it was generally apparent that short-term rates were likely to decline. In this situation, a gradual decline in longer-term rates would promote funding more effectively than a quick decline.

(3) It was by no means certain how much of a fall in longer-term gilt-edged yields would be fully sustainable. A healthy market was necessary for the continuing of funding: it would be better preserved by moderate rises in price until it was clearer at what sort of level it would settle down, subject always to the usual short-term fluctuations.

(4) Looking beyond the immediate market situation, the general economic outlook did not appear to call for a pronounced reduction in the cost of long-term capital. A moderating influence on the upward trend of gilt-edged prices did not seem to run counter to the general interest over a rather longer period.

11920. If I can interpret that, what you are particularly anxious to draw attention to is that it would still not be true to say that the Bank were aiming at any particular range of rates, but, taking into account the four considerations that follow, their weight in their dealings in the gilt-edged market has been thrown in favour of keeping prices down and yields up?——Yes.

11921. We shall come back to the substance of it in a few later questions. Might we now have a look at the questions we have listed out to you? The first is: "How far, and by what means, is it known in the gilt-edged market what are the day-to-day operations of Her Majesty's Government?". Mr. Mullens, perhaps you can help us on that because it is rather difficult for the outsider. I picture you as being known to everybody not only as being the Government broker, but as being a partner in a firm which deals generally for private clients as well as for the Government, and I cannot get clear in my mind if it is known in the market as to what the sales and purchases made on behalf of the Government or the National Debt Commissioners are. Can you help us on what the picture is?——*Mr. Mullens*: Yes, my Lord Chairman. I have a partner who is in the market place all the time. There are about twenty jobbing firms in the market, and it is his duty to keep in touch with them all. When there are, as indeed there are most of the time, certain stocks which I have had instructions from the Chief Cashier to sell, the price at which we are prepared to be approached for those stocks is known to my representative, who in turn keeps the market advised of the prices and also of any change that there may be not only in the day-to-day policy but hour to hour as the market progresses.

11922. Your partner, who is dealing indifferently for the Government and for other clients, lets the jobbers generally know that there is a shopping list of stocks and the prices at which he is prepared to sell?——Yes. I want to make it quite clear that we do not leave a definite position in the market; the jobbers must come to us and say: "Can we have so much of stock at such and such a price?".

11923. *Professor Sayers*: And similarly, on the other side, the jobbers would ascertain that you are prepared to buy such and such stocks at such and such prices?——They would. I am completely in touch with my partner. I am never away from my office or our "box" near

the Stock Exchange I am available all the time so that he can and will nearly always ask me; but he is in the market place the whole time, and therefore is easily got at by anybody who wishes to approach him.

11924. *Chairman*: How is it known whether these are sales and purchases on behalf of the Government or on behalf of other clients? By the nature of the stock?——Yes. We would never disclose who our client is; but it is, as you say, guessed by the nature of the stock. A recently issued stock of Her Majesty's Government is normally for sale subsequently to the issue, and if the market approached us for any of that particular stock it would be almost an understanding where it came from.

11925. *Sir John Woods*: Is the converse true about a shortly maturing stock?——It would be almost true about the very next maturity, although it is not impossible that my firm would have an order from, say, a discount house or a big company to invest in the shortest dated security.

11926. The inference which the market would draw is clearer in the case where you are selling a recently issued stock?——Yes, I think so.

11927. *Professor Sayers*: Are there any other stocks that are recognised as being at any time on the Government's shopping list?——No, I do not think so; but whenever the market wanted to buy a particular stock which they had not got on their own books, they would go immediately to my partner and ask and then it would be for me with the agreement of the Chief Cashier to see if we were able, or if it was in the Government's interest, to find that stock for them.

11928. That might happen with any stock in the gilt-edged range?——Other than the next maturity, yes.

11929. *Lord Harcourt*: A jobber finding himself short of any particular stock might easily inquire about that, simply on the off-chance that you would be a seller of that particular stock?——Indeed.

11930. *Chairman*: Where does the difference come between your letting it be known to the market that particular stocks are available and indicating the price at which you are ready to sell and letting them know the price at which you are ready to be approached. What is it you are keeping in reserve?——If there is a particular stock, whatever it may be, that we are at the moment selling on behalf of the Bank of England, we only sell certain amounts of stock at certain prices. The amounts of stock that we sell at each price depend very much on whether I think, having discussed it with the Chief Cashier, that we can raise the price quietly, and so encourage the market to go up, which is obviously our best chance of selling. At some stages we only sell quite a small amount of stock at each of a series of rising prices; for instance, when we come to the end of selling a particular stock. At the beginning we tend to sell more stock at a particular price. If I were to leave the jobbers with a definite position, it could be that some news might come in and twenty of them would rush at me to buy stock at a price. So I leave myself the right to say no. Although we do it, I hope, with their full confidence and support, it is just that difference which I feel is vital.

11931. You have the next step in the back of your mind and you arrange it with the Chief Cashier, but the market operating from different angles cannot tell when the step comes?——No, and it is vital that they should not be able to.

11932. *Professor Sayers*: You indicated just now that when your supply of a particular stock is running short you would be likely to raise its price. Would that be irrespective of your general policy at the time about prices?——Not quite. I will try to explain. Generally speaking, the stock which it is well known that we are selling tends to be lower than the equivalent stocks in the market. If we suddenly said that we had no more to sell, that would be reflected in a large jump in the price of that stock and we try and iron out those movements in the last few days or weeks.

11933. *Lord Harcourt*: You therefore adjust your tap price more frequently as a result of a smaller volume of sales in order to bring it up to the general levels?——That is true.

11934. *Chairman*: Is it possible for tap prices to change more than once in a day?——It has often happened.

11935. *Professor Sayers*: Or it may remain unchanged for days and indeed weeks on end?——Certainly, especially when the market is falling.

11936. *Lord Harcourt*: In your operations in the market do you only deal with the jobbers?——Yes.

11937. You never do a deal direct with a discount house, or an insurance company?——Never. My firm never does; we make that a rule.

11938. *Professor Cairncross*: Would a large buyer wishing to know the price at which you are prepared to sell be required to ask a jobber, who would in turn ask you?——That is true; but it is fair to say that most brokers also become aware of the prices at which we are prepared to sell, and negotiate with their clients subject to being able to deal in the market.

11939. *Chairman*: How do they know? Is it market chat that goes on?——Yes. It is so highly competitive that it is important for brokers advising their clients that they should know. Somehow they find out.

11940. *Professor Sayers*: So that if a large institutional investor wanted to know whether he could get such-and-such stock at such-and-such prices he would ring up his broker and could often expect him to say whether or not the Government broker is selling such-and-such a stock at a particular price?——I think his broker would often know.

11941. *Professor Cairncross*: Have you any idea in what proportion of cases or over what proportion of sales a jobber would come to you in order to obtain stock, compared with the total dealings in which he was engaged?——If it was a stock which had been recently issued, 90 per cent. of the time he would come to me. If it was a stock that had settled itself in the market, he would as often get that stock from an insurance company or a bank through a broker as through me.

11942. *Chairman*: When we are talking about the sales on behalf of the Government how much of this is to be regarded as switching, in which you are exchanging one kind of stock you want to get rid of for another you are taking in against it, and how much is direct sales for cash?——Without looking into detail it would be difficult for me to answer your question specifically, but I might put it this way. When the market is really firm and is expecting lower interest rates, nearly all the business that we would do on behalf of the Bank would be selling. On the other hand, when markets are inclined to be quieter or indeed perhaps even going down, we are then prepared, in consultation with the Chief Cashier, to sell one stock of which we have a lot and buy another of which we may have none or anyway very little. But nearly always it would be a security of shorter date, so that we are in effect stepping back all the time.

11943. That has represented your current policy over a period of years now, that when you are making a switch you are giving a longer-term stock in exchange for a shorter one?——*Mr. Mullens*: Exactly.—*Mr. O'Brien*: Our object has been to fund as much as possible. We also have the object of facilitating the re-funding of the next maturity; the basis of that policy would be to buy the next maturity as it came on offer and to sell other stocks as far as possible. But there are various positions between that which we take up throughout the course of the year, depending on the state of the market. As Mr. Mullens says, when the market is strong we have an easy run and we are selling all the time, buying very little. If we are buying, it is probably the next maturity or something very near it. But there are other times when the market is not so strong, when nevertheless in the interests of facilitating market operations we do things which suit us not perhaps very much at the time, but which are likely to help us later on when better conditions return, by taking in shorter stocks against longer stocks.

11944. Would you never have a policy which led you to say that, whether or not you could obtain cash by outright sales, you had a general wish to lengthen the debt and therefore would switch for the sake of switching?——We have done that.

11945. That is equally likely to be a policy activity as the other you were describing?——Not equally likely. It has not been in recent years, because of the great need to get in cash in order to reduce the floating debt. But if that

were not such an urgent consideration (for example, it is not at the present time, when the banks' liquidity is so much lower and the general position somewhat modified), we would have a considerable interest in lengthening the debt in that way. It is an interest we have all the time, but at times it is perhaps a secondary objective rather than, as nowadays, a primary objective.

11946. *Professor Sayers*: Do people operating on a big scale ever express a willingness to switch at certain prices, and you say that you would rather not do the transaction at all?——*Mr. Mullens*: Yes, that frequently happens. Switching is not really so welcome to us as an outright sale, as the Chief Cashier says, but if we do a switch such as you have suggested I make it quite clear that the terms on which we will do it are favourable to us rather than to them.

11947. *Lord Harcourt*: A great deal of switching goes on in the gilt-edged market the whole time without it ever coming to you at all, I imagine? The jobbers hold considerable books in all stocks themselves, and therefore there is constant and large switching in which you are not involved in any way?——Absolutely.

11948. *Professor Cairncross*: Are you able to give us any idea of the size of the jobbers' books? What is the magnitude of the resources they bring into this market?——The amount of stock that they would carry on their books would vary according to their view of what was going to happen, but I suppose it would not be unusual for the bigger firms to hold a position of somewhere between £5 mn. and £10 mn. worth of stock.

11949. But in the aggregate it would be well under £100 million?——Yes, I think it is undoubtedly well under it, because I was only speaking about the few really big firms in the market.

11950. And the turnover in the market might run at £50 mn. a day, I suppose?——If you mean by turnover, the purchases and the sales, yes.

11951. I am judging by the figures given to the Parker Tribunal which were for Wednesdays and may therefore be rather higher than average, but these averaged about £50 mn. on the seven days quoted. Is that an unreasonable indication of the scale on which the gilt-edged market now operates?——No, not at all. It varies tremendously with the conditions at the time, but that would be a perfectly fair figure to go by.

11952. *Chairman*: But a large constituent of that is switches, I gather?——Undoubtedly.

11953. *Professor Sayers*: Could you make any guess at all as to what kind of proportion is switches, week in, week out?——Seventy-five per cent. of the longer business.

11954. *Professor Cairncross*: The proportion must vary a great deal in different conditions of the market?——Yes; rather as I was suggesting that we ourselves will sell outright on a rising market, so that at those times the percentage of cash sales would go up, since these are straight purchases by the public or the institutions, whereas when the market quietens or tends to go down, our interest goes to switching and that probably forms a large part of other people's business too.

11955. *Chairman*: Our second question is: "How far, and by what means, is it known in the gilt-edged market what is the standing or current policy of Her Majesty's Government with regard to operations on departmental account?" From what you have been saying, I should assume that it is not known except in so far as it may be deduced from operations which are known to have been conducted recently on behalf of the Government?——*Mr. Mullens*: That is quite correct.—*Mr. O'Brien*: Of course it is known throughout the country to anyone interested what the Government's overall policy is. For example, successive Chancellors have said that their policy is to fund so far as possible, and the Government have been seen to issue stocks for that purpose. So that sets the picture, and then Mr. Mullens comes in.—*Mr. Mullens*: Each individual jobber naturally keeps very much to himself what he is doing; so the whole market is not necessarily aware of what was going on at all.

11956. Jobbers all stand more or less in a row on the floor of the house?——They stand in an area.

11957. They are very much side by side; but because you are doing a deal with one jobber on particular terms, it does not mean that the next jobber knows what has happened?——No, very much the reverse.

11958. How does it get around to the brokers what the Government is doing that day, if each jobber individually does not know what the other one is doing?——Because any jobber can go up to my partner and say to him: If I bid you so much for such and such stock, would you sell it? ", and my partner would say: "Yes," subject to his just confirming it with me. That information could go from any jobber in the market to any broker.

11959. *Sir John Woods*: Is it right to say that what the brokers get to know is price; what is not known is the volume?——Nor any other business that might be done that day; that is right.

11960. *Professor Sayers*: People sometimes make guesses either that the Government broker has been selling a great deal or that sales have been very small. Would those guesses be rightly described as guesses?——Up to a point, yes, but you must remember that if we are selling to any large extent there are probably one or more large buyers, it may be banks or may be insurance companies. They see dozens of brokers every day and might impart some information to them. That is the way it gets around.

11961. *Professor Cairncross*: When you name a price to a jobber, do you impose a limit on the scale of the transaction at the same time, or would you carry through a transaction of any size, particularly if it were a selling transaction, at the price quoted?——I would always say to the jobber that he must tell me what the amount is. I would never get myself into a position where he could deal with me in any amount that he liked; I should say to him it would probably be all right up to a certain figure and he would then come back to me.

11962. Would you impose a ceiling on a transaction where the jobber wished to buy the latest stock at the price you were quoting?——It is unlikely, but it could happen, especially towards the end of the tap.

11963. *Lord Harcourt*: You might very well, I suppose, tell a jobber that he could have half his requirements at one price but if he wanted more he would have to pay a sixty-fourth over that price?——Yes, that is undoubtedly often done. In any event we would move the price immediately after that deal, if it were big.

11964. *Mr. Jones*: How would the change in price be determined, in view of the fact that you act under the instructions of the Chief Cashier?——By and large that would be left to me by the Chief Cashier. I see the Chief Cashier every morning, I speak to him always about lunch-time and then report the business at the end of the day; and on occasions I may see the Chief Cashier or speak to him a number of times. But the actual alteration of one price is generally left to me unless there is some particular reason to ask the Chief Cashier about it.

11965. There are opportunities then for stimulating sales by moving prices?——Yes. When we raise the price it does tend to encourage people to buy; of that there is no doubt.

11966. What happens when the market is quiet?——*Mr. Mullens*: We probably should not do anything if we were not actually dealing. We would not tend to move the price unless there was a demand for particular stock.—*Mr. O'Brien*: Mr. Mullens has been working with us for many years, and he knows our minds on these questions completely. A thing like this is something which he does every day, knowing that it is what I would wish him to do and what my predecessors in the past have wished him to do. When he puts a price up in these circumstances he is doing no more than what anybody in the market would do if faced with a very strong demand for stock. If there is strong demand for any commodity the price tends to go up; to keep it down would be artificial. He responds to specific demands in that way. That rise in price has the incidental effect of bringing in other buyers who tend to come in on a rising market; but I would not want it to be thought that that is a lead given to the market, consciously given to drag the market along. It is responding to market conditions which has the effect of pulling in other buyers.

11967. Would there be any circumstances where the Bank through the Government broker would reduce prices in the market in order to dispose of stock and to encourage

funding?——*Mr. O'Brien*: I would say not.—*Mr. Mullens*: It does not unfortunately work that way. The moment that people see prices coming down they hold off immediately, or even tend to sell in competition with us. The majority of people who are in charge of investing money, whether it be on behalf of banks, insurance companies or pension funds, do not only look at the stock at the price it is on sale that day. They look to see what they think it is going to be in two or three months' time, and if they see the market falling nobody will buy. In fact, people come in to sell and the market goes further down until it comes to a moment when people think that it has gone far enough and if the long-term trend is generally upwards it resumes that trend.

11968. In circumstances like that would departmental funds available for investment have a tendency to be used for Treasury Bills rather than for long-term investment?——*Mr. O'Brien*: The main funds would be the Issue Department or the funds under the control of the Comptroller-General of the National Debt Office. The Issue Department has its body of stocks and its holding of Treasury Bills. If in a weak market it cannot sell stocks on the market, any funds becoming available would be re-invested in tap Treasury Bills. The Comptroller-General of the National Debt Office, for whom Mr. Mullens is the broker, does not do a great deal of business in the market nowadays but he might well, I imagine, consider that a weak market was a good opportunity to buy something that he wanted.—*Mr. Mullens*: Nine times out of ten we should not buy direct for him unless we had made some compensating sale.—*Mr. O'Brien*: The general rule which we try to follow with the agreement of the Comptroller-General of the National Debt Office is that, once having got money in from the public through the various funds, the Post Office Savings Bank or whatever else it may be, he should not put it out in the market again.

11969. *Professor Cairncross*: Are funding operations entirely in terms of the Issue Department and not of the Comptroller-General of the National Debt Office?——I am thinking primarily of them, but the actions of the Comptroller General can also promote funding if by funding we mean lengthening the average maturity of the debt in market hands.

11970. His decisions would be taken independently of you?——He has independent responsibilities, but he works very closely with us. As I think I have said before at this table, where he can reconcile his primary responsibilities with a helpful attitude towards our general policy, he very frequently does so.

11971. *Lord Harcourt*: Mr. Mullens, do you deal direct with the Comptroller-General of the National Debt Office, or does he pass his orders to you through the Chief Cashier's office?——*Mr. Mullens*: No, I deal direct with him.

11972. *Chairman*: I am not quite clear about this principle of not reducing your prices when the market looks weak. Have not some stocks that had been issued at one price in fact been got rid of in the course of the following months at a considerably lower price? I think we have heard that the 3½ per cent. Funding Stock 1999-2004, issued at 80, at one stage was being sold at a price in the 60s before it had finally been all disposed of. How has it come that that reduction took place?——Generally speaking it comes from conditions completely unconnected with me. It might be a question of some international incident which would put the market down, possibly only temporarily. At the time to which you are actually referring it was undoubtedly due to the raising in interest rates at the short end. That would have been at a period when the Bank Rate was actually being moved upwards; that, of course, does have a depressing effect on the long dated stocks, although not quite so quickly. The stock that we sold was purely on the occasions when people thought: "They won't put the Bank Rate up any more", or: "Things are looking better", and so we got that turn round which we always do get at the end of a fall. On that small rise people will come in again, and so our sales for the Government are much more spasmodic. They would probably happen over weekly periods or monthly periods as opposed to a general flow of sales which occur in a steadily rising market.

11973. *Professor Sayers*: How far are you able to judge who are the people or who are the classes of people or institutions which are doing the main buying or selling or switching at any time?——It differs according to what stocks we are actually concerned with. With the short dated stocks, the deals are mostly those of the discount market, and possibly to a small extent the banks.

11974. Is this in the whole market and therefore also in your own operations, or is this just a statement of the switches with you?——No, the general position in the case of switches in medium dated stocks, those between five and fifteen years, is that probably the banks would be most likely to be switching. Then with long dated securities insurance companies are a very big factor, and pension funds too.

11975. Can you judge at any time where the big buying or the big selling is coming from, when there is a buying pressure or a selling pressure in the market?——It is very difficult to tell at the time where it is. Subsequently it can appear, as in the banks' monthly statements. But during the period when buying or selling is taking place it is very difficult for me to tell actually who is doing it.

11976. But is it difficult for you to judge the general direction from which the transactions are coming?——*Mr. Mullens*: I can only guess largely by the type of stock which is being pressed for sale.—*Mr. O'Brien*: And the size of the deal.

11977. *Lord Harcourt*: The market as a whole usually has an idea where big movements, whether they be buying or selling movements, are coming from?——*Mr. Mullens*: There is nothing on earth to prevent the jobber knowing, because nine times out of ten he can see the name on the transfer; but he would not normally disclose to a broker who that was.

11978. Certainly not the name; but is not the type of buyer apt to get known in the market?——It could get known.

11979. *Professor Sayers*: But if you are comparing one period of weeks when prices are on the whole tending to rise and therefore public buying is on the whole big, with another such period, can you judge that the origin of the buying is different in the two cases? Have you sufficient knowledge and judgment of the situation over a period of time to know that?——I do not think that I have ever given that particular thought. Pension funds and insurance companies tend to be perpetual buyers by virtue of the fact that the funds of those two particular institutions are continually growing. But it is difficult to say which is doing the buying at one period of time or another.

11980. *Professor Cairncross*: Surely the purchases of the pension funds and the insurance companies, while they are very large, are only a fraction of the total outright sales from the Issue Department in any given year. You sold one year at least £400 mn. of bonds. The purchases of the insurance companies and pension funds might be half or a little more than half of that total. Have you any idea of what the remainder might be made up? Are these transactions of private persons in the main?——I think that there are a considerable number of what we know as small buyers; obviously it is that type of business with which the smaller jobber deals. There is investment on behalf of private trusts, and the Public Trustee, and (although this gets into slightly bigger figures) the building societies and the Trustee Savings Banks. These are, of course, nothing like so big as the ordinary commercial banks, but they undoubtedly make up quite a big proportion and have a very big effect at times on the actual market itself.

11981. Would it assist you if there were a running record of the ultimate buyers of gilt-edged?——I am afraid that I am not concerned with that. I do not mind who are the buyers so long as they appear.

11982. You do not think that market research might help?——I doubt it very much.

11983. *Professor Sayers*: During the last year I understand that there has been a great deal of buying on the rising market. Would you say that that buying has been more widely spread in its origin than buying over the previous years?——I find it very difficult to answer this. I would have said that during the relatively short period when there was very heavy buying it was very general indeed. I see it myself to a certain extent from my firm's business and there is no doubt that the actual buying

came from a very large section of the community who had kept the money idle during the shock of the 7 per cent. Bank Rate of last year.

11984. Is the buying on a market rising from a point at which yields were something like 5½ per cent. differently spread from buying on a market that is rising from yields of 4½ per cent. or 4 per cent. Has your experience anything to help us on this?——No I do not think so. It is really dependent upon what people think is going to happen. I do not think that the actual rate of interest, provided that it is reasonable, really attracts some people more than others. I think that they are all prepared to invest in the market at a time when they think the market is going up.

11985. Does the circle of people who are interested in a rising market widen or narrow according to what sort of level of rate of interest there is?——*Mr. O'Brien*: I suppose that one factor is the comparison with other rates of interest available. But I would have thought that a long-term rate of interest of 5 per cent. is likely to be more attractive than a long-term rate of interest of 2½ per cent.

11986. Has Mr. Mullens any definite evidence that would tend to support that?——*Mr. Mullens*: I do not think that I can help, because it is very difficult for me to know who is actually operating.

11987. *Lord Harcourt*: You deal in bulk with the jobbers, and you may have from the type of stock dealt in an idea of where the buying is coming from; but there may be a large increase in small orders which you will not know about, except when the jobber comes to you to cover his position in a large sum?——That is correct.

11988. *Professor Sayers*: Does a great deal of dealing with you then originate in another jobber rather than with a broker?——All brokers have to go to a jobber. One broker does not deal with another broker. I will not deal with another broker.

11989. *Chairman*: So you are always in the position of dealing very largely in bulk with this jobber or that, who has concentrated the dealing in his own hands?——That is right.

11990. Sometimes reference is made to a particular stock at any one time as a "key" stock, or as the "bell-wether" of the gilt-edged market. Let us take the 5½ per cent. Funding Stock 1982-84, issued in February, 1958, at 98½. *The Times*, on 23rd September last, said of this stock: "This is the stock the authorities are using to control the level of yields on long dated British funds." Would you recognise that as a description of that stock?——Yes, I think that is fair comment.

11991. What then does the control amount to in this sense? Is it that your actual prices for that stock day-by-day would be known to the market, as you have told us, and that the prices for the range of gilt-edged adjust themselves to what you are doing with that stock?——Yes. Not only do the prices of other Government stocks relate themselves to it, but also (and this is what, I think, prompted that statement in *The Times*) the terms of new corporation stocks and other similar issues in the market. They were all being issued with the same coupon, with a fairly long or medium-term life and between 98 and 100. It obviously depended very much on the price of the 5½ per cent. Funding Stock, 1982-84, as to at what prices and on what terms these other 5½ per cent. stocks could be issued. As the price of the 5½ per cent. stock rose, it was possible to issue loans for corporations on terms slightly more favourable to them.

11992. What makes it the determining stock? The fact that it is a tap stock for the time being?——Definitely.

11993. Would it be true as a generalisation that as long as the Government has a stock on tap (I know we may have to separate it afterwards into long term stock and medium term stock) the terms on which you are currently peddling that stock will determine the level of yields and prices in the rest of the gilt-edged market, stretching out into the local authority borrowing and possibly into industrial debentures?——Yes, that is perfectly true, even into industrial debentures; and that stock will be the one to which everybody will look, as long as it is on tap.

11994. *Professor Sayers*: Am I right in thinking that, at any rate speaking over many years, there is always a Government stock on tap?——There was one occasion for a very short period of time, when there was not, but that is virtually true.

11995. *Chairman*: It would be true that on the day the tap ran dry of the 3½ per cent. 1999-2004 the 5½ per cent. 1982-84 was brought forward, so that there was no gap in that case?——There was no gap in that case.

11996. Is there any limit to the Government's power to create a new tap stock to exercise this function?——*Mr. O'Brien*: The policy has been to fund so far as possible and, as I said in the preliminary statement, our belief is that that is more likely to be encouraged by a higher rather than lower level of interest rates, and by a gradual reduction in those rates rather than a swift reduction. The existence of suitable tap stocks is an essential means of pursuing that policy. But that does not mean to say that it would necessarily be better served by making no formal issue at all for a specified amount, but merely (as we did during the war) having stocks available in the loans office to which anyone could go at any time and buy at the price of the day. The formula of issuing stocks to a limited amount and varying the terms and the length of the stock is all part of the process of retaining the confidence of the market, which is the most essential part of this policy of funding.

11997. I follow that. Is it also right to say that, as long as you have a tap stock, then the terms on which you are prepared to deal in it at any one time give you a leverage upon the yield required in the market generally on other stocks which centre on what you do?——That would he right.

11998. *Sir Oliver Franks*: Would you say simply as a matter of experience that if in the earlier part of this year there had not been this quantity of the 1982-84 Stock on the shelf, and if you had not been selling it off on demand and therefore of set purpose keeping prices only gently rising, that the yield on longer term gilt-edged would have gone down quite sharply?——*Mr. Mullens*: I believe that to be so.

11999. Then would it not follow that the use made of this particular stock is an important positive and negative control, negative in the sense that having it on the shelf and selling it at prices as determined prevented the long term yield falling as fast as it would otherwise have done, positive in the sense that it becomes a powerful engine for managing the market?——Yes.

12000. Would you confirm my impression during the earlier part of the year that the way in which this 1982-84 stock was sold off the shelf at the prices which were quoted for it represented the expression of a clearer and more conscious policy in the management of the long term market than had often been the case before when the stocks were on the shelf and were being sold by the Government broker? It seemed to me that there was a different level of purposefulness about it?——*Mr. O'Brien*: I indicated something in my preliminary statement to that effect, and I would confirm that that is so. We must remember that 1957 was a bad year for funding; the 7 per cent. Bank Rate pushed the long-term rate out quite appreciably. It having got out as far as that, we have been intent upon making full use of it in conditions which fortunately for us have been very much better than they were last year. My point is that a conscious policy is much more easily seen when there is the kind of market in which it can be seen to work. In the previous year, whether the policy had been conscious or not, it would have been very difficult to show it in operation.

12001. I have no desire at all to raise the matter in a controversial form, but it did seem to me that, given the general position that the authorities do not and cannot go against the ultimate trend of the market, and that in that sense the trend of long-term gilt-edged rates is from their point of view a product of nature, yet the experience in the earlier part of this year shows an enlargement within that total field of the area of conscious management?——I would not dispute that.

12002. *Chairman*: You had, I think, another "key" stock on tap at the same time as the 1982-84; was there not one for the medium-term market?——*Mr. Mullens*: There was the 5½ per cent. Conversion Stock, 1974.

12003. I was thinking of the 5½ per cent. Exchequer Stock, 1966. Were three on tap currently?——*Mr. O'Brien*: In effect there were four; we also had the residue of the 4½ per cent. Conversion Stock, 1963. That was a most unusual situation.

12004. Would it be true that in your operations in disposing of those you would have the same leverage on the medium-term market as with the 1982-84 stock on the longer term?——*Mr. Mullens*: Yes, I think so; it is very likely that a different type of investor is concerned, but undoubtedly by and large they do give us that leverage.

12005. What happens in the market when you run out of a stock of that kind? Is it known at once that the tap has run out?——Yes, it is. It is probably known before, because, as I think I mentioned, we accelerate the price movements of tap stocks when the tap is running out, because generally tap stocks are cheaper in relation to other stocks. Generally speaking, nothing much happens for some time after we have stopped selling.

12006. *Professor Sayers*: Does the market in that particular stock tend to go down after the tap has run dry?——Market operators buy it and are therefore able to meet investment demand after we have stopped selling.

12007. *Chairman*: The terms on which you part with tap stocks are intended to be more favourable than the current prices for stocks in the market?——*Mr. Mullens*: Yes, it is the only way to get the stock out.—*Mr. O'Brien*: One is dealing with a stock of which there is known to be a supply, though the amount is unknown, whereas of other stocks there may be no appreciable supply; so there would tend to be a differential in price anyway.

12008. *Professor Sayers*: Suppose that the authorities took the view at some time that the volume of sales of long-term securities had become of quite secondary importance, and that the important thing was to get the yield up; would there be any technical difficulty in the prices of the key stocks being dropped, even if that would dry up the market?——It would be perfectly possible to issue a new Government stock of any maturity which was thought to be appropriate at any price we decided upon.

12009. Would it not be possible without even a new issue to drop the key prices of the existing stocks on the shelf?——*Mr. Mullens*: It would be possible, undoubtedly; but it would have a very bad effect on the market as a whole. The Government would be thought to be breaking faith with those people who had actually supported them on the prospectus when it was originally issued, probably not very long ago, and also with all those people who actually bought the stock in its early period of being on offer.

12010. This is something that is done indirectly. When Bank Rate is put up sharply that forces the prices down, as Mr. O'Brien has just told us; is that action taken by the authorities interpreted by the market as a breach of faith in any sense?——No.

12011. When the price of a key stock is dropped from 84 to 80, say, or from 84 to 82, without there being a change of Bank Rate, why should that be interpreted as a breach of faith when it is not so interpreted in the other case, when it is the same people who are taking the decision in either case?——I do not pretend to know the policy about moving Bank Rate, but I would like to point out that if one is going to alter the long-term rate of interest by a half per cent., one has to move prices ten points in order to do it. That is a very severe move.

12012. But it is a mere fraction of the extent to which it has moved over a period of years.——Over a period undoubtedly; it is another matter to do it overnight.

12013. I can see that that would be something very desperate for existing financial institutions; and I am asking why it should be regarded as a breach of faith. I do not dispute your argument that it would be regarded by the market differently from a change in Bank Rate; I am asking why the market regard it differently?——*Mr. Mullens*: If an investor subscribed to an issue which the Government had offered to the public, and then quite shortly afterwards they arbitrarily lowered the price of that offer, I think that the investor would feel, rightly, that he had been swindled.—*Mr. O'Brien*: I think that people tend to underrate the degree to which investors work in watertight compartments, to look on a narrow front. All investors reckon that they have to take the facts of life, be it a Suez crisis, an exchange crisis, or a rise in Bank Rate, as one of those inescapable things with which they have to contend; but when they look on the narrow front of borrowers and lenders, then they think that borrowers should behave properly. They think that a borrower issues a contract, and that he should stick to his contract, and should not himself so affect the market in his stocks that he appears to be swindling the lender. They undoubtedly do, and I think it is reasonable that they should, look at that kind of action in an entirely different light from the larger facts of life which may affect them, adversely or to their benefit. Do you agree, Mr. Mullens?—*Mr. Mullens*: I think that that is absolutely right.

12014. Over quite a short period of years the price of Consols was halved and the price of War Loan dropped from 102 to 60. This was something that hit people and institutions very widely indeed, and this change in price was recognised as coming about very largely because the authorities had decided to use interest rates, and had pushed Bank Rate up quite severely. Do you think that there is no trace of a feeling of breach of faith in that?——*Mr. O'Brien*: I would not say that there was; would you, Mr. Mullens?—*Mr. Mullens*: No; but they have had the opportunity to get out during that period of time. If suddenly, on instructions from the Chief Cashier, I lowered our tap stock rate by 5 per cent., they would lose 5 per cent. overnight, if that is the suggestion, and would have no opportunity of taking any evasive action.

12015. *Chairman*: What would happen to the jobbers, if you made overnight sharp adjustments of the kind we are talking about?——For anything of the nature we have been discussing we should have to take them into our confidence, or we should ruin them. They were nearly ruined over the 7 per cent. Bank Rate.

12016. *Professor Sayers*: You might in fact have to make special arrangements?——Yes.

12017. *Chairman*: What would you do? Would not taking them into your confidence mean giving them advance warning of a Government move that is equivalent in its importance to a change of Bank Rate?——*Mr. O'Brien*: Possibly a better alternative, would be to clear their books for them without loss, after the change.

12018. To give them an indemnity, in fact?——Yes.

12019. *Professor Cairncross*: You do not extend the logic of what you are saying to National Savings Certificates. There are overnight adjustments in the rates paid?——They are securities in which the capital value is not affected by the change.

12020. Cash value is not affected?——A Bank Rate change will adjust the rate payable on a bank deposit; it does not alter the amount of the deposit. That is one of the facts of life that is perfectly well recognised by people who are dealing with it.

12021. *Professor Sayers*: Some of the jobbers, I suppose, hold on their books appreciable amounts of Government stocks at the very short end. These must be very substantially affected when there is a sharp change of Bank Rate. Are you asked to make special arrangements then?——*Mr. Mullens*: No.

12022. Do you give them warning?——*Mr. Mullens*: No.—*Mr. O'Brien*: The large number of holders of very short bonds are the professionals right at the heart of the market. They have views about Bank Rate; though they are not always right, it is one of their jobs to look out for that kind of thing.

12023. But the widows and orphans can have a third removed from their capital value in course of years, without getting much sympathy?——It is not true to say they do not get sympathy. What we are trying to do is to distinguish the attitude towards these general actions from the attitude towards a particular action aimed directly at bond prices. I agree that both have the same unfortunate consequences.

12024. *Sir Oliver Franks*: We are dealing with one authority and two voices, one which expresses itself in movement of interest rates, and the other which expresses

itself through the actions of the Government broker. If the general public thinks of these voices as separate, then the conditions which you describe obtain; but if these voices are thought to cohere or to permeate each other, then the utterances of the one voice are always thought of in conjunction with the other voice, and the situation that you describe would not exist. Is this therefore basically a matter of convention according to which the matter is traditionally applied in this country? Is it that, if convention had been different, people would have felt and believed differently, but that what you say is true simply because the facts are as they happen to have been over the last few decades?——*Mr. O'Brien*: That is part of the explanation, I think; but even so I am not convinced that this particular kind of action which is contemplated would not have unwelcome consequences.—*Mr. Mullens*: I entirely agree with the Chief Cashier. If those actions were taken I feel that we should lose a great number of our supporters. I fully appreciate that banks and the discount market must invest from time to time in Government stock; but insurance companies, pension funds and private trustees need not, and they are the people who I think would be frightened away if we were to take the sort of action that has been suggested.

12025. *Professor Cairncross*: Mr. O'Brien said that the policy had been to fund as far as possible. Is it reasonable to interpret that as meaning that, if throughout the past five years the instructions had been to sell longs to the maximum, the Government broker's success would have been what it has been and no greater? Even if the Government's funding requirement had been greater by £500 mn. or £1,000 mn., you do not think that you could have so managed the market as to procure that additional volume of funds by selling long-term Government bonds?——*Mr. O'Brien*: I can only say that since the credit squeeze began virtually at the beginning of 1955 all our efforts have been bent upon selling as much as we could at all times, having before us the excess liquidity of the banks which we were desperately trying to get down. If we had been more enlightened we might have been able to sell more than we managed to sell, but we were certainly trying as hard as we could all the time.

12026. *Professor Sayers*: You mean by "more enlightened" that if you had had a greater knowledge of the appetite of the market from day to day?——I really meant that if somebody could think of better ways of doing it than we have managed to think of they might have sold more.

12027. *Professor Cairncross*: You made what I thought were some rather far-reaching admissions to Sir Oliver Franks. If it is true that you have been able to take advantage of the situation over the past year, in which long-term rates were thought to be likely to come down as well as short-term rates, earlier action to the same end would surely have facilitated greater sales over the period?——If you mean if we had put Bank Rate up to 7 per cent. a year earlier, those who had to decide decided that was not the thing to do; but they might have decided otherwise, I suppose. Of course funding is not the only object in view. The thing has to be seen as a whole. No doubt there were very good reasons for not taking that drastic step earlier.

12028. Would I be right then to add to what you said just now a reservation: provided short-term rates had behaved as they did behave, you do not think that you could have been more successful in selling long-term bonds?——I do not think that we could have been more successful than we have been.

12029. *Chairman*: We have covered the first four questions, and that brings us to clearing up the points arising out of the fifth question, about the four special occasions. ——That, I think, is a question for me, with any additional information which Mr. Mullens may be able to provide, as these are matters of history concerning the policy followed by the authorities. In the preamble to the question you say: ". . . in recent years there were four specific occasions when the Government broker took what was thought to be exceptional action". "Exceptional action" is, so to speak, the subject of this question. Of the first occasion in November, 1949, I cannot speak from personal knowledge, but I think the Government broker can. It will be remembered that the then Chancellor of the Exchequer, Sir Stafford Cripps, in a speech at Bristol on the 27th November, 1949, stated that the Government had stepped in to steady the gilt-edged market during the preceding three weeks. This action had in fact been taken during the week ending 17th November. During the previous weeks the market had been in a highly nervous condition. We had in fact been doing nothing more than buying in the next maturity, the 1¾ per cent. Exchequer Stock 1950. A steadier tendency was evident on the morning of Friday 11th November, and on the appearance of official support an immediate and substantial rise took place, followed after the weekend by a further sharp rise, which was, however, not fully maintained. Price increases ranged from $\frac{1}{16}$ in short dated securities to approximately 3¼ in the 2½ per cent. undated stocks. The very appearance of official support had been enough to bring this about. Gross purchases of stocks by the authorities other than purchases of 1¾ per cent. Exchequer stock during the week in question totalled only £5 mn., and were in fact exceeded by gross sales of £5,300,000. Our purchases consisted of five stocks, and our sales of six stocks.

12030. *Professor Sayers*: Did the stocks purchased include any undated?——They included a substantial portion of undated stock during the week.

12031. *Chairman*. How does official support manifest itself?——*Mr. Mullens*: It so happened that this does come under the category of an exceptional occasion. It is the only time that I ever remember it happening during the time I have been with the firm. I was not the Government broker then, but my predecessor was away that day, and it therefore fell to me to put this into operation. It was on the instruction of the Governor that I could disclose the fact of official support. I did in effect go into the market and say: "I will buy any stock you have to sell". I have never done it or seen it done before or since. It was a matter of policy, as the Chief Cashier has said, emanating from the Chancellor. The total purchases on that day were £500,000.

12032. But you let it be known that you were prepared to deal without limit?——It had that effect.

12033. Then we come to the first half of 1952?——As Mr. Mullens has said, of these four occasions the first is the only one where exceptional action was taken. In the first half of 1952, far from "giving strong support to undated stocks" the Issue Department was a net seller of such stocks, gross sales being some £33 mn., and gross purchases some £7 mn.

12034. You may have a marked effect on the market by a particular operation over a more limited period than that; the net result over a longer period does not necessarily give the effect. Could you say whether at any time, perhaps a few days, there was any marked action during that period?——I have no evidence even of any particular day on which we did that.

12035. This was stated in evidence before us by the representatives of the Council of the Stock Exchange, who said that, when it was known that the authorities were starting an active interest rate policy, there was a good deal of "jettisoning" (that was the word used, though it was subsequently qualified) particularly of undated stocks. We were told that it was not unusual to get a hand when the market is under pressure, and they thought that in the first half of 1952 that kind of assistance had been applied from time to time.——*Mr. O'Brien*: Gross purchases of £7 mn. even within a few weeks, could not be regarded as enormous, although that would be rather more than we would usually take. I should be happy to make further inquiries, but I do not believe that it will be found that we took any exceptional action. I certainly cannot recall it.—*Mr. Mullens*: I recollect that we sold considerably more stock than that during that time. I have a note that we actually sold a considerable amount of undated stock pretty consistently through that period.—*Mr. O'Brien*: Sales of undated stock took place on thirty-nine days in that period from January to June. The largest purchase of undated stock we made during that period was for £2 mn. on 3rd April, 1952.

12036. It looks as if you were credited with action which you did not actually take. What about the next occasion, that is, the first half of 1955?——This is a period we have discussed before. Far from giving strong support to the market at that time when the banks were selling heavily, the authorities themselves were even heavier sellers,

12037. You have established that in your figures to us. Were there any short periods during that when there was intervention on any unusual scale?——Certainly not on any unusual scale. There were large operations, but nothing exceptional. Between mid-February and mid-July 1955 the clearing banks sold to the market over £100 mn.; during the same period the Issue Department sold about £225 mn. net of gilt-edged stocks to the rest of the market and indirectly the Issue Department bought about £50 mn. net from the clearing banks. To that extent it might be said that we were assisting the clearing banks to liquidate their securities, but this net figure includes about £80 mn. of 3 per cent. Serial Funding Stock 1955, the next maturity due, which we were taking in in the normal way to prepare for the maturity.

12038. *Mr. Jones*: The Treasury and the Bank had been concerned during this period particularly about the degree of liquidity. In supporting the market, or at any rate in helping the banks at this particular stage, were not the Bank taking a line of action which was defeating Government policy?——No, because, as I say, we gave help to the clearing banks to the extent of about £50mn. net, but within the gross turnover we took in £80 mn. of their next maturity. It is our object at all times to gather that next maturity in so as to facilitate the refunding operation, so that we were merely serving our own ends there. Far from supporting the market in general, and thus making it an easier market for the banks to sell in, we ourselves sold £225 mn. net and put securities on the market.

12039. *Professor Sayers*: Before 1955 bankers commonly said that, if they tried to unload a large amount of their gilt-edged securities in a short time, they would just find that they had to change their minds, because there would not be that sort of capacity in the market. In 1955 they did in fact unload quickly, I think more quickly than your figure of £100 mn. over the half year indicates, because it was a greater amount over a short period. As a result of that we asked various witnesses to whom this stock went, knowing from the figures you had given us earlier that the Government was on the whole selling during this half year. We had an answer, again from the Stock Exchange representatives, that it must have been that the authorities were supporting the market heavily at the times of these big sales. You make it quite clear that that was not so. Can you help us in trying to track down where the bonds did go?——I think I have made it clear that a large part of what the banks were selling did come to us because it was the next maturity.

12040. But over the period your net sales plus the banks' net sales were very substantial. Who were the buyers?——*Mr. Mullens*: I have no definite knowledge, but I would have thought that it was the discount market.

12041. The discount market figures do not entirely fill the bill. This is a period in which we have interested ourselves a good deal, because we wanted to know about the absorptive capacity of the market when interest rates were behaving in such and such a way.—*Chairman*: Someone else suggested the discount market might have been a big contributor in taking them on, but Professor Sayers points out that the figures do not support that. Would you yourself be surprised to know to what a large extent these securities which had been sold passed into other hands? All the banks' sales had to be taken care of by somebody, and you were net sellers at the same time; there must have been a very large range of new or enlarged holders of these gilt-edged securities. Does it seem to you odd to have happened on that scale?——*Mr. O'Brien*: It is a little surprising if the discount market were not concerned.

12042. *Professor Sayers*: I did not say that they were not concerned, but that their figures do not solve the mystery, or come near to doing so.—*Lord Harcourt*: It still leaves a big gap?——I think we must say that we cannot answer the question; we do not know.

12043. *Chairman*: You have not the sources of information. Is it not of interest to your general conduct of policy if there is such a surprising elasticity in a period like that in the gilt-edged market?——*Mr. Mullens*: Yes. I remember clearly that we were selling a tremendous amount of stock, and I am surprised to hear that it was not the discount market that took most of it; but, as I say, I would not have specific knowledge. Both the brokers and the market make a great point that the client must never be mentioned, and therefore it is obviously difficult to know who does these things.

12044. *Professor Sayers*: Has the Bank tried to find out, as a matter of enlarging its knowledge of how the market behaves, what happened during this half year?——*Mr. O'Brien*: We have not tried to enlarge our knowledge of what happened during this particular half year, but we are currently trying all the time to enlarge our knowledge in these matters, so that if it occurred again we should be better informed.

12045. *Chairman*: Does that mean that you are trying to order some new series of statistics as to holders, that would help you on changes in holdings?——We have not got so far yet as to get people who do the investing to tell us what they have done, but we are trying to get what we can from such information as we have available.

12046. *Sir Oliver Franks*: Have you any reason to suppose that the bonds that were taken up in this rather surprising way were taken up in large part by foreign holders, or people acting on behalf of foreign holders?——That could well have been true in part; for example, countries getting large oil revenues.

12047. *Chairman*: Then we come to September 1957, when it was said that the Government broker was edging up prices before the change of Bank Rate?——From the beginning up to the middle of August, 1957, the gilt-edged market was active and firm. It then became unsettled because of fears of impending exchange difficulties, but immediately before the rise of Bank Rate to 7 per cent. it became steadier and prices tended to advance again. From the second week in August to the week ending 18th September, 1957 (and for another three weeks thereafter) the Issue Department was substantially a net purchaser of gilt edged, almost entirely because we were preparing for refunding the 2½ per cent. serial Funding Stock due to mature on 14th November, 1957. During this period total purchases were £103 mn. gilt-edged, including £76 mn. of the next maturity, while total sales were £24 mn. In the case of one stock only were sales made at rising prices, and that was the 3½ per cent. Treasury Stock 1979-81. On the 17th and 18th September a very strong demand for this stock developed, and sales were made by the Issue Department at rising prices. On 17th September £500,000 was sold at 70$\frac{13}{16}$, and £125,000 at 70$\frac{7}{8}$. The following day we sold £475,000 at 70$\frac{7}{8}$, £500,000 at 71 and £500,000 at 71$\frac{1}{8}$. There was nothing exceptional in that at all. It was in accordance with the practice which Mr. Mullens has already described to you.

12048. Was that stock at that time on tap?——A second tranche had been issued in the previous year; presumably it was the residue on our portfolios.

12049. Do you buy stocks into the portfolio from time to time?——We occasionally acquire them, from the National Debt Commissioners, for example, if there is a reviving demand for them which we want to meet. This particular stock may in fact have been obtained from the market in exchange for a longer stock which the market wanted, but I would not completely trust my recollection on that. After such a long period I would have expected it to have been something which we bought in.

12050. Any suggestion of edging up as a policy is not substantiated by the facts. What increase of price took place was over two or three days in response to a sudden demand, and was following the usual practice?——*Mr. Mullens*: Absolutely.—*Mr. O'Brien*: This was in fact a peculiar embarrassment to us after the rise in Bank Rate, because it had led some people in the market to believe that the market was going well up, and that any idea of a rise in Bank Rate was not to be considered, let alone to 7 per cent. But we were being pulled along then; if we had failed to do what we did, we should have revealed that something else was in the offing.

12051. Do you know what was the reason for that sudden demand for that stock?——*Mr. Mullens*: No. It was relatively cheap compared to other stocks, and I think that a large investor came into the market.

12052. *Lord Harcourt*: It was out of line?——Yes.

12053. *Chairman*: Are there any other points?—*Professor Cairncross*: I would like to ask a rather different question, of which Mr. Mullens has not had notice, I am afraid, about the mortgage market, in local authorities' loans particularly. There is some difficulty in getting information about the scale on which the local authorities have borrowed in the mortgage market and the price at which they have been able to raise the money. I understand that you collect reports on this, and I wondered whether it would be possible for the Committee to have the benefit of any indication as to the movement of prices of the local authority mortgages, and if possible the scale on which these borrowings have gone on in the last few years, say to 1955?——*Mr. O'Brien*: I do not know whether we can go back to 1955. We certainly get a regular report from the brokers on the state of affairs in that market, and that should provide you with something.*

12054. *Lord Harcourt*: Are there many brokers who deal in corporation mortgages?——*Mr. Mullens*: There are three main ones, but I dare say that now that the business has increased others have come in. There are two who have done that since before the war.

12055. And they make returns to you?——They do not all do so. I am in fairly close touch with one of them, and on what he tells us and what my partners see we give a weekly report to the Bank, which is at best only a guess, admittedly, but somewhere not far out.

12056. *Professor Cairncross*: Are these all long mortgages, or do they include short-term mortgages, of a single year, for instance?——The returns we give cover all those categories. The largest amount is in the seven-day period mortgages.

12057. Has not this been a very rapidly growing market, in short-term mortgages particularly?——Yes. When the Public Works Loan Board were not allowed to lend so freely and the stock market could not accommodate all the local authorities that wished to borrow money, the mortgage market was the obvious answer.

12058. You keep an eye on this, I take it, on account of your responsibility for marshalling the queue of local authority borrowers?——*Mr. Mullens*: I do not do anything more than take an academic view, other than anything I may be asked to do by the Chief Cashier.—*Mr. O'Brien*: One reason why we take an interest in it is because, as you know, the Public Works Loan Board had a change in their arrangements some years back, and they now lend much less to local authorities, and much less willingly, than they did formerly, so that local authorities have to go to the market for their money. They either get their money by market issues, which is where the marshalling of the necessarily somewhat slow-moving queue comes in, or those who cannot get a place in the queue go to the market in other ways, principally for mortgages.

12059. Do you know where they get this money?——*Mr. Mullens*: Two main sources I would have said are the building societies and the Trustee Savings Banks.

12060. It appears to be an elastic source of funds. Has not the total been mounting steadily?——*Mr. Mullens*: Yes. The majority is short-term, I would suggest.—*Mr. O'Brien*: We have by the courtesy of the Comptroller General of the National Debt Office quite detailed information of the mortgages taken up by the Trustee Savings Banks. They nowadays take up fewer mortgages than they did because their investment policy has been revised, it being felt quite recently that they had better invest in securities which are relatively liquid.

12061. Would it be a fair comment that local authorities have been doing some un-funding while you have been doing a lot of funding? Is not the larger proportion of their debt short-term while a larger proportion of the central Government debt is long-term?——I believe that to be so. I know some of them have very heavy short term commitments, some would say too heavy in some cases.

12062. It does not cause you any uneasiness?——We would prefer to see it otherwise.

12063. Can you give us any idea who are the buyers of undated Government securities today?——*Mr. Mullens*: They are getting fewer. Undated stocks became rather unpopular and the Press have frequently referred to the unsatisfactory investment they have been over a period of time. I would say that the people who buy them today are people who exchange other stocks for them. I do not think that there is a great deal of new buying of undated securities but there is always a moment of time at which a professional operator such as an insurance company, will sell one stock and buy irredeemables with a view to reversing that position at a later date.

12064. The market is quite an active one?——*Mr. Mullens*: Yes quite active.—*Mr. O'Brien*: Trustees of permanent funds which have to provide income for as far as one can see leaving the capital undisturbed may buy undated stocks.

12065. *Lord Harcourt*: There are certain foundations where capital appreciation or loss makes no difference at all, where they only look to their interest. I suppose those people still buy undated stocks?——*Mr. Mullens*: Yes, if they are only concerned with the highest possible interest for the longest period.

Chairman: Thank you very much; we are very grateful to you both for the trouble you have taken in clearing up our questions.

(*The witnesses withdrew.*)

(*Adjourned until* 2.30 *p.m.*)

SIR CHARLES HAMBRO, K.B.E., M.C., SIR JOHN HANBURY-WILLIAMS, C.V.O., and SIR ALFRED ROBERTS, C.B.E., J.P., Directors of the Bank of England, called and examined.

12066. *Chairman*: Sir Charles, we have your memorandum† in front of us. I would like to divide our questions to you into two quite distinct parts, the first part dealing with what more detail you can give us about the part that the part-time director can play in the work of the Bank of England as the central bank; and the second part as to the difficulties of the part-time director that were alluded to in the report of the Parker Tribunal, and the embarrassments he may find in his work, arising from his position as a director of the Bank of England. On the first part, you have told us quite a lot in your memorandum about how the Bank is organised and what people can do. You have given us as the appendix to your memorandum a list of the standing committees of the Bank upon which the directors serve. Are all the standing committees, other than the Committee of Treasury, concerned with the internal affairs and organisation of the Bank?——*Sir Charles Hambro*: That is so.

12067. The Committee of Treasury is the standing committee that deals with central bank operations as such?——It is the policy committee, and the committee to which every other committee reports before its report goes to the Court.

12068. The various policy decisions one associates with the Bank of England as the central bank, such as questions of the alteration of Bank Rate, open market operations, the portfolio of the Issue Department, would be for the Committee of Treasury, not for other committees?——They are not dealt with by any of the other committees, except that the Committee to consider the Security of Certain Funds deals with the securities actually belonging to the Bank as part of its capital, and the securities that are managed by the Bank for trust and other funds, such as the Sinking Funds of loans, such as the American Memorial Fund investments, and any funds where the Governor is a trustee are dealt with in that committee. Apart from these trust funds it is only the Bank's own funds that are invested by that committee.

* Information on these points was subsequently supplied by H.M. Treasury: see Qn. 13269.

† Memoranda of Evidence Part I No. 15.

12069. *Professor Sayers*: What are the Bank's own funds?——The Bank holds a certain number of gilt-edged securities as part of its normal banking investment.

12070. Are those the securities shown in the Bank Return as securities in the Banking Department?——That is right.

12071. This Committee does not deal with the securities in the Issue Department?——No.

12072. *Chairman*: You speak in your memorandum of certain *ad hoc* committees which are formed from time to time without giving them the status of a standing committee. What sort of subject would those deal with? Would they be policy matters?——Only internal policy matters where the running of the Bank is concerned, not policy matters where the Government is concerned.

12073. Then we should like you to give us as much picture as you can of the amount of time that a part-time director can spend on the work of the Bank, apart from his work as a member of one of these committees?——*Sir Charles Hambro*: It rather depends on what the part-time director does outside the Bank. It is generally the custom for a part-time director, apart from attending the committees which he is attached to, to be in the Bank two or three days a week for lunch, and to drop in and out of the Bank, largely at the request of the officials or the executive directors or the Governors, to discuss some specific subject in which they are interested, or to discuss some subject with which he thinks the Governor or Deputy Governor or whole-time directors should be acquainted. It varies tremendously according to the work which has to be done. I should say that the directors in the City, such as Sir John Hanbury-Williams and myself and others, are there probably more often than the directors who work up in the North or in the Midlands on their own business. But most directors, when they are in London from the provinces, come and lunch at the Bank, and spend an hour or so talking to the Governors or the officers on any subject which they may be called upon to discuss.——*Sir Alfred Roberts*: The Staff Committee meets fairly regularly, but its members have another function, and that is to visit the various departments of the Bank from time to time, partly to get some knowledge, even if it is superficial, of what is happening in that department, and partly to see how the staff conditions are generally. This involves, from my own personal experience, some two days every three months at least in visiting these departments. By this means one gets an internal knowledge of the workings of the Bank.

12074. Do part-time directors have an office of their own in the Bank?——*Sir Charles Hambro*: No. There is an ante-room, and writing desks are there which can be used, but there is no specific room allotted to any one director.

12075. Do they have secretaries allocated to them?——No. The Secretary's department would provide any form of secretarial work that they wished to be done. The Secretary's department looks after the Court, and if a director wants statistics or any information or any secretarial help, he only has to ring up the Secretary and he will send somebody along.

There is another duty which the outside directors perform, and that is the visiting of branches. Every branch is visited once a year by two directors, one of whom is always an outside director, not necessarily on an inspection but rather to get to know the people in the branches and discuss their difficulties. The opportunity is then taken to meet at lunch outside people round the district whom the Agent thinks would be interesting for the directors of the Bank of England to meet.

12076. How many branches does the Bank of England maintain outside London?——Newcastle, Glasgow, Liverpool, Manchester, Leeds, Birmingham, Bristol, Southampton, and the Law Courts Branch.

12077. That gives you an opportunity for cultivating local contacts?——The opportunity is taken then.

12078. As well as keeping your own branch Agent in touch?——We get to know the staff and what they are doing.

12079. *Professor Cairncross*: What is the size of the staff?——About 4,500 clerks, apart from the employees in the printing works and the Office of Works of the Bank. The total including those is just over 7,000.

12080. *Chairman*: How far, since you are necessarily living and working outside the Bank, are you bombarded with material, circulars, information, papers and that sort of thing?——Not a great deal outside the Bank, but we are often asked to go and read a memorandum inside the Bank. We are sent the minutes of the committees for which we are responsible, but if there is anything on policy matters on which the Governor may wish to consult us we are usually asked to go and read it in the Bank. If there are any reports on economic conditions which the Governor thinks we should see, he sometimes sends them; but largely they are kept in the Bank, and we are asked to go and read them in the Bank, after Court or whenever it may be.

12081. Apart from the Members of the Committee of Treasury, when a part-time director comes to a Court meeting, how far is he briefed in advance with information and material about the subjects which are going to arise?——On the question of the running of the Bank he has probably been on one or more of the committees responsible for that side and has seen the recommendations of those committees before they went up to the Committee of Treasury. At the Court he has in front of him the printed recommendations of the committees in a shortened form, which he can read during the Court. Apart from that he has probably been consulted by the Governors and asked his general views, for the Governors' own information, on certain questions which will affect the Governors' policy and recommendations to the Committee of Treasury. But on the broad business of, for instance, the Bank Rate, he probably does not know what the final decision of the Committee of Treasury may be before it is recommended to the Court.

12082. *Professor Sayers*: Will he have been given any memorandum that will bring to his notice the advantages and disadvantages of a possible decision on Bank Rate?——In my experience (and I have been on the Court over thirty years) no. He may have been consulted by the Governors on the state of the money market, if he understands the money market, but he will not be given any memorandum.

12083. Will he have been asked to read a written memorandum inside the Bank?——Never, in my own experience.

12084. *Professor Cairncross*: You mentioned the money market; did you mean that the Governors would naturally consult the directors on their views on Bank Rate with reference primarily to the money market?——*Sir Charles Hambro*: The directors might themselves go and see the Governors and give their own views about Bank Rate, but I do not think that the Governor would give the directors his views about Bank Rate. He would feed on their brains rather than they feeding on his.——*Sir John Hanbury-Williams*: At the Court, so far as I can recollect in the time I have been a member, no figures are circulated at all beforehand. The Governor reads out every Thursday morning at 11.30 a.m. the figures you see published in the newspapers, and it is on that, and on his recommendation after having consulted the Committee of Treasury and having been in touch with the Chancellor of the Exchequer, that a decision is taken as to whether the Bank Rate should be put up or down.

12085. *Mr. Jones*: Those are the figures that appear on Friday mornings?——That is right.

12086. *Professor Sayers*: In what way are they considered relevant, if a decision has to be taken?——*Sir Charles Hambro*: The figures read out by the Governor are a little more broken up than the figures actually published, and they give the Court a good background as to how the situation is forming. Apart from the current figures, we get the comparable figures for a year ago, and we have the figures for the previous month which we know of; and it is probable that in explaining the figures the Governor will elaborate them a little, if he wants some decision over Bank Rate or some decision on policy.

12087. Could you give us an example of what figures are given that do help the decision?——The trend of the figures over the past weeks of what is happening in the

circulation, in the money market, the rate of bills, the rate of discount, the demand for money; the credit situation as a whole can be followed by watching those figures week by week.

12088. Have you found those figures helpful in deciding upon whatever steps have to be decided upon?——I think that the elaboration of them is helpful; but it is a little difficult for me to answer that. I have been in the banking business in the City for about forty years and the Bank of England for about thirty years, and past history and past experience and the general trends must influence one's mind in taking any decision on whether the rates should go up or down, or what should happen to the Bank Rate. In my own experience it is not so much the figures but the general indications of the situation as a whole that make me willing to recommend one thing or another.

12089. Are any of those figures, or the commentary that the Governor gives upon them, of a kind that, if published, would help the public to understand the steps that are taken?——*Sir Charles Hambro*: I should say not. —*Sir Alfred Roberts*: I would agree that it would be impossible.

12090. They help you to understand what should be done but they could not possibly help anybody outside the Court to understand: is that the position?——On the day when we actually make our decision the explanations are given in much more detail as the reasons for a proposal to change Bank Rate; but I do not think that the trend would help the general public in any way. If one has been in sufficiently long one can follow a trend but not a trend that would help one to decide whether Bank Rate is going to go up or down; that would be my experience. It is really the accumulation of these figures week after week which leads the Governor to consult the Treasury as to whether Bank Rate should change, and then the accumulation of these trends is given to us on the final day when Bank Rate is changed.

12091. Which trends have you found most helpful?——I would say the trends of business experience; for example, the way industry is running, how much unemployment there may be, what the money market is doing, what the foreign exchange is like. Those are the factors which help me to decide one way or the other; but I could not say that this morning, for example, the trends suggest that there should be a rise or another reduction in Bank Rate today; it would not help me in any way at the moment.

12092. But the ones you have mentioned are the ones you in fact find most helpful in coming to a decision?——*Sir John Hanbury-Williams*: It is not the figures themselves but the elaboration of these figures by the Governor that helps me.—*Sir Alfred Roberts*: If the figures alone were given it would not help at all, because one cannot follow weekly trends unless one has an extremely retentive memory. We do not write them down and take them away.

12093. *Mr. Jones*: You look at this in the same way as an experienced man would look at a barometer, and would have cumulative experience as to how that barometer would be affected by certain weather or atmospheric conditions?——*Sir John Hanbury-Williams*: That would be a very fair way of putting it.

12094. *Professor Sayers*: Is there anything in the Governor's elaboration that would be impossible to publish, consistent with public policy, after a lapse of time?——*Sir Charles Hambro*: I would not have said that it would have been at all helpful to have them published.

12095. I was not asking whether they would be helpful, but whether there is any difficulty in the nature of public policy that would make it impossible to publish?——*Sir Alfred Roberts*: That would involve consultations with the Treasury, and therefore I do not think that it would be a matter for us as members of the Court.—*Sir Charles Hambro*: We must leave that question to the Governor.

12096. *Sir Oliver Franks*: If when the Bank Rate has been changed I ask myself what may have led to it, I find that I think about the course of money rates in the United States, the general trend of the world economy, anything that I know about the situation of order books in Britain and the movements of stocks, what has come to my ears about the movements of foreign exchange; I ask myself what I think of the general prospects for the economy and I review any information that I possess about the more technical operations in the money market itself. None of this appears to me to be irrelevant to trying to understand why the Bank Rate has been moved either up or down. I should have thought that, if the figures which you receive are essentially those which are published from week to week, the mere contemplation of the figures would not help very much in relation to the sort of questions which I ask myself, and that therefore the interpretation and the additional comments that the Governor may give must certainly be all important in persuading the Court that the proposed decision is correct. That would therefore seem to mean that by deliberate decision of the Court active discussion about an important decision of policy on Bank Rate would in fact take place in the Committee of Treasury, if it took place, and would be very unlikely to take place at the Court, the Court having in a measure delegated their authority in the matter, though not their formal authority, to the Committee of Treasury, where the Governor may put forward his views at much greater length in a smaller and more intimate gathering. Is this picture in essentials true or false?——I should have said that it is quite true.

12097. *Professor Cairncross*: When a proposal to alter Bank Rate comes to the Court from the Committee of Treasury, has it already been agreed at that stage with the Treasury that they raise no objection?——*Sir John Hanbury-Williams*: Ordinarily the Governor or, in his absence, the Deputy Governor would have seen the Chancellor of the Exchequer and ascertained from him what was in his mind before any definite report to the Court.

12098. Would the Court in any circumstances you know, overturn a proposition from the Committee of Treasury or suggest a delay in the movement of Bank Rate?——It has never happened during the time I have been a member of Court.

12099. So by the time the Committee of Treasury has approved subsequent reference to the Court is largely a formality?——To a large extent.

12100. *Chairman*: In this matter of the relationship between the Committee of Treasury and the Court, the position taken up by the then directors at the time of the Revelstoke Inquiry was that they were inclined to accept the recommendation of the Committee of Treasury as long as they had the right to select which of their members should be on the Committee of Treasury. Do you think that the attitude of the members of the Court who are not on the Committee of Treasury has changed, or is that the understanding today?——*Sir Charles Hambro*: We treat the Committee of Treasury as our conscience in these matters. We should not be inclined to try to change a recommendation of the Committee of Treasury. We might ask them not to do it again but we certainly would not change a recommendation on the day it was made.

12101. *Professor Sayers*: Do you regard yourselves as an electoral college for electing the Committee of Treasury, which will take decisions?——*Sir John Hanbury-Williams*: The Committee of Treasury is elected by secret ballot each year by the Court of Directors.

12102. Is that the most important function of the Court of Directors, in practice?——*Sir Charles Hambro*: On the questions of policy which affect the Treasury, I should say it was, but on the question of running the Bank it certainly is not.

12103. *Chairman*: As I understand it the tendency on the Committee of Treasury would be to accept the recommendation of the standing committees on those questions?——Yes. As Chairman of one of the standing committees I have often had a recommendation put back to me by the Committee of Treasury for reconsideration; or, as happened only last month, a recommendation of a committee may be delayed for two weeks by the Committee of Treasury because they want to think about it. But by and large, on the more or less routine matters of the Bank, the Committee of Treasury are apt to take the recommendations of the committees.

12104. Can you tell me the origin of the rule you refer to in paragraph 4 that not more than one executive director can be a member of the Committee of Treasury?——*Sir John Hanbury-Williams*: It is in order to have

a majority on the Committee of Treasury of non-executive directors.

12105. What year does that rule date back to? It is not in the 1946 Act?——*Sir Charles Hambro*: No, it is not, but I can get you that information.*

12106. *Professor Cairncross*: What is the significance? The existence of a majority of part-time directors does not mean in practice that the part-time directors ever exercise a veto or oppose a decision by the Governor?——The origin was that they could.

12107. It is a power that has never been exercised?——*Sir John Hanbury-Williams*: I can recollect there being some quite long discussions on matters of importance in the Committee of Treasury; often if there has been a long discussion in regard to a particular matter, the Governor has postponed the decision for a week until he got his colleagues to see his point of view, or modified his own.

12108. Has there been since the war a postponement of a decision about Bank Rate, because of disagreement in the Committee of Treasury?——I cannot recollect there being any postponement of decision because of disagreement amongst the members of Committee of Treasury. It might be that the Governor has not persuaded the Chancellor or the Chancellor has not persuaded the Governor that such and such an action should be taken.

12109. There have been occasions when there has been delay in movement of Bank Rate because of disagreement at some point?——*Sir Alfred Roberts*: That is between the Treasury and the Governor, not the Committee of Treasury.

12110. *Professor Sayers*: May I ask Sir John on what he was basing his supposition of a delay? Have you knowledge, for instance, of postponements of decision over an important matter other than Bank Rate?——*Sir John Hanbury-Williams*: Yes, there have been postponements.

12111. *Professor Cairncross*: Would those have been decisions relating to central banking policy rather than to the domestic affairs of the Bank?——More in regard to domestic affairs.

12112. *Mr. Jones*: Could there be a situation where there was a cleavage of opinion either in the Committee of Treasury or in the Court of Directors that could postpone the variation in the Bank Rate?——*Sir John Hanbury-Williams*: I do not think so.—*Sir Alfred Roberts*: If the Chancellor of the Exchequer were not involved, theoretically there could be, but in practice no.

12113. *Professor Cairncross*: By the time a proposition is put by the Governor to the Committee of Treasury it is presumably the upshot of discussion between the Governor and the Treasury and is a joint agreement between the parties, and therefore it would be a little embarrassing if the Committee of Treasury attempted to put a veto on the movement of Bank Rate?——*Sir Alfred Roberts*: I do not think that could happen.—*Sir Charles Hambro*: I used to be on the Committee of Treasury before we were nationalised, and I do not think that the Governor would go to the Chancellor on a question of policy unless he felt that he had the support of the Committee of Treasury behind his argument.

12114. *Sir John Woods*: You said just now that on the whole you regard the Court's most important function as being an electoral college to elect the Committee of Treasury, except where the running of the Bank is concerned. Paragraph 9 of your memorandum led me to suppose that a large part of the importance of the outside directors was not so much to give their views on central banking as to make available to the Governors and executive directors of the Bank their knowledge about affairs in industry and commerce both at home and abroad, about leading personalities, about significant events they had heard of in the course of their business, which they thought were important to the Bank and might have some effect on their policy. Would you not regard that as an important function?——I regard that as their main function. I thought Professor Sayers was asking me which was the most important function of the Court in regard to dealing with the policy of the Bank, and that would be their election of the Committee of Treasury; but as regards giving the Governors the information and guidance they have and can give, I should have said that that was the main usefulness they could give to the Bank.

12115. In other words it is a deliberate device to prevent central banking becoming sterile and divorced from the practical world where industry and commerce are carried on. It seemed to me that we had been discussing this as though the first way in which the outside directors came in to an important question on central banking policy was in a discussion at the Committee of Treasury; but may it not be that the formulation of decision or of policy in the minds of executive directors may be affected or delayed because of the individual consultations which go on, as you have described, from day to day between individual outside directors and executive directors?——My feeling would be that the policy which the Governor would put to the Chancellor would be formulated as a result of his conversations not only with the Committee of Treasury but with those outside directors whom he felt he ought to consult.

12116. These discussions with the outside directors do really play a part in formulating the views of the Governors and the executive directors?——From my own experience, yes.

12117. *Chairman*: Discussions with some outside directors whom the Governor thinks particularly qualified?——Who ought to be consulted in the particular matter.

12118. *Lord Harcourt*: That consultation and advice which you give to the Governors is a continuing matter which goes on daily on an informal basis rather than at a formal meeting of any one of the committees?——From day to day, every day; and it comes from a continuous contact with the Governors, the executive directors and the staff, from knowledge of the running of the Bank, which is what the directors know about, and knowledge of what the Bank and the Governors and the executive officers of the Bank require to know. Our main day-to-day job is to keep the executive directors acquainted with what is going on outside and give them the benefit of the experience we get outside, looking from the outside inwards rather than from inside outwards.

12119. *Professor Sayers*: So the Committee of Treasury is not as such an important policy-making body? If the outside directors are consulted by the Governor as individuals, what does the Committee of Treasury do?——*Sir Alfred Roberts*: I would say that it is the accumulation of views, of consultations individually, or maybe even collectively, on an informal basis, which tend to suggest to the Governor that it is time the Committee of Treasury were consulted about certain things. This is very intangible, but nevertheless I think that these week by week consultations with individual directors about their views about the trend of industry and so on are important. The Governor would not say to the individual director: "I want to consult you about a change in the Bank Rate"; that of course is out. It is merely a matter of ascertaining the views of these diverse people representing various activities in the country. This also includes the members of the Committee of Treasury.

12120. *Sir Oliver Franks*: These individual conversations probably play the major part in the processes by which policy is formulated, but the processes by which policy is formulated must be kept quite distinct from the questions of their formal ratification in the name of the Bank. This formal ratification must always be in the name of the Court, but the body to which the Court listens is the Committee of Treasury. Therefore when the Governor approaches the Committee of Treasury with some major policy proposal prepared in the light of these individual consultations, while the debate may not be long, and while in fact the position put forward by the Governor may never be overturned, yet that act of

* *Note by witness*: No executive directors were appointed before 1932. Between 1932 and the outbreak of war it was exceptional for an executive director to be elected to the Committee of Treasury. During the war it was usual for there to be one executive director on the Committee and sometimes two. Up to this time the Committee consisted of not more than *nine* directors, including the Governor and Deputy Governor *ex officio*. It was not until the passing of the Bank of England Act, 1946, that the Court made a precise rule on the subject when, on the 1st March 1946, it was resolved that the Committee of Treasury should consist of not more than *seven* members, including the Governor and Deputy Governor *ex officio*; and that not more than one of the remainder, who were to be elected annually by the Court by free and secret ballot from among all the directors, should be an executive director,

decision in the Committee of Treasury is where the Bank as an institution first comes formally and distinctively into action. Is that a correct way of putting it?——*Sir Charles Hambro*: Perfectly correct.

12121. *Chairman*: What would prevent the executive directors having outside contacts, supposing you had a system under which you had not the advantage of the part-time directors?——The Court of Directors is always encouraging the executive directors to have certain contacts, and they do have many outside contacts. But they cannot talk to outside contacts in the same way as they can talk to inside contacts, people that they know, people who know the running of the Bank. In my view giving advice to people when I am not responsible is very different from giving advice to people when I have to follow up that advice by taking the responsibility for the decisions.

12122. I suppose that the executive directors travel a good deal on behalf of the Bank?——A great deal, at home and abroad; and many members of the Bank staff are lent and sent all over the world to act as advisers and helpers; in the International Monetary Fund, in the colonial exchange controls, in the Commonwealth central banks, and so on.

12123. *Professor Cairncross*: Would the part-time directors have the same contact with bankers in other countries as the executive directors?——*Sir Charles Hambro*: The banking directors certainly would, because in their own banks they contact central bankers and other bankers all over the world.—*Sir John Hanbury-Williams*: As a matter of courtesy one would, if one was travelling in the Commonwealth, go and pay a call on the Governor of that particular bank. That would apply also to the United States, more particularly on the eastern seaboard and at Washington; but that would be politeness more than anything else.

12124. I would assume that the most important international banking institutions are the I.M.F. in Washington, the E.P.U. in Paris and the B.I.S. in Basle, if I had to choose three. Do the part-time directors have much contact with any of these three agencies?——It depends on the director; if he travels a good deal he probably would have a good deal more contact than somebody who did not travel quite so much.

12125. Would he go to Basle?——Not on behalf of the Bank.

12126. *Chairman*: If you wanted to recruit an executive director from outside the staff of the Bank, from your knowledge of the city would it be possible to do so?——*Sir Charles Hambro*: When we first appointed executive directors they were recruited from outside the Bank. As a junior director at the time I was told by Lord Norman that we wanted some good young men with outside experience to come into the bank, and we went out and got them. Mr. Cobbold and Sir George Bolton were two.

12127. They both came in as executive directors?——As advisers to the Governor and then as directors. Nowadays we recruit certain people with outside knowledge; they usually come in first as assistant advisers to the Governor and they may or may not become advisers to the Governor, and from there they may or may not become executive directors. Executive directors are chosen firstly from the staff of the Bank and secondly from those advisers who have usually come in from outside.

12128. *Lord Harcourt*: With the object of being worked up to executive director?——Yes.

12129. *Chairman*: What kind of tenure may they expect if they give up their outside connections and come into the Bank?——They come in as whole time employees of the Bank.

12130. With what security of tenure?——As secure as they would be if they were employed as regular Bank people.

12131. Is it on annual contract?——No. I do not think there is any contract. They would qualify for pensions in exactly the same way as anybody else.

12132. *Lord Harcourt*: Are they subject to one month's notice?——*Sir Alfred Roberts*: No.

12133. *Chairman*: The assumption is that they join the establishment?——*Sir Charles Hambro*: They join the establishment. They do not come in for five years or ten years or anything like that. They have to give up all outside interests.

12134. *Professor Cairncross*: You agreed that it was necessary nowadays in deciding what to do about Bank Rate to keep an eye on the movement of world conditions, and that this would require not merely general information and impressions about what was happening in other countries elsewhere, but a fairly consistent examination of economic trends. If you, as a part-time director, want to inform yourself on that in the Bank, what do you do?——The first thing I would do is to talk to the Governor, and he would probably advise me to go and talk to one of his people who had made a study of the question and ask to have his memorandum which I could then read in the Bank. That is usually what happens.

12135. You would be confident that you would find a memorandum on the subject?——On most subjects one would find somebody who has been doing a study.

12136. *Professor Sayers*: Have you ever found that there was a subject which you felt was highly relevant to a decision on which you could not get information that you thought relevant within the Bank?——*Sir Alfred Roberts*: I certainly have not.—*Sir Charles Hambro*: I cannot remember any. One can always find somebody there who can talk to one intelligently on what one wants to know.—*Sir John Hanbury-Williams*: I would confirm that.

12137. *Sir Oliver Franks*: One of the difficult things, I think, in the formulation of policy by any central bank is how to marry theoretical long-term considerations with practical experience. Do you find on the whole that this marriage between a more theoretical analysis of longer term trends and the more practical knowledge of how things are actually working out is adequately met with in the memoranda which you get, and the conversations which you have with the permanent members of the Bank staff?——*Sir Charles Hambro*: I would say yes. I have always been very impressed ever since I have had anything to do with the Bank of England with the quality of the discussions one has with the people inside the Bank, and the quality of the resultant memoranda, if any, that might arrive as a result of the discussions. It is very remarkable; I am sometimes amazed at how practical it is as well as being good theoretical stuff.

12138. *Professor Sayers*: Memoranda tackling such subjects successfully would represent a very important addition to the material available for the outside world. There is nothing that entirely fills that need produced by anybody outside the Bank of England. Anything produced inside the Bank of England of this kind with this success would add to the ability of outside people to form a sensible opinion on what was going on and what should be done, and would therefore help to muster support for any reasonable policy that was being followed. Do you see any objection to such memoranda being published?——There again I think that is a question for the Governor; I do not think it is a question for a part-time director to answer. I think a great deal of information is given, especially by the statistical department of the Bank of England, to outside parties. How much further that could be taken I cannot say.

12139. But these memoranda do help you, I understand; so would they not probably help people outside?——*Sir Charles Hambro*: Some of them would, some of them would not. I do not want you to think that there is a plethora of memoranda going about the Bank of England; there is not.—*Sir Alfred Roberts*: Some of them one would have to spend two days on before thoroughly understanding them.

12140. Is that not partly because the outside world has not had sufficient of these things before?——That may be true, but if you are thinking of the outside world in the sense of the general population I do not think it would be any good at all. There would be a few outside who would understand. This is really a matter for the Governor to decide. These memoranda that he has within the Bank he would use when he meets his colleagues at Basle, for example. That would be a source of dissemination rather than letting it become public property through the newspapers. I would say that the views that are expressed about long-term and short-term programmes might be objectionable to other people

in other countries of the world. That may be one reason why one could not publish them.

12141. I wonder if you are helped by such memoranda when they are published by another central bank?——They have not helped me because I have not read them.

12142. *Professor Cairncross*: The diagnosis with which you are confronted is surely the same as the diagnosis which faces the Treasury, who have equally to make up their mind about the occasion. Do you want access to the memoranda that the Treasury prepare, trying to cover the economic trend?——I do not, personally. We rely upon the Governor to tell us what are their essential conclusions.

12143. Would you draw any distinction between their problem and yours?——I would sometimes.

12144. In what way?——I would disagree with their analysis sometimes, and certainly with the conclusions they draw, but not to the extent necessarily of disagreeing with a change in the Bank Rate.

12145. I was beginning with the problem rather than the diagnosis. Would you think the problem any different?——No, I do not think so. It is mainly a question of conclusions that would be drawn; they would be different.

12146. If there is a difference of view, do you think it should be resolved exclusively by the preparation of memoranda and subsequent discussion inside the Treasury and the Bank of England, and that people outside should have no access to their assessment of the situation, that they should not equally try to make up their minds what is going on on the basis of the information you have?——That would involve, I think, some almost insoluble problems, if what you are suggesting is that the Treasury memoranda and the Bank's views on those memoranda should become public property for the public to discuss and make up their minds about.

12147. No, I was not suggesting that. I had in mind the possibility of consultation between experts in the Bank and the Treasury and people outside, without commitment, on the problem of diagnosis, not on the possible recommendations?——I would not like to answer that question.

12148. *Sir Oliver Franks*: Some of us who are outside and observe the decisions of the Bank of England from time to time, more particularly on the movement of Bank Rate, have seen it said sometimes that what has been done has been a "technical adjustment". No doubt sometimes that is all that can and should be said about the change made. But there are other times when it is difficult to believe that this statement, while true, does not represent a certain economy of truth, and that there are not in fact wider issues of policy involved in the decision which has been made. From the point of view of the Bank of England itself, and also perhaps from the point of view of the efficacy of the actual changes made, some understanding of why and wherefore, beyond the sacred phrase "technical adjustment", might be vital. How far has the Court, when considering the relations of the Bank of England as an institution to the public, really looked at and reflected upon the extent to which what is said about its actions gives maximum help or not in the pursuance of the Bank's own policy and in the effectiveness of the actions taken?——*Sir John Hanbury-Williams*: The Bank of England have always been exceedingly careful in publishing figures and giving information on secret or confidential or semi-confidential matters for fear that people might take advantage of it. Lord Norman was very careful indeed in regard to the question of information given out; latterly the Bank of England have been perhaps giving a little more information than during Lord Norman's days. Whether they are giving sufficient or not I am afraid I cannot answer. I am not a banker by profession.

12149. *Professor Sayers*: Has the Court given consideration to the kind of explanation that should be given after a major change of policy?——*Sir Alfred Roberts*: Yes, that has occurred in recent times. Sometimes when the Governor is delivering an address somewhere he consults the Court about what he should or should not say.

12150. *Mr. Jones*: Would there be any value in seeking to eliminate as far as possible some of the mystique of banking operations by the central bank?——*Sir John Hanbury-Williams*: I do not know that I am capable of answering that. There may be advantages, there may be disadvantages.

12151. *Chairman*: Our questions up to now have been rather directed as if the only policy actions of the central bank were concerned with the level of Bank Rate, and I think you have given us a clear picture of the amount the part-time directors can contribute to the policy decision when the time comes, and how the decision is taken. But there must be quite a number of other policy activities of the Bank as a central bank, such as the discernment of excessive or inadequate liquidity in various parts of the economy, and what action should be taken about it; the Issue Department portfolio; the handling of open market operations. How do the part-time directors come in on that part of the policy?——*Sir Charles Hambro*: In exactly the same way as the other part. It comes out of discussions. The Governor formulates his views and then discusses them in more detail in Committee of Treasury, and as a result of a combination of views outside and inside the Committee of Treasury, a recommendation to the Court will be made and an explanation will be made to the Court as to why this and that is done. None of these policy matters is of a sudden nature; they develop and gradually come up to the point where it is quite clear that everybody concerned is in agreement.

12152. *Professor Sayers*: As part-time directors you must at one stage or another be concerned with the central banking task of the Bank of England. What do you conceive the task of the central bank to be?——*Sir Charles Hambro*: That is a difficult question. You know that almost as well as I do, I think.

12153. I would like to know what your version is?——To act as the bankers' bank; to regulate the monetary policy of the country; to advise the Chancellor as to what trends they consider should be followed; to regulate the money market according to the requirements of the situation; to act as father and mother to the banks; and to act as the bankers' medium of communication with the Chancellor and the Government. There are lots of other less important matters which a central bank has to look after, such as relations with other central banks abroad in the Commonwealth and outside it.

12154. I wonder if either of your colleagues wishes to add anything to that?——*Sir John Hanbury-Williams*: I have nothing to add.——*Sir Alfred Roberts*: The only thing I would like to add is to serve the interests of the nation in this field; that is the overall consideration, I would say.

12155. I notice that you did not mention specifically the management of the Government debt. Was that deliberate, or was it just that you forgot it?——*Sir Charles Hambro*: It is not the affair of a part-time director.

12156. It is the task of a central bank?——Yes, it has to manage the Government debt, unless the Government do it themselves, as they do in some countries.

12157. As a part-time director are you called upon to advise on this aspect?——That is managed by the Bank on behalf of the Treasury, in the same way as exchange control is managed by the Bank on behalf of the Treasury.

12158. That applies to the portfolio of the Issue Department; you would equate it with the exchange control from the point of view of your position?——Yes.

12159. *Chairman*: Now I would like to take you to this question of the position and the possible embarrassments of a part-time director. I would like you all to realise that we want to take this fully with you because it arose out of the Bank Rate Tribunal Inquiry. It was left as an unresolved question, and it was one of the questions that as a Committee we were invited by the Government to consider. You have put down in your memorandum your views upon the extent of the embarrassment, and you say that this aspect of it has been greatly exaggerated, and that the occasions of difficulty are rare and relate principally to matters of Bank Rate.

Before we go on I should remind you that the two part-time directors who gave evidence before the Bank Rate Tribunal expressed themselves in a rather more serious way than that. Mr. Keswick described the position of a director of the Bank as being "a very, very difficult position"; Lord Kindersley said: "It is a difficult thing . . . I have been in a very awkward situation many a time", and then in a further answer he said that it was "very awkward indeed", and said that there were ten or twelve occasions upon which he had been conscious of this difficulty or embarrassment. On the other hand Lord Bicester said that the amount of embarrassment he had experienced had been "slight, sometimes", and the Governor took the view that, although there was some strain, the occasions were few and were capable of being dealt with on easily recognised principles.* That is the background of published evidence to date of which we have to take account. Of course it may be that some part-time directors are so placed that the occasions when they experience difficulty are less frequent than those of others. Would you agree with that?——Personally I have not been unduly embarrassed at any time, though I am a banker, which makes it likely that I should be more embarrassed than somebody who is not so closely connected with the banking side. I do not remember any great embarrassment. It has to be borne in mind that we undertake, when we join the Bank as directors, to put the Bank first before everything else, as stated in our memorandum; therefore the interests of the Bank must be one's first interest in any situation in which one may find oneself. I think that, if a man keeps that well in his mind, there should be very little embarrassment. If anybody asks me awkward questions I say: "That is not a question I can express any opinion on," and there it ends. I have been much more embarrassed sometimes by my outside boards of directors, where I know a decision of one board which I attend one day and am supposed to advise on the same thing on another board the next day. That may embarrass me much more than anything I hear or know as being a director of the Bank of England.

12160. Do you think that the position tends to be more difficult for someone who comes in from the banking field than for somebody who comes from a different field? Most industrial concerns have some holding in gilt edged stock today, and some have very large holdings?——The occasions on which one has to be absent from the counsels of, or refrain from giving advice to, one's own business may be more frequent for a director in the banking profession than in an industrial profession, because bankers are dealing every day in the sort of securities that may be affected by Bank Rate decisions; but I do not think that the degree of embarrassment is any more or less because it is quite clear.

12161. Sir John, have you ever been conscious in your long experience with the Bank of any of this kind of embarrassment?——*Sir John Hanbury-Williams*: Not in my own business because, as chairman of my company, I have an arrangement that my deputy chairman, the managing directors and the financial experts are free, with the board's approval, either to sell or buy gilt edged securities when they think desirable, and I keep out of it. There must be embarrassment, I suppose, in all these things, but I do not feel that a part-time director of the Bank of England should necessarily be any more embarrassed by the knowledge that he has than, say, a chartered accountant in his profession or a doctor or any professional gentleman. If one is a director of various companies the information one gets from one company may be of such a nature that if one is not an honourable person one may make use of it, and I do not think that the embarrassment arising from the knowledge one gets from the Bank of England is any different from the embarrassment one would get in many other walks of life.

12162. Is your arrangement to isolate yourself from dealing with your company's decisions due to your being a director of the Bank or is it a working arrangement you would have made in any case?——Over a period of years I have told my colleagues that they are to deal with those matters and leave me out of it.

12163. Sir Alfred, does this arise as a problem in any position of yours?——*Sir Alfred Roberts*: I suppose it could, because my own organisation has gilt-edged securities, and the Trades Union Congress also has, as have the affiliated unions. But I have had no embarrassment whatever in this respect. It may be because the T.U.C. recognise the fact that it would embarrass me that they do not ask any questions about it, knowing that, if they did, they would not get any answers. As far as my colleagues on the Court are concerned there may be more embarrassment in some cases than others, but I do not see why it should not be possible to make arrangements to avoid embarrassments in future. So far as my knowledge of colleagues goes, I would regard them as men of highest integrity.

12164. As you are here to represent the part-time directors as a whole, how did it come about that Mr. Keswick and Lord Kindersley expressed themselves very much more strongly than you have about the difficulties of their position?——*Sir Charles Hambro*: I do not know that I could answer that; I just disagree. I do not doubt that what they say may have been right in their cases, but I have not had that experience myself.

12165. It is sometimes said that the difficulty really lies in not giving a hint by evading discussion of these matters when something is in the wind. Do you recognise that as a difficulty?——I have got to the stage now where my partners never discuss these matters with me. They never ask my opinion because they know it is a thing on which I cannot advise them.

12166. You mean month in, month out?——Yes.

12167. *Sir John Woods*: You mean that your colleagues would never consult you about dealings in gilt-edged?——They might do; my inclination, if two colleagues came to me and said: "We would like to do this or the other in the gilt-edged market", would be to say: "You do exactly as you like".

12168. On every occasion?——On every occasion. That would really be my answer to the problem.

12169. *Chairman*: Do you think that the best solution is that people in anything like your position should follow a regular policy of that kind, so that they are never involved in the question of giving advice?——I think that where the Bank of England is concerned that is so. I do not think that it interferes with running one's own business in any way because there are so few things that are affected by Bank Rate policy, which is about the only thing which can really do any harm.

12170. *Professor Sayers*: I suppose that a public issue by an issuing house with which a part-time director was concerned could be affected by Bank Rate policy. Could a part-time director who was concerned as a matter of policy month in month out stand out of all discussions affecting these?——No, but I do not think that arises.

12171. It did in the September 1957 episode, and obviously could at almost any time?——In that case the Bank of England director concerned carried on with that issue as if nothing was going to happen; he did not give any indication of the change.

12172. No, but the evidence indicated that he was consulted by his fellow directors about the time of the issue. Was that not so?——The decision to make the issue was made before the question of a change in Bank Rate arose.

12173. Yes, but we are considering the practicability of a part-time director taking the line month in month out that he does not take any part in discussions where a change in Bank Rate is relevant, and surely that includes all new issue arrangements? Would it not be very difficult for some part-time directors to follow this line?——I do not think that there is any practical difficulty because the date of an issue is usually decided weeks before the issue is made.

12174. But not the terms of the issue?——The terms of an issue are decided at least a fortnight before the issue is made.

12175. Yes, but they have to be decided; is not the decision a speculation on what is going to happen to

* *Proceedings of the Tribunal appointed to Inquire into allegations that information about the raising of Bank Rate was improperly disclosed* (December 1957). Qns. 4604, 7518, 5275 and 8040 (Statement marked Exhibit 10).

Bank Rate in the interim?——I suppose in exceptional cases, yes; I cannot remember any case where I have had the experience that having knowledge of a change in Bank Rate has interfered with the ability to decide on the date or terms of an issue.

12176. That would not necessarily be true of all part-time directors of the Bank?——It might not be.

12177. *Sir John Woods*: It would seem that a good deal turns on the way different businesses run their own affairs. In the proceedings before the Tribunal Mr. Marris said that he and his partners as managing directors found it "a great handicap" that they could not feel free to seek the advice of their chairman at moments of difficulty.* That is not at all the kind of situation which you describe in your own business. There there does not seem to be a rule that the chairman is invariably not available when anything arises to which his connection with the Bank of England might be relevant. In such a case might there not be some hint given on the occasions when he did absent himself from the discussion?——*Sir John Hanbury-Williams*: I have not worked in a partnership, but I know the City of London well enough to know that in a partnership of that sort it would not arise. The fact that the senior partner absented himself would give no hint whatsoever that there was likely to be a change in the Bank Rate.

12178. *Professor Cairncross*: But if the prospect of a change in Bank Rate is perpetually before us, surely he must absent himself regularly; otherwise on the rare occasions when he is away it will be known that the chances are that it means something?——*Sir Alfred Roberts*: If there were ten changes of Bank Rate and those were the only occasions he had absented himself, then there would be difficulty next time.

12179. *Lord Harcourt*: You say that the date of a new issue is almost invariably arranged many weeks ahead of the issue for a variety of reasons over which the issuing house has no control. When it comes to the fixing of the terms of a new issue is it not a fact that that would never be a direct and sole decision of the partner in the issuing house who was also a director of the Bank of England? Would it not be the consensus of opinion of the partners of the issuing house in conjunction with the brokers?——*Sir Charles Hambro*: I should have thought invariably.

12180. And the director of the Bank of England could either absent himself or be completely self-effacing during those discussions, which probably take place during half a dozen or more meetings?——So far as we are concerned, yes.

12181. It would not be the direct responsibility of the director of the Bank of England to fix the terms of a given issue in a firm way?——As far as I am concerned I should be the last person to be able to do so; my colleagues are more versed with the market.

12182. *Professor Sayers*: Would you suggest that it should be a standing rule that no part-time director of the Bank of England should take part in discussions about the fixing of such terms?——No. I think it would be a great pity to make any rules on the subject. A man is not made a part-time director of the Bank of England unless he can be trusted.

12183. You accept the fact that the embarrassment must sometimes occur, and a man must be left to deal with it as best he can?——The few times the embarrassment may occur it is up to the individual to deal with. If he is not worthy of dealing with it, he is not worthy of being a director of the Bank of England.

12184. And you cannot make any rules?——I do not think that you can make any rules at all.

12185. *Sir Oliver Franks*: I think we all accept that the questions we are asking have no relationship to issues of integrity and the like, but there are two different situations. The first is one in which someone may have to face the difficulty of his own conscience; the other is one in which he so places himself that he either can or cannot tell a convincing public story of that occasion. When I read the evidence given before the Tribunal I wondered about this distinction, because it is very easy to be in situations in which one gets by with complete satisfactoriness from the point of view of this potential embarrassment, but in which it would be very difficult to prove that one could not have influenced the course of events or given something away in words. One has to look at the question whether in the case of the Bank of England and the part-time directors, because of the responsibility assumed by being on the Court and the far-reaching importance of decisions which can be made, a part-time director needs to be in a position to demonstrate his disinterestedness in addition to in fact being entirely disinterested. The arrangement which Sir John Hanbury-Williams described, by which his deputy chairman and the finance director look after all questions of gilt-edged dealings, enables him to do the second thing as well as the first; the public story is there if evidence is required. I thought that one of the remarks which Sir Alfred Roberts made rather tended in that direction, when he said in effect that he would want to put himself in a position in which the public question could not arise. This is a rather complex question; we should be glad to hear your views, as you have lived with it?——*Sir John Hanbury-Williams*: I do not know whether I can add very much to what I have already said. Anybody in possession of a secret must obviously find himself embarrassed on occasions; I have been embarrassed, but somehow or another one has to get out of that embarrassment in the same way as you had to when you were in the public service.

12186. I was really on a rather different point. When we were within the Government service one of the things we learnt about was the difference between taking a right decision in the circumstances and taking a decision the grounds for which could be publicly defended by the Minister in Parliament. This is the distinction between acting rightly and being able to give the public story of acting rightly in a form which will carry conviction. It is this sort of distinction that I am really asking about. Given that the members of the Court act as they think rightly and on more normal occasions escape any embarrassment there might be, is it in the circumstances of importance that the public story which can be told should be equally clear? If it is, the questions the members of the Committee have been putting, as to whether there should be a rule that on certain types of question a part-time director is never consulted, become important. This seems to me to be one of the issues on which we may have to try to make up our minds; that is why I have put it to you for any help you can give us?——*Sir John Hanbury-Williams*: So far as my own company is concerned I am perhaps in a very much easier position than some of my colleagues who are bankers by profession (whether they are merchant bankers or not), because the number of occasions upon which my own company has to deal in gilt-edged securities is infrequent. But I think that there is importance to be attached to the public side of the matter. We have given a lot of thought to this, but it is awfully difficult to try and work out in one's mind what rules and regulations one could lay down in this respect.—*Sir Alfred Roberts*: I agree that there is a very considerable difficulty; frankly I do not think that one can lay down rules and regulations. I am not in the unhappy position of being embarrassed and therefore perhaps can speak freely on this. It seems to me that, if a man finds his position as an outside director of the Bank of England incompatible with his responsibilities to his company, then he must think seriously about maintaining the two positions; but I would have thought that one could avoid these embarrassments by thinking ahead about what to do to avoid them. I see the importance of your point that they must not only be just but they must appear to be just. It is a question not merely of trusting to a man's probity and honesty, but that when the public story is to be told the public must know that he is honest on the facts before them. I would say that it is not possible to lay down rules and regulations; it is really for the man himself to provide his own rules and regulations in the conduct of his own business. I do not think that it would be possible to say that nobody should be an outside director of the Bank unless he avoids certain particular responsibilities and duties in his own company.

12187. *Mr. Jones*: Does that mean that a chairman or director of a company who is called upon to serve as a part-time director of the Bank of England should have his position tailored to meet that particular position in his

* *Proceedings of the Tribunal, etc.* Qn. 6202.

own company?——I would think so. If his company are depending upon this man to advise them about investments at all times when Bank Rate is likely to be changed, that is a very great embarrassment to him; and if he has to make the decision and no one else it is an impossible situation every time.

12188. Would it be logical for the company to tailor the responsibilities of the director to his own firm having regard to the fact that the director is also a part-time director of the Bank?——I would say yes. If there is a director of the Bank of England who is in a position of responsibility with his own firm, his own firm should recognise his responsibility to the Bank and not embarrass him by involving him in these kinds of decisions.

Chairman: I think that concludes our questions, gentlemen. We are very grateful to you for the help you have given us.

(*Adjourned until Tuesday*, 2*nd December*, 1958, *at* 10.45 *a.m.*)

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-SECOND DAY

Tuesday, 2nd December, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

SIR HAROLD SMITH, K.B.E., D.L., Chairman, WILFRID BAILEY, ESQ., Secretary, and R. DAVIS, ESQ., Chief Accountant, The Gas Council, called and examined.

12189. *Chairman*: We are much obliged to you, Sir Harold, for the answers* you have given us to the questions we put to you. You tell us in your note that the organisation of the industry consists of twelve Area Gas Boards and the Gas Council. The Boards are separate financial entities and their revenues are not pooled. Parliament established as a central body the Gas Council, which is specifically responsible for capital finance, labour relations and research for the industry as a whole, and for advising the Minister. Your first two paragraphs give us the general position. Are there any questions on that?—*Sir John Woods*: You say in paragraph 2: "The Gas Council alone can raise permanent capital by the issue of stock or accept capital advances from the Minister." Did you issue stock guaranteed by the Treasury until fairly recently? Could you give us any figures about that?—*Sir Harold Smith*: Yes; we had five issues. The first issue was shortly after we were nationalised; that was a compensation stock of just over £189 mn. Then we issued £40 mn. on 5th May, 1949, for other purposes authorised by section 42 of the Gas Act, 1948. Then £75 mn. of British Gas 3½ per cent. Guaranteed Stock 1969/1971 was issued on the 12th July, 1951. We were only allowed really to fund our overdrafts; we were not allowed to issue stock for future requirements, although we may have had a small margin of £2 or £3 mn. On the 7th August, 1953, there was an issue of £80 mn.; on 14th July, 1955, an issue of £100 mn.

12190. Would that be the last stock that was issued before the new arrangements for advances from the Treasury?—Yes.

12191. *Professor Cairncross*: When you speak of shortage of finance in paragraph 6 in the more recent years, are you thinking of the years since 1955?—Yes. During the last two years, having formed our programmes and having got the general consent of the Minister to our programmes, we were subject to the squeeze and they had to be curtailed considerably.

12192. *Chairman*: It was the Government restriction on the amount you could have for capital development?—Yes.

12193. *Professor Cairncross*: Did you feel that you were subject to any shortage of capital finance in earlier years?—No.

12194. Only that your programmes were restricted?—The programmes were really only restricted in the last couple of years.

12195. In each previous year your programme had to be approved by the Minister of Fuel and Power. Did that mean all the submissions you made were approved, or that they were cut down?—They were not necessarily cut down, but they were amended to a certain extent. Before programmes go to the Minister, they have been prepared by the individual Area Boards; they have also been thoroughly examined by the Gas Council, and as a result of that examination they have probably been amended. So by the time they go to the Minister they have had a pretty good vetting. There is not a large technical staff at the Ministry who can really say whether the plans should be amended any further or not. Their amendment is more likely to be from the angle of what capital is going to be available.

12196. I was drawing a distinction between approval and vetting of individual schemes and the determination of the aggregate to which you were to work. The determination of the aggregate is presumably not settled by the Gas Council?—No, by the Minister.

12197. Does it happen to coincide with the total submitted?—Except for these last two years by and large it has been reasonably within the same limits. The Minister may have had to ask us whether we could do with just a little less, and as our programmes really are based on something like five-year plans (in the earlier days if we wanted to build a new gasworks it took five years to do it) it might have meant spending a little more one year and a little less the next. They had to be elastic to a certain extent.

12198. Why did your plans as originally submitted by the Area Boards not reach a bigger total? Did you feel you were doing all that was worth doing in relation to the return you expected on the money?—We made our estimates of what gas we were likely to require, and what we wanted to do in the way of main laying, and prepared our plans in relation to that. We did not make wild schemes just to spend money; we tackled this just as any other business would have done.

12199. What was your general basis of procedure?—We have to pay the interest on our stock; we have to put a certain amount to reserve; we would like to do more by way of self-financing, but at the same time we have to look at the cost of gas to the consumer. We were not expecting any particular return as a private enterprise would expect it. Most of us in control were working in private enterprise before we were nationalised. In those days we were definitely out for increased dividends, but we have to have an entirely different conception of the operation today.

12200. Do you not work to any rate of return which you regard as critical, below which you reject schemes?—We would look at the rate of return for shutting down a gasworks and linking up with another works; we might look at it for supplying a new district. But we should not say that unless we could get 20 per cent. on our capital we would not do it.

12201. What percentage would you take?—We do not take any fixed percentage.

12202. None at all?—No common percentage throughout the country. Each Area Board would look at every programme on its merits.

12203. *Chairman*: In comparing one possible scheme with another, must not the rate of return expected from one rather than another act as a guide?—It is not quite

*Memoranda of Evidence Part X, no. 3.

so easy as that. We have to supply gas to the public, and we have to take a reasonable chance of getting a fair return on the money we spend in order to supply gas to the public. If we are looking at a scheme there are so many problems that come into the decision. It might be that it was cheaper to put up one type of gas-works than another, but the cheaper type of gasworks would not really be acceptable to the local authority from the amenity point of view. We cannot just say that we are going to put up the plant which gives us the best return.

12204. But I should have thought that one of the elements in making a comparison between two different possible ways of achieving the same result would be the rate of return on the two respective schemes?——I do not think that the actual rate of return would ever have been the factor that caused an Area Board to decide on a particular scheme. It would want a plant to do a particular job. They might be in an area where they had a good coke market that they wanted to satisfy, and they therefore would put in a plant which would give them the best return from their coke selling business. In another part of the area they might not have the coke market at all, and they might put in a plant that made no coke. The suitability of the plant for the operations that it has to carry out would generally be the deciding factor. When it is all boiled down, with the plants as we know them today, there is not very much difference in the actual cost of making gas from one plant or another.

12205. *Mr. Woodcock*: On the distribution side you say that you aim to satisfy all reasonable demands; but "reasonable" is a matter of judgment. There must be cases where people have not got gas, or where the mains that you have are not entirely adequate, and you have to decide whether you supply it or not. It is not a question of manufacture but supply; yet you have to supply it at the same price, I imagine, all through?——The Area Boards decide the prices at which they sell gas.

12206. Do they have different prices?——They may have within their area.

12207. But when you decide on an extension to supply a new housing estate, or to some building or group that have not had it before?——If that came within an existing area of supply the price charged would be the general price.

12208. But the extension itself might be quite expensive in capital; would you not have to consider what you would have to pay on the capital you are borrowing?——There might be a loss on that business for a time.

12209. What would decide whether you did the extension or not?——I could not tell you what would be the deciding factor in twelve Area Boards. I could not say that any particular Board has any particular return that it wants on its money.

12210. Have you ever known a change in interest rates to have an effect on a plan already formulated?——I should not think any effect at all. If the Area Board has decided that it is the right thing to lay mains to a particular estate, I do not think the rate charged by the Treasury for borrowing would affect that plan. If the Area Board has decided that it is going on with a particular plan, subject to the Minister's consent, the fact of a slight change in the rate of interest would not stop them.

12211. *Professor Cairncross*: If it had a 10 per cent. cut in the total to which it was to work, would it strike out schemes that might show a poor return or an actual loss, or would it be indifferent to that?——If the Minister said that we could not have all the money we wanted, they would certainly look at the return on the different schemes.

12212. *Sir Oliver Franks*: When an Area Board is considering a particular scheme, is there always a calculation of what the return on the sum of money to be invested will be, or is that disregarded by the Area Board?——No, the Area Board would see what return it estimates it is going to get from any of the plans it carries out.

12213. Is there any negative level of return at which they would decide not to go on with it. Is there a loss too heavy to be borne?——I think so; but what it would he I could not say. It might vary with each Area Board.

12214. *Sir John Woods*: Am I right in assuming that the Gas Council itself would not negative a plan solely on the ground that it was uneconomic?——We should not look at any plan in such detail as to be able to say whether any particular operation was going to be a profitable one or not.

12215. You leave that to the Area Board?——We have to; it is responsible for it. We can look at the overall picture; we can see what sort of estimates it is making of the future possibilities of gas demand, we might say that we think that its estimates are based on an unrealistic forecast of the increase in output, and we can say that we will refuse to suggest to the Minister that it is a reasonable plan from that point of view. But we should not look at the Board's plans in detail and say: "We do not think you ought to be supplying this particular housing estate". That would he right outside our remit.

12216. *Sir Oliver Franks*: From what you have been saying the picture which is built up in my mind is of the Council and the Boards deciding upon a variety of schemes in which the money return is hardly ever a significant element in making up the joint mind. If that is so, and since you will be up against the question whether or not you can service the borrowed money, one would be led to think that the selling price was the variable: if you cannot cover your costs at the existing prices, you put your prices up. That would be all right if there was no competition in the products, but I understand that there is competition between gas and, say, electricity; so there is a limit to which price can be the variable. If you cannot make price do all the work, how is it that the question of the return on any given capital investment in relation to the money borrowed is so unimportant as you have seemed to me to make it? We are not trying to argue at all that it should be the sole determining factor; we are suggesting that the return on the money invested must surely make a difference?——Of course it makes a difference, and of course it is taken into account. But for the first nine years of our life as a nationalised industry we have been trying to put the industry back on to a decent physical basis. We suffered losses during the war which have had to be replaced; and we have shut down a large number of the old inefficient gasworks. We started off with 1,050 gasworks; we have shut down 500 of those and concentrated the manufacture on the remainder, and those plants have been reconstructed. Obviously when the Area Boards are considering their plans for reconstructing these plants they take very seriously into account the capital cost of the plant, but that is a small factor compared with the cost of raw material for gasmaking and the cost of labour. Those are two factors which are looked at even more closely than the actual return on the money, 5, 6, 7 or 8 per cent or whatever it may be. Of course, all the factors have to be taken into consideration in arriving at a final figure, but we are in such a state of change. First of all we have had this reconstruction of the industry, and now after nine years of research we are coming on to a lot of new processes, and the number of gasworks which today is 500 may well in fifteen years' time be down to 100. We are really building up an entirely new gas industry. The test we are applying to ourselves is what we are doing by way of self-financing, whether we are improving on our self-financing each year. We certainly are; it is not right yet, but we started off in 1949–50 providing from our resources 32 per cent. of our capital requirements; last year it was 48·7 per cent.; it has gone steadily up each year, and all our projections for the future show that it is going to go on increasing. Of course we could improve on that enormously by putting up the price, but then we come up against the competition problem. We say that our price is too high now. We have had to try and keep a balance between maintaining a competitive price and doing as much as we could for self-financing.

12217. *Professor Cairncross*: In the years since 1955 you have had to reduce the total amount of capital spent on the industry; where previously you were rising year by year you had to make some reduction?——We went on rising but not as much as we wanted to.

12218. In real terms?——Yes, in real terms.

12219. According to the National Income Blue Book your capital expenditure was in 1955 £59 mn. and in 1956 and 1957 £52 mn. If I may put the question to you irrespective of the figures, where and for what reasons did you make cuts when the credit squeeze was brought

to bear on you? You said that, if you were obliged to make a reduction, the Area Boards would have regard to the return on the money. How did that take effect?——The cuts that we have made really are by way of delaying the work. The Area Boards look for that part of their programme which they think they can with the least harm defer. If it went on too long we should suddenly find ourselves in a mess and unable to satisfy the demand.

12220. *Mr. Jones*: It is suspension rather than cancellation?——It is not cancellation; it is deferment.

12221. *Professor Cairncross*: On what kind of schemes would that be most in evidence?——The first scheme an Area Board would be likely to defer would be improvement to showrooms or offices. Many of them still ought to have better or more centralised offices than they have, but if there is a squeeze they would defer things like that first of all. They might have bad plans for taking their mains out to rather further parts of their area; if it is perhaps just a little chancy as to whether it is worth doing it or not, they would defer that. The actual manufacturing plant they would not be likely to defer because it takes so long. If they began to defer that they would find themselves in trouble in a comparatively short time.

12222. That would not be financially economical?——It is most uneconomical.

12223. *Sir Reginald Vernon Smith*: Is each area regarded as running its own self-financing or is it grouped by the Council as a whole?——Each area is responsible for its own finances. Our great difficulty in self-financing arises from the pre-war assets which we took over, which are a pretty heterogeneous collection. The new plant we have built since we were nationalised is being depreciated on a straight line basis over the life of the asset, and that is why we are improving each year. We are shutting down more of the pre-vesting assets and we have in operation more of the post-vesting assets.

12224. *Mr. Jones*: If you are developing at the rate of £53 to £54 mn. a year, and you are now self-financing roughly 50 per cent. of your total capital expenditure, as against a third at the beginning, would you be borrowing from the Treasury for the margin between the capital required and the sums that were available from self-financing?——We should have to have new capital for that.

12225. How would you fund the capital you have by the arrangement with the Treasury?——We repay the advances from the Treasury over twenty-five years.

12226. Paying interest throughout at the rate in force at the time when they were made available?——Yes.

12227. *Chairman*: When there is a change in the market rate of interest, I gather that that has no impact upon the operations of the gas undertakings except in so far as it may mean that the Treasury, in advancing money to you, will also make a change?——They will charge us more or less, according as the market rate goes up or down.

12228. But the variations in the charge that they make to you in your experience have not affected the thinking or the operation of the gas undertakings?——I have spent the whole of my working life apart from wars in the gas industry, and I have never known a time where the cost of money has prevented us from doing what we felt was necessary in order to maintain our production and distribution plant. Naturally when we were free to go to the public we chose the time, and we have spent a lot of time deciding when was the right time to launch our issues, but we never said that we could not build a new gasworks or a new distribution plant because it would now cost us, say, 6 per cent. instead of 5 per cent.

12229. Do you think that freedom from the influence of the change of interest rates arose from anything special, or from the fact that you have been throughout a semi-public undertaking? Were you not always controlled by parliamentary regulation?——We were always subject to parliamentary control of some sort, or limitation of dividends, and we either had to get our own private Acts of Parliament or statutory orders to cover our operations.

12230. And would you think that had any bearing on your feeling?——I do not think there was any difference then from the way we think now.

12231. *Professor Cairncross*: When the rate of interest is raised you then have bigger payments to make to the Treasury. Would not that affect your self-financing plans?——Yes, but the changes are very marginal.

12232. Even when the short-term rate moves between 2 per cent. and 7 per cent.?——It has not affected the rates we pay very much; they have varied between 5 and 6 per cent., the current rate being 5½ per cent. We have advances each month and the rates might vary from month to month.

12233. What was the rate on your Compensation Stock?——3 per cent.

12234. So there has been a variation there between 3 and 5¾?——Yes.

12235. *Mr. Jones*: What was the change in the rate of interest on your borrowing between 1955 and the middle of 1957?——*Mr. Bailey*: At first it was 5¼ per cent.; then it dropped to 5 per cent.; then it increased to 5½; then to 5¾; then to 6; and it is now 5¾ per cent.

12236. *Professor Sayers*: What proportion do the total capital charges of the industry including your self-financing provisions bear to the total sales value of the gas?——*Sir Harold Smith*: In 1957-58 the total income was £388·6 mn.; the interest charge was £20·5 mn. and we did £27·1 mn. self-financing in that year.——*Mr. Davis*: The proportion was roughly 12 per cent. on total income for last year.

12237. So that, if you thought it necessary to raise your contribution to capital outlays in the way of self-finance appreciably, and the rate of interest at the same time rose from 4 to 6 per cent., this would make an appreciable difference to the margin on which you were running?——*Sir Harold Smith*: Yes.

12238. *Professor Cairncross*: But you could probably more readily than most large industries cover a rise of that kind in your price?——Yes. We have to get our costs of production down or increase our price. All our thinking is on getting our cost of production down; we are doing our very best to keep down the price to the consumer.

12239. But in comparison with electricity, which is the chief competitive form of power and heat, you have a much less capital-intensive product?——Our labour charges and costs of raw material are probably far more important in our case than the capital charges.

12240. *Sir Reginald Verdon Smith*: One of the duties of the Area Boards is to pay their way taking one year with another. Has this ever proved a problem in relation to any one of the Area Boards so far?——We have never yet decided what "taking one year with another" is. I have tried to argue that it is looking at two years; that one and one is two. I think that, looking at it reasonably, they have met their obligations.

12241. *Professor Sayers*: Is the statutory obligation to break even over a period or at least to break even?——*Mr. Bailey*: The words in the statute are "not less than sufficient".

12242. *Chairman*: Does the obligation to break even allow for the formation of a general reserve?——Yes.

12243. *Professor Sayers*: So that you have freedom so far as the statute is concerned to do quite a lot of self-financing?——*Sir Harold Smith*: Certainly. If the income tax gatherer would be a little kinder to us and not charge tax on what we do by self-financing, we might do far more. I think it is a little hard on the gas consumer to have to pay double when we put anything aside for self-financing.

12244. *Mr. Woodcock*: Do you charge consumers any part of the capital cost of supply?——Not the domestic consumer. We should charge for the various pipes in the house but not the supply up to the meter from the main.

12245. Are there any special consumers who seek gas supply where you say that they can only have it if they make a contribution to the capital cost?——A large industrial supplier who requires a main would probably be asked to pay a contribution.

12246. Is that annually a considerable sum or is it a mere nothing?——I have no figures, but I should not think that it is material.

12247. *Chairman*: I think that we have covered the substance of the first three questions; that leaves us with the two remaining questions on stocks. Is your answer on stocks that there is really no scope for changes in interest rates to have any bearing because your general policy is to keep the minimum level required for efficiency

anyway?——The main stock is coal; we have to build up stocks during the spring and summer, in the summer months particularly, to be sure of having adequate supplies during the winter. When we could get all the coal we wanted of the kind we wanted most gas companies used to like to have about eight weeks' supply at the beginning of November. Now it is probably down to about five weeks' supply. That is partly due to the fact that with twelve Area Boards now instead of a thousand boards of directors and municipal gas undertakings the Area Boards can control deliveries within their own area so that the total stocks can be lower.

12248. Whoever was writing the memorandum said in paragraph 13: "Changes in interest rates or restrictions of bank credit have not materiallly affected the level of Boards' stockholdings." That suggests they have had some effect but not much. What is it that is in mind there?——I take it that what you are really asking is. "If the rate of interest is low would you keep more appliances and more coal in stock?". The answer is that we keep such amounts of appliances, meters, and the various materials from which we make gas in stock as we know we need to maintain a supply to our consumers.

12249. If there is a change in the level of rate of interest, does that affect anything you do in regard to the amount of money that you keep in stocks?——The answer in substance is no.

12250. Why do you say that they do not *materially* affect the level? Is there any significance in "materially"? ——*Mr. Bailey*: We were trying to say that the Area Boards themselves maintain such a level of stocks as they find necessary to carry on their business, and they are kept, as far as one can keep them, at that minimum level. If there is a substantial change in the rate of interest, something of the order of 2 or 3 per cent., they may well have built up their stocks slightly, but it would be marginal, not substantial. Changes in rates of interest by and large do not affect the level of stocks as they would in a commercial concern. The Area Boards keep the level of stocks, appliances and materials, at such a level as they need to carry on their business, but as these cost money they do not keep more than are necessary.

12251. *Sir John Woods*: Would it be fair to say that, if there was a sharp increase in the rate of interest, it is possible that an Area Board might have a special look at their stocks?——That is the sort of change I was trying to infer here; it would be marginal.

12252. *Sir Reginald Verdon Smith*: Both the statement in paragraph 10 and the statement in paragraph 13 are in the perfect tense; therefore it is not a judgment you are making about what might happen but what has in fact happened. Is it in fact the case that rates of interest have not affected Area Boards?——*Mr. Bailey*: I would say that that would be a fair statement. The fact that there are now twelve bodies instead of a thousand has had a far greater effect on the level of stocks than any interest rate.—*Sir Harold Smith*: I do not think that one can suggest that the interest rates are likely to affect the level of stocks very much. Our coal stock is the most important thing, and we must have a certain amount of coal in stock. Since we have been nationalised we have never had quite as much coal in stock as we would have liked. On about six occasions in six separate years we have been asked in the autumn by the then Minister of Fuel and Power to cut down our use of coal because we are not going to get enough, and we have been asked to make more use of oil and coke for water gases. We have never been in a position since we were nationalised of having in stock as much coal of the right quality as we would have liked, so the question of interest on the capital involved in that stock has not come into the picture at all. So far as the appliances we keep in stock are concerned, the incidence of hire purchase has a far bigger effect on the quantity of stocks than any interest rates.

12253. *Professor Sayers*: What about paragraph 10? The writer of that paragraph might have said that changes in the rate of interest had not affected the volume or timing of the Area Boards' programme; in fact he said "not materially". What does it mean?——*Mr. Bailey*: It would not be absolutely true to say that a change of interest rate has not affected the level or timing of an investment programme. There might be projects from time to time, as I know from the examination of programmes of Boards, where they might say that these must wait another year or two with the rate of interest at 6 per cent. But they are marginal; we are talking about small projects now which in total may not be more than 1 per cent. of the total investment for the year.

12254. Is your 1 per cent. of the programme a serious guess?——*Sir Harold Smith*: I do not think that you must take that 1 per cent. as any guess at all. It is certainly less than 1 per cent., and I should say so small that it cannot possibly affect the position. I should say that there is no effect that is really worth taking any notice of, and that other factors have been far more important in deciding these problems than the rate of interest.

12255. It may not be worth taking notice of from your point of view, but it might be from ours?——If you feel that it is from your point of view, I will try and ascertain what the figures are.

12256. *Chairman*: I think we would like to know the order of the small qualification that you had in mind when you put in the word "materially". I do not see how you can get a precise figure for it.——I will ask the Area Board Chairmen if there are any cases where they have let the rate of interest affect their decision as to volume or timing. I think that it is likely that they will say they have not let the rate of interest influence them at all. As I explained earlier on, all these plans are looked at by the Gas Council and then by the Minister. We have had during the last two years quite a considerable squeeze. There has always been a little bit of curtailment. It is those factors which have cut our programmes down, and I think the answer I shall get from the Chairmen is that the rate of interest has not caused any curtailment.*

12257. *Professor Cairncross*: Do you know of any large scheme that has been deferred or set back in any way in the past few years because of any questions raised over finance?——There have been quite considerable schemes that have been deferred because of this general squeeze that has been put on.

12258. These would be schemes involving expenditure stretched over a five-year period. How much did these cuts amount to?——*Mr. Bailey*: The figures are given in paragraph 8. The amounts approved were for 1958–59 £53¼ mn. as against a programme of £61 mn., and for 1959–60 £47 mn. as against £55½ mn. There was a good deal of squeezing done to get down to these figures.

12259. We heard earlier that showrooms, offices and so on were cut out; is there a delay which takes effect in respect of really large projects?——*Sir Harold Smith*: There would have to be some delay to meet cuts of that order.

12260. *Mr. Jones*: Are your big capital projects mainly reconstruction, or are there new plants?——They are tending to become new projects, and the future is likely to be much more devoted to new projects than reconstruction.

12261. And the capital sums involved in new projects will be fairly substantial?——Yes.

12262. £2 mn. or £3 mn. in each?——It depends entirely on the project. We are tending to build now complete gasification plants, and the capital for similar output will certainly be less than on the old carbonising plant.

Chairman: Thank you very much, Sir Harold; I think that that has covered all our questions. We are very grateful to you and your colleagues.

* *Note by witness*: The word "materially" was used as in considering programmes every factor is taken into consideration. The Area Boards in preparing their plans act in a similar way to the board of a commercial industrial company, the difference perhaps being that, whereas a commercial company may have to look at every operation it conducts with a view to profit that may accrue to the company from that operation, in the case of the Area Gas Boards the object is not so much to make a profit from the new plans projected as to see that the proposals are designed to give the most economic and satisfactory service to gas consumers, after meeting costs of production and distribution and all proper charges.

My short reply, therefore, is that changes in the rate of interest have not been the deciding factor in any case. Such changes cannot be said to have affected the volume, the pattern or the timing of our fixed investment programme.

I have had an opportunity of discussing this at a meeting of the Gas Council at which all the Area Board Chairmen were present, and they have authorised me to say that they agree entirely with my answer.

(*The witnesses withdrew.*)

SIR BRIAN ROBERTSON, BT., G.C.B., G.B.E., K.C.M.G., K.C.V.O., D.S.O., M.C., Chairman, and SIR REGINALD WILSON, Member, British Transport Commission, called and examined.

12263. *Chairman*: Sir Brian, you have kindly supplied us with a written note* in answer to the questions that were outlined for you. Would you mind having it in front of you so that we can run through it and see what questions need supplementing? Would there be anything you would like to add in enlargement before we start?——*Sir Brian Robertson*: There is one gloss I should like to put on it. The written answer we gave is a fair description of the way we work and guide our policy, but there are rather special circumstances influencing us at this particular time. I am thinking especially in saying this of the railways rather than the rest of our undertaking. For reasons that I need not go into the railways are in great financial difficulties at the moment, and naturally, as one would in any other concern, we are seeking somewhat desperately to better those difficulties. The effect that has on our capital investment policy is to make us choose those items first which are likely to be remunerative. It is not an entirely easy thing to do in any case: having launched an electrification scheme it would be great folly to check it; indeed, one knows that in the end it will give a better result than other things. So there is a limit to this; but at the present time we are seeking very hard to put our money where it may give the quickest return.

12264. Then may we take our first main question: "What are the main considerations which determine the size and content of your organisation's fixed investment programme?" At the end of the second paragraph you say:

"And the financial return from the plan promised to he so great—and in fact has been great wherever a real modernisation has been carried through—that the 'inducement' to invest was equally compelling, always unless the rate of interest should reach some quite unusual level, or a quick fall in the cost of new equipment and capital works was a virtual certainty—the reverse having been true for many years."

You make some qualification there about the possibility of the rate of interest having a material bearing upon your plans. What kind of change to an unusual level are you thinking of there; something outside anything we have seen?——Yes, something outside anything we have seen; though it is possible that when the rate of interest went to its highest point, influenced by the rise in Bank Rate to 7 per cent., we were more cautious than ever about our projects and examined them with greater care. But it was only a matter of degree.

12265. You reviewed the projects you had in mind with extra care. Did it lead to any alteration of the decision actually to carry them out?——I cannot remember an occasion when it did.

12266. That is because the margin of return you are expecting to get on any particular venture remains sufficient to carry the burden at any rate of interest charged to you for your money?——Yes. I suppose that our industry is exceptional in this respect, that there is an almost unlimited number of projects upon which money could properly and profitably be spent, virtually nothing having been spent for a long period of years. There is an enormous amount to be done, and we have only chosen what we believe are the best things to do to start with. Therefore, even if the rate of interest we have to pay goes up somewhat, they are still very good things to do.

12267. Was I wrong therefore in saying that, the rate of return being so high, the interest rate up to anything that it has been raised to did not affect you, or were there other considerations so important to you that you had to go on with a number of things whatever the rate of interest?——There are some things we do for other reasons, but on the whole we go for the rate of return.

12268. *Professor Cairncross*: Your estimate of the rate of return would be subject to considerable uncertainty; is the rate of interest important in arriving at this estimate?—I do not know that I can do better than answer that question in the same way as I did previously, by saying that when the rate of interest gets high we look at the rate of return even more carefully.

12269. There would be no element in the plan that might be vulnerable to a substantial rise in interest rates?——There are elements in the plan which are vulnerable in that they do not give a very good financial return immediately; but they are essential for other reasons. If I may pick one at random, King's Cross Station ought to be reconstructed, not because it will give a direct financial return, nor just to have a nice station, but because we cannot get proper services up and down the line (which will affect our financial returns) unless we do. But to estimate the return on the reconstruction of King's Cross would be beyond our best accountants. There are cases of that sort; but, having worked on a rate of interest of 5 per cent. as a general rate throughout our calculations, I do not think that raising the rate above that has so far knocked out any project that I can remember.

12270. It would not cause you to end up with a negative return rather than a positive one, but it might induce you to become more cautious in your approach to particular schemes?——That is correct.

12271. *Sir Reginald Verdon Smith*: On paragraph 3, is it the case that you have had to take very considerable account of interference with export requirements in planning your capital investment programme for equipment so far?——I have no doubt that some of our suppliers have had to bear that in mind; certainly our advance in some directions has been limited by the ability of our suppliers to meet it. We have had great co-operation from industry as a whole, but there are clearly cases when they cannot do everything. They have export commitments which to some extent set a limit on what they can do for us.

12272. This is a consequence of the effect of order books and suppliers rather than a conscious act in the planning programme of the Transport Commission?——That is certainly true; you touch on a point of great principle there.

12273. *Chairman*: In paragraph 4 you say:

"Subject to the fact that the results of the individual railway projects are often closely interwoven together (e.g. the results of one section of electrification cannot be assessed separately from the results of electrifying the whole stretch) and that modernisation must normally be advanced simultaneously in various directions to have its full value, the Commission have some regard, in arranging their priorities of investment, to the financial yield expected. This is only possible in a very general way, however, and to a very limited extent."

That means, if I understand it, that in deciding within a programme how much you are going to do, and which of the many possible projects you are going to undertake, some priority has been given to investment according to the financial yield?——Yes. It was precisely that wording which, when I re-read it, caused me to make my opening remark. At the present time the expression "some regard" is not strong enough; at present we pay all the regard we can.

12274. Our second question is: "How far ahead does your organisation plan the size and content of its fixed investment programme?" Is there anything on that?—*Professor Cairncross*: You say in paragraph 12:

"Once a plan is set, whether for three years or five years, its scope and rhythm should be safeguarded from casual disturbance."

This has not quite been your experience in the past. You have had to make important changes in the programme and that presumably has been a fairly expensive experience?——Yes.

12275. If the national needs call for it could you vary within any marked degree your total capital expenditure? What sort of limits do you think are feasible without too much disturbance?——One can obviously vary a programme, but in this kind of business every time we vary it we do so at some cost. In the case of the big projects it is likely to be a very heavy cost. An electrification

* Memoranda of Evidence Part X, No. 5.

scheme involves a number of things. It is not just a matter of stringing up a wire which the train can hitch on to; it involves a large programme with rolling stock and many other things. That is true to a lesser extent of diesels too. If we suddenly jog the reins there is a great waste immediately in a number of directions. It is equally hard to urge the animal forward suddenly too; that is also apt to be expensive. But to say that there is no elasticity would be absurd, and indeed would be useless, because an industry like ours has to expect a certain amount of elasticity in its operations. We could not expect to be given an assured cheque for the years ahead.

12276. Is your position very different from that of a large private industry like steel or chemicals, or do you think you are in the same position?——I would say that we are in a different position, because we are tied to control and less sure of our future than a large private enterprise would be. That is not said by way of criticism.

12277. The problem of deferring part of your capital expenditure would be rather similar to that of deferring any substantial capital expenditure in large chemical plants?——A good deal of this capital expenditure is in the nature of essential replacement.

12278. *Sir John Woods*: There is however this general difference between the railways and private industry, that in the case of private industry it is within the control of the undertaking itself whether it will defer or cancel the programme, whereas in your case the deciding authority is really outside yourselves?——That is why I said we are more tied up.

12279. *Chairman*: Our third question is: "How far have changes in interest rates affected the volume, the pattern or the timing of your organisation's fixed investment programme?" You say in paragraph 21:

> "The investment in railway modernisation which can be carried out in the next 15 years is expected to provide an ample margin over the interest rate assumed viz. an average of 5 per cent. per annum over the whole period."

Have you been taking 5 per cent. as an average figure from the beginning of the nationalisation planning?——From the beginning of our modernisation plan.

12280. So far nothing has led you to alter the allocation of that figure to your future plans?——No.

12281. Then you say:

> "A temporary increase in the long term rate of interest is not itself a decisive deterrent to carrying on with the railway investment programme either in volume or in timing."

Why do you call it a temporary increase in the long term rate of interest? The rate of interest which the Treasury charge you for your long term accommodation varies but may it not represent something very much more than a temporary change?——I can only say that we have not experienced a rate of interest that has looked like being permanently above 5 per cent.

12282. *Professor Cairncross*: You are at present, however, paying the Treasury more than 5 per cent. on new advances?——*Sir Reginald Wilson*: 5½ per cent.

12283. This is for twenty-five year loans?——*Sir Brian Robertson*: Yes.

12284. *Professor Sayers*: You are committed to 5½ per cent. for twenty-five years?——*Sir Brian Robertson*: For the period of the borrowing.—*Sir Reginald Wilson*: The scheme itself may be a long one. Take the electrification of the London—Tilbury—Southend line, which is going to take four years; we have to try to estimate what we are going to pay for all our money for a number of years to finance that. We have defined that at 5 per cent. The signs so far are that we are on the safe side, but we are taking 5 per cent. as a reasonably prudent assumption. —*Sir Brian Robertson*: We are not only committed to a higher rate of interest on the money we are taking now but also a lower rate for that taken previously.

12285. Is it averaged over the period of construction of a particular project?——*Sir Reginald Wilson*: We do not actually work it out for each project in isolation.

12286. This is your working figure?——When we worked out the London—Tilbury—Southend electrification scheme we worked to 5 per cent.

12287. *Chairman*: Then you say:

> "The financial cost to the railway of any further delay in investment far outweighs the additional cost of borrowing, but it is true, of course, that the future financial problem is easier, other things being equal, the lower the long term rates at which money is borrowed.
>
> 22. In the case of other investment, however, and particularly non-essential investment in such things as a new hotel, or entirely fresh or quasi-separate investment in undertakings such as new tubes or mono-rails to airports, a high rate of interest has had a significant bearing."

Are there any questions on that?——*Professor Cairncross*: Have you on occasion turned down schemes of this kind on the ground that you were penalised by the interest rate?——*Sir Brian Robertson*: I can recall an incident of an hotel which we wished to build and which we have deferred; the interest rate was one of the factors which entered into our decision.

12288. *Chairman*: Is the distinction that you regard this as comparatively non-essential compared with works directed to the railway itself?——There is also the point that in the case of an hotel we know that the margin between profit and loss is a very narrow thing.

12289. *Professor Cairncross*: The interest charge is certain and the return is not?——That is so.

12290. *Chairman*: Then we pass to our questions about investment in stocks.—*Professor Sayers*: At the beginning of paragraph 26 you say:

> "While interest charges on stocks held by the Commission are substantial, such charges have little effect on the level of stocks because the Commission are not free to speculate".

Are we to take that to mean that they have some effect? ——*Sir Reginald Wilson*: Whether in point of fact they have any effect I would not like to say; but it is something to which we drew the attention of the stores committee and other people charged with the responsibility of procuring stores.

12291. *Chairman*: It gives you a handle?——Yes. Of course there are the other arguments, whether the stores really must be procured, and whether the value of the stores is going up or down in the near future. But by and large we do not speculate in our stores; our stores are what our people think we must have to run the business properly.

12292. And under your system the level is kept constantly under review?——*Sir Brian Robertson*: Constantly.

12293. Therefore a change of interest is one more occasion for making a review that you are making all the time?——*Sir Reginald Wilson*: Yes.

12294. Do you regard your bank borrowing as covering your investment in stocks?——*Sir Brian Robertson*: We have current bank accommodation of a limited nature to take account of the ups and downs of the period.—*Sir Reginald Wilson*: We do not earmark our borrowing to any particular project or any particular part of the balance sheet.

12295. *Professor Cairncross*: At the current rate of interest would you not have some incentive to take as little as possible from the banks?——You mean from the banks as distinct from the Treasury? No, I should have thought it was the other way round at present.

12296. Does the level of the rate of interest affect your dependence on bank finance?——*Sir Reginald Wilson*: No; our bank borrowing is the fluctuating margin.—*Sir Brian Robertson*: We can borrow from the banks up to a certain limit to see us through the fluctuations of a limited period. The remainder of our money we get from the Treasury.

12297. *Mr. Jones*: That would be short-term borrowing, at a rate corresponding to the rate at which the Treasury raises its short-term requirements?——*Sir Brian Robertson*: We are allowed to borrow, apart from capital requirements, during the period of modernisation to cover our deficits under certain terms laid down at the end of 1956.—*Sir Reginald Wilson*: There is no short-term borrowing from the Treasury in the sense of borrowing for two or three months and then repaying.

12298. But to the extent that your current account is in deficit, have you a feed from the Treasury in respect of which you pay short-term borrowing rates?——No.

12299. *Professor Cairncross*: Have you thought of an instrument by which you could borrow from the Treasury for limited periods at lower rates of interest?——We have thought of it, but it has not come to anything.

12300. *Lord Harcourt*: When you borrow long-term from the Treasury, do you take it at regular intervals during the year, or are you entirely free to decide when you will go and the amount for which you will go?——We go either monthly or twice a month. We usually need the money so that there is in practice very little choice about it.

Chairman: Thank you very much, Sir Brian; we are very grateful to you and to Sir Reginald. I do not think that there are any more questions.

(*Adjourned until Thursday, 18th December, 1958, at 10.45 a.m.*)

*The following note was sent in advance to the former Chancellors of the Exchequer who gave evidence to the Committee :**

The Committee's purpose in issuing its invitations is to obtain the views of persons who have had special experience of the conduct of relations between the Treasury and the Bank of England since 1946. There are not many people in a position to record such views. Among those who are, persons who have held the office of Chancellor of the Exchequer take an important place. We wish to stress that what we are concerned to obtain are opinions based on experience: we are not concerned with particular facts or incidents except so far as a witness may wish to refer to one to illustrate his point of view.

The points (which overlap each other) to which we would like to direct particular attention are as follows:—

1. Is the structural relationship between Her Majesty's Government and the Bank of England established by the Bank of England Act, 1946, the best arrangement to regulate relations between the Executive and the central bank?
2. Is the power vested in the Treasury by that Act to give statutory directions to the Bank a sufficient or satisfactory provision for securing co-ordination of the Bank's actions with Treasury policy?
3. What are the best working arrangements for securing co-ordination between the Bank's actions and Treasury policy or actions?
4. Should any change in the structural relationship be in the direction of greater or, alternatively, of less independence for the Bank in the formulation or carrying out of policy?
5. In so far as the Bank enjoys independence of action, should there be a more direct relationship between itself and Parliament?
6. Should the Bank be invited to produce a larger volume of information relative to the working of monetary policy, including periodical reviews of action taken? Should it be encouraged to enlarge generally the scope of its public relations? If so, what attitude should Her Majesty's Government take as to its responsibility for such activities?
7. Does the present relationship between the Treasury and the Bank set up any undesirable obstruction to contacts between the Treasury and the clearing banks or other constituents of the financial system?
8. Is the Bank's statutory power to issue directions to bankers "subject to the approval of the Treasury" in satisfactory form for the purposes of credit control?
9. Subject to the foregoing questions, are any changes called for in (*a*) the method of appointment, (*b*) the period of office, or (*c*) the range of selection of directors of the Bank?
10. Should part-time directors be included in the Bank directorate? If so, is any change called for in the weighting of part-time as against executive directors or in their respective functions?

* The Rt. Hon. Peter Thorneycroft, M.P., Questions 11250 to 11302.

The Rt. Hon. H. T. N. Gaitskell, C.B.E., M.P., Questions 12324 to 12374.

The Rt. Hon. R. A. Butler, C.H., M.P., Questions 12375 to 12445.

The Rt. Hon. Hugh Dalton, M.P., Questions 12446 to 12506.

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-THIRD DAY

Thursday, 18th December, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH (Questions 12337 to 12445 only)
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

THE RT. HON. THE LORD KENNET OF THE DENE, G.B.E., D.S.O., D.S.C., called and examined.

12301. *Chairman*: Good morning, Lord Kennet. We mentioned to you when you were last here* that we were very much interested in the Bank of England and in questions which had arisen in connection with the part-time directorate, and you expressed a willingness to give us your views on this subject. I followed that up by letting you see a list of ten questions, which I thought might be a starting-ground for you. We recognise that a number of them overlap each other, but that is inevitable. Would you care to give us your views on the questions raised?——*Lord Kennet*: I am a little doubtful as to whether I am going to be of help to you, because my point of view throughout these questions is "let well alone". In searching for some practical suggestions to make which from the range of my experience I thought would be worthwhile as regards tampering with the structure in order to effect improvements, I have not been able to think of anything. So, generally speaking, my answers to these questions is really going to be one or another variation of that rather unhelpful phrase "let well alone". To illustrate what I was thinking about, let me say that the relation between the Bank of England and the banks and the discount houses and the financial houses is not like an engine with a blue print, in which one can, by dealing with a nut or a screw, change one part or the other; it has not grown in that way. It has grown as a living organism. With a living organism one does not execute an operation or administer medicine unless it is ill, and I have not been able to think just what the illness is. That is just to give you a picture of my point of view, and to explain why I am afraid I shall be so unfertile in answering your questions.

Your first question is: "Is the structural relationship between Her Majesty's Government and the Bank of England established by the Bank of England Act, 1946, the best arrangement to regulate relations between the Executive and the Central Bank?" I have had no recent experience of relations between the Executive and the Central Bank. I was a Treasury Minister in the days when the Bank was still an independent authority, long before the Act of 1946, and so I have not been able to think of any practical suggestion to make.

12302. In the eyes of the outside world, in the City or abroad, do you think that the change brought about by that Act has affected the status of the Bank of England? If so, in what way?——It has affected it, but I think that what is remarkable is that it has affected it so little. I have seen, in the course of the last seven or eight years, representatives both from Australia and Canada in search of ideas for the development of their own money markets in relationship to their central banks; and in both cases I found how little they realised that there is any connection between the Bank of England and the Executive at all. The first thing I have had to explain to them has been that there is this relationship now; that it changed in 1946. It has been rather difficult for them to understand that there has been that change. It has been a disappointment that in both those cases one has to realise that it is too late for them to grow the same kind of plant that we have here; they have had to institute systems which have a much sharper separation between the Executive and the outside world.

12303. *Sir John Woods*: Do you mean by that, that in the discussions you have had, presumably as head of a large discount house, with people concerned with money in these overseas countries, you are given the impression that they have, notwithstanding the Act of 1946, somehow felt that in that area of relations with the money market the Bank still enjoys a high degree of independence?——That is what I meant to convey. They come to me as Chairman of the Union Discount Company, the biggest of the discount houses.

12304. *Chairman*: Does that large measure of independence appear to be valued by them?——Yes. I am not conveying anything but quite a definite impression I have had from both sides of the world, of regret that they cannot now achieve the same kind of intimacy of connection between the two, as regards the officials and the outside world.

Your second question is: "Is the power vested in the Treasury by that Act to give statutory directions to the Bank a sufficient or satisfactory provision for securing co-ordination of the Bank's actions with Treasury policy?" I am afraid I cannot throw any light on that, because my Treasury days were before the present era of relations with the Bank, and I have known nothing of those inside relations since that time.

Your third question is: "What are the best working arrangements for securing coordination between the Bank's actions and Treasury policy or actions?" That is really rather the same aspect as No. 2, the internal relations between the Bank and the Treasury.

12305. *Sir Oliver Franks*: I appreciate that you do not wish to express opinions on the working of this system in the last twelve years, but if you consider it not from the point of view of practical experience but from a more theoretical point of view, do you think, given the status of the Bank and that of the Treasury, that a mechanism of directives is likely to be the best way of securing co-ordination, or do you find that you have doubts about it? The fact that the mechanism exists and has never been used could provoke some reflections of a quite general order, apart from detailed experience on how it has worked?——My difficulty in answering the question is that I do not know what alternative mechanism there might be which is not the present one of directives. It looks on the surface of it as though these matters are to be settled by hard and fast directives from one authority to another, which is not often a very satisfactory way of proceeding; but actually my observations would lead me to think that the result of the existence of the power to direct would be consultation to effect an approximation of opinions between the Bank and the Treasury.

12306. *Chairman*: Might not that exchange take place, even if there was no theoretical power to direct?——As a matter of fact, I think it did.

* See 24th Day, Qns. 6087 to 6248.

Your fourth question is: "Should any change in the structural relationship be in the direction of greater or, alternatively, of less independence for the Bank in the formulation or carrying out of policy?" I should be uneasy at any shift in either direction, after the practical experience and evolution of the relations between the Bank and the market since the Act of 1946. We have a working practice; I myself do not see any evil consequences in the practice. It seems to work smoothly. I would view with more apprehension than relief any substantial change in the working of the system.

12307. *Mr. Jones*: Neither greater nor less freedom?——Neither greater nor less.

12308. In other words, your answer to this question is again: "let well alone"?——That is what I am really saying.

Your fifth question is: "In so far as the Bank enjoys independence of action, should there be a more direct relationship between itself and Parliament?"

12309. *Chairman*: That hardly arises, in view of the views you have given us on the earlier questions.——I do not quite see how that would work.

Your sixth question is: "Should the Bank be invited to produce a larger volume of information relative to the working of monetary policy, including periodical reviews of action taken? Should it be encouraged to enlarge generally the scope of its public relations? If so, what attitude should H.M.G. take as to its responsibility for such activities?" In fact the various regions in the money market are constantly in intimate touch with the authorities at the Bank with regard to what information is useful and necessary, and I can give the most favourable report upon the facility with which the Bank has understood any changes which are necessary and the provision of information to the market. Did we really feel any further need from the public interest for further information we should not have any difficulty, I think, at any rate in bringing what we should like to know to the attention of the authorities of the Bank. My experience in the past is that they have always taken a most reasonable view of what is helpful.

12310. But for the circles outside the market who cannot have the same expert background, the public, instructed and uninstructed, is it not of some importance that they should have ample material to know what policies the Bank, on behalf of the Government or on its own behalf, is pursuing?——I do not at the moment apprehend the sort of information the public would be wanting in addition to what it presently gets from the Bank.

12311. Their interest would be in the wider significance and purpose of the operations that the Bank was conducting in the markets?——As regards the general public I suppose the natural source of information about monetary policy and so on is rather the Treasury than the Bank. I rather question whether the Bank would have very much to add which would be of interest or value to the general public as regards the policy of the Bank in administering Government policy. I am all for their giving statistics and information; as I say, we have always found them most ready to supply that.

12312. *Professor Cairncross*: It is sometimes suggested that it is undesirable that it should be left to one private institution to issue a review of financial operations in this country. Are you aware of any other review that is issued, either through official channels or privately?——What I had in mind was a statement by a Treasury Minister as to what the financial policy of the country is.

12313. These statements occur rather on occasion and not systematically; the Budget statement for instance, is largely occupied with fiscal and general economic matters rather than monetary matters, but there is no adequate regular review of financial operations?——It is quite possible that more periodical reviews of financial policy might be useful in addition to the statements, which have not been infrequent lately, from the Chancellor of the Exchequer, but I think that they should emanate from the Treasury.

12314. *Professor Sayers*: But these statements, if they are to stand examination and provide the basis for assessing the value of more general statements made by the Chancellor, must be very detailed and must be backed up by adequate batteries of statistics. Would you not agree that these statements and these statistics are best prepared in the body that is concerned with the day-to-day operations which are connected with those statements?——Statements of fact are best prepared by the Bank of England: statements of policy should emanate from the Treasury.

12315. *Professor Cairncross*: You draw a very sharp distinction between the two. Do you find, in your own affairs, that it is possible to distinguish a statement of policy from the setting out of figures in particular ways?——I have two regions of information in my mind, and I do not find very great difficulty in distinguishing between those which tell me about what the Government and the Bank are after, and the statements of figures and statistics which show what is going on in pursuance of that policy.

Your seventh question is: "Does the present relationship between the Treasury and the Bank set up any undesirable obstruction to contacts between the Treasury and the clearing banks or other constituents of the financial system?" The clearing banks are very powerful people, and I would not venture to express an opinion as to what would be right for them. In the discount market we are comparatively humble people, and we would not expect direct contact with the Treasury. For the conduct of our business, contacts with the Bank are all that is needed; and, of course, a knowledge of what the Chancellor of the Exchequer says about general policy.

Your eighth question is: "Is the Bank's statutory power to issue directions to banks 'subject to the approval of the Treasury' in satisfactory form for the purposes of credit control?" It does not occur to me that there is anything wrong about that.

Your ninth question is: "Subject to the foregoing questions, are any changes called for in (*a*) the method of appointment, (*b*) the period of office, (*c*) the range of selection of directors of the Bank?" The question really is whether there should be part-time directors on the Court; so it embraces your tenth question, which reads: "Should part-time directors be included in the Bank directorate? If so, is any change called for in the weighting of part-time as against executive directors or in their respective functions?" In my experience it has been of very positive value to have the part-time directors with the "market mind" at the table as well as the executive directors with the "official mind". If there were no more part-time directors, the market would always be dealing with officials only; being specialists and working in the Bank, they would have an intimate knowledge of the machinery of the markets they were dealing with, but it would be like having a theoretical knowledge of how people ought to swim and never having been in the water oneself. Considering the extreme complexity and the extreme rapidity of changes, the extreme delicacy of touch necessary in the money market, the amounts involved and the narrowness of the margins, and the extreme obscurity of many of the sources of supply and demand and how far they ramify over the world, I think that it is an enrichment for the Bank to have this element of those who have swum in the water and know it. I should be sorry to see it end.

12316. *Chairman*: From your point of view as a chairman of a discount house, they are men having the same practical knowledge of the markets as yourself?——Yes.

12317. Of course, the range of selection of part-time directors has gone a good deal wider than that?——Not unnaturally, I was thinking of those I know most about, the people who have worked in the market. I am afraid that I am uninstructed as regards the other part-time directors who have not been in the money market; but I can understand that their relation with sources other than the money market would be the greatest possible reinforcement to the Bank.

12318. *Professor Cairncross*: But would you not agree that some of the executive directors, including the earlier executive directors, have learned to swim before they were appointed and were recruited from the market?——It does occur, but I do not think it is a very strong element.

12319. *Chairman*: You have stressed the importance of what the part-time director can bring into the Bank to help it to do its job properly. Is there another value, in that he can bring to the outside world a knowledge

of the Bank's work and its policies generally?——As an ambassador and to compose differences of opinion and that sort of thing he can be most valuable; but there is not the least suggestion that anybody in the market ever gets any useful information from any part-time director.

12320. I was not on the more limited point of conveying practical information; I was regarding him as capable of explaining the Bank's position generally?——Yes; it is useful to have a diplomatic link.

12321. But, compared with the other element you are stressing, you think that that is not of any great importance?——No; I think that it is much more important to the Bank than it is to us.

12322. Suppose that the part-time directors were converted into advisers; do you think that they could render service of equal quality to the Bank?——No. I do not suppose that there is one of us here who has not known the difference between working with executive power and working as an adviser.

12323. So your general advice to us is to "let well alone", and you are satisfied that it is well?——I am satisfied that it is well. Of course, I am not satisfied that I always get all I want, but then I do not deserve it.

Chairman: Thank you very much, Lord Kennet; we are very much obliged to you for coming back to give evidence to us again.

(*The witness withdrew.*)

THE RT. HON. H. T. N. GAITSKELL, C.B.E., M.P., called and examined.

12324. *Chairman*: Good morning, Mr. Gaitskell. We are very grateful to you for coming to help us today on these difficult questions about the Bank of England. I sent you a list of ten questions*, which was an attempt to bring together the points that our minds are turning on. I do not want to tie you down to any particular order in giving us your views, but I thought they would be a structure for you to work on. As you know, the answers that you give us are evidence for the record. Would you like on the basis of this line of questions to start to give us your views?——*Mr. Gaitskell*: I would like to make one qualification at the outset. It is seven years since I have been Chancellor of the Exchequer, and I was only Chancellor for one year. That must be borne in mind in anything I say; the situation may have changed. What I am going to say this morning is reflection in retrospect; I do not want you to think that what I am saying this morning was continually in my mind while I was Chancellor; one was really too busy for that. My answer to your first question is that I think that the intention of the Act was broadly correct, but I believe that, at any rate when I was Chancellor, that intention was not entirely carried out, principally not because of anything that was wrong in the Act itself, but because the relationship between the Bank and the Treasury had not settled down to what I personally would like to see. There are, however, one or two ways in which an amendment to the Act should be considered, to which I will come a little later. The second question asks whether the power to direct is sufficient to ensure co-ordination of the Bank's actions with Treasury policy. I think that the powers of the Chancellor to give statutory directions to the Bank are sufficient, subject to the point which is raised in 7 and 8, namely, the directions to the clearing banks. If I may, I will leave that one until we come to questions 7 and 8.

I would now like to go on to what I think are the really basic questions, 3 and 4. One has to begin by saying what sort of relationship one wants between the Treasury, the Chancellor of the Exchequer, and the Bank. Not everybody may be agreed on that. My view on this is however perfectly clear—that under modern conditions the Chancellor of the Exchequer must be supreme, and that there should be today no question of any independent policy of the Bank of England. There was a time when it was argued that it was desirable to have a central bank independent of the Government because it would prevent the Government from pursuing inflationary policies. I totally disagree with that attitude. I think that the Government must have complete power and complete responsibility. I think that the democratic processes today are just as likely to produce in the Government a fear of inflation as a fear of deflation. That is the basic point from which I start.

The problem is how to achieve this in the case of an institution like the Bank of England, which is engaged in a number of highly technical operations which most people outside the Bank do not begin to understand at all, which has, and is bound to have, close, intimate and to some extent secret relations with other foreign banks and financial institutions of all kinds both here and in other countries, and which has also in its long history a tradition of independence. To some extent this problem of the relationship between the Chancellor and the Bank is similar to that between a Minister and other nationalised industries. In the case of the coal industry, for instance, there are bound to be a large number of technical problems on which the people in the National Coal Board will probably know better than anybody outside. Here again there is some difficulty, therefore, in reconciling the ultimate authority of the Minister with the fact that he probably will not have technical advice outside the Board available to him. In the case of the nationalised industries we have tried to solve the problem by drawing a line between day-to-day matters, which are quite specifically reserved to the boards, and matters of major policy. That makes it a great deal easier for a Minister to exercise the necessary authority without having to rely continuously on the advice of the board itself in making his decisions. The major issues of policy which a Minister has to decide are such things as the investment programme, where it is largely a question of relating one corporation's programme to what is being done in other sectors, and which does not on the whole raise very acute technical difficulties.

But it seems to me that, if one looks at the Bank of England and, as one is rather inclined to, compares it with the nationalised boards there is the difficulty that the day-to-day operations of the Bank are often of enormous importance. They are often matters which must be of great concern to the Chancellor of the Exchequer; open market policy, for instance, may obviously be very significant for the economy, but it may be fairly described as a day-to-day matter. The operations on the foreign exchange market are again highly technical, but enormously important. So I do not believe that this line of division which we have adopted in the case of the other nationalised industries is one which really meets the case so far as the Bank of England is concerned.

What is the answer? I do not pretend to be sure about this, but I think that I can at any rate make the problem more precise by saying this. A Chancellor of the Exchequer, granted my initial premise, must have both expert advice and at the same time a relationship of complete confidence between himself and the people giving the advice. He has that, in my opinion, in the ordinary civil service relationships in the Treasury. He is seeing these people day by day; he gets to know them well. There are a number of very important matters, some of them highly technical, on which they are advising him, but it is extremely rare for a Minister to feel a lack of confidence between himself and his civil servants. As things are at present there is not the same relationship between the Bank of England and the Chancellor. It is more remote; the officials are a long way away. At any rate when I was Chancellor, in the ordinary course of events only the Governor would see the Chancellor himself, whereas with the civil servants the Chancellor would see not only the Permanent Secretary to the Treasury and the Second Secretary in charge of overseas finance; he would almost certainly, if he wished, have a meeting in his room at which all the senior officials would be present, at which he would hear the matter argued out; and as a result of this argument, and from the minutes and so on that are written, the Chancellor would make up his mind. There is nothing like that in his relations with the Bank of England. I do not recall when I was Chancellor ever seeing any files of the Bank of England. I no doubt received letters from the Governor from time to time,

* See page 846.

and I certainly had some conversations with him. I recall one or two meetings to which I asked him to bring one or two of his senior officials, but there was certainly not the same kind of freedom of expression as when dealing with the civil servants. The whole thing was on a more formal basis.

12325. When you were Chancellor were your contacts with the Bank wholly conducted with the Governor?——With the exception of the cases I was just mentioning, when he brought with him Sir George Bolton, probably Mr. Mynors, and maybe one or two other people; but certainly for the most part solely with the Governor.

12326. Would that represent some established tradition as you understood it?——That is what I understood.

12327. *Professor Cairncross*: If you take your relationships with the Board of Trade or the Board of Inland Revenue, would you have expected to see a number of civil servants from these departments when matters of common interest were being discussed?——I would draw a distinction there between the Board of Trade, which does not come under the Chancellor, and the Inland Revenue, which does. I think the Inland Revenue is a very good case to take, because it is independent of the Treasury, but, since it is a civil service department, one's relations with the officials there were not essentially dissimilar from one's relation with Treasury officials.

12328. *Sir John Woods*: It is independent of the Treasury but under the Chancellor of the Exchequer?——Precisely; but of course the same is true of the Bank. The Chancellor has the legal powers to instruct the Bank to do what he wants. But there is nevertheless a different relationship.

12329. *Mr. Woodcock*: Do you know anything about the relations between Treasury officials and Bank officials?——I knew that officials of the Bank would come along to the Treasury and meet the senior officials, and no doubt the Treasury officials sometimes went down there.

12330. Would you think it possible that the point you were making about the remoteness of the Bank or the Bank officials other than the Governor from the Chancellor was to some extent met by the fact that you met the senior officials who were in turn meeting the Bank officials?——No, I do not think so, because one is dealing with matters of immense importance which are also highly technical. If I am in that position I want to see and talk to the man on the job himself. It is not really good enough to have the Bank's advice conveyed at second hand by officials who, if I may be frank, may not themselves be very expert in this field. One makes no criticism of that. Why should they be? They have been in the Civil Service all their lives doing all sorts of different jobs, and they may not have the same expertise in the foreign exchange market as the Bank. I had the impression that in the main the Treasury officials, with some exceptions perhaps, found themselves in difficulties in arguing with the Bank on the technical field. There were perhaps some exceptions to that; the Economic Section was rather more inclined to differ from the Bank on certain points. But there is a real problem here, where the technical expertise is some way away and yet it is the advice of the technical experts which is so vital.

12331. *Professor Cairncross*: Would you say that the relationships at the official level between the Bank and the Treasury are as intimate or as frequent as the relationships between officials of the Treasury and those in the Board of Trade or the Board of Inland Revenue?——No, I would not have thought they were; certainly not as intimate, nor as easy.

12332. Would you think it desirable that there should be closer association at these working levels?——I would go further than that, as I hope to say later in dealing with more specific questions.

12333. *Sir Oliver Franks*: In what you have been saying so far one can distinguish three different elements: (1) a relationship of confidence between the Chancellor and the Treasury on the one hand and the Bank on the other; (2) the way in which the Bank itself is organised; and (3) a point about the flow of information from the Bank to the Treasury. It may be that all these three things are interconnected, but I think it would be of help if you would be willing, when you come to your more specific points, to relate what you have in mind to these distinguishable matters?——I will certainly try to do that. You ask in question 4: "Should any change in the structural relationship be in the direction of greater or, alternatively, of less independence for the Bank in the formulation or carrying out of policy?" It will be obvious from what I have said that I think the Bank should be less rather than more independent. The question is: how? I am inclined to the view that the most important reform that should be made is a much greater mixing up of the staffs of the Treasury and the Bank, I do not mean at very junior levels, but at medium and senior levels. It would greatly assist the relationship if it were a normal thing for some Treasury officials (not all, of course) to spend five years or even ten years in the Bank and then go back to the Treasury or some other department. Equally I think that it would be very good that officials who come into the Bank should have a period of service in the Treasury. That at least would establish something more like the relationship which Professor Cairncross mentioned between the Board of Inland Revenue and the Treasury. It would also have the advantage that the Treasury would have far more people who have some experience of what the Bank's problems are and how they handle them. There are far too few such persons at the moment. Before the war I believe that the foreign exchange market was largely managed from the Treasury; Sir David Waley and Sir Frederick Phillips, who were Treasury officials, in large part did that job. From the point of view of the Chancellor that would, I think, be much more satisfactory; they were Treasury officials, and he would have had a close relationship with them. Just why the management of the foreign exchange market was removed from the Treasury and went back to the Bank I do not know, but it seems to have happened. If there was this much greater mixing up of staffs, there would be more technical expertise in the Treasury, a closer understanding between officials as to what each was up to; that would help to build up a convention of closer relations between the Bank and the Treasury than there are now.

12334. *Mr. Woodcock*: You said that you wanted to deal with the people actually on the job. The fact that they come from the Bank to the Treasury would only help some way in that?——I entirely agree. I think that the Chancellor's relationships with the Bank and with the Bank officials should be much more like those which he has with the Inland Revenue, in which the officials come in; but I think that that process would be greatly facilitated if among the Bank officials were people who had been Treasury officials; equally I think it would be quite healthy for the people in the Bank to have a spell with the Treasury. I would like the whole thing mixed up rather more, as it is in the Inland Revenue. The Chairman of Inland Revenue is frequently a Treasury official; and one knows of leading Treasury officials who started in Inland Revenue.

12335. *Chairman*: It is, if I understand it, your general approach to the position of the Bank as between itself and the Government that it should be as like a Government department as the circumstances which are rather peculiar to it permit?——Yes, I think I would say that, because the work of the Bank is so absolutely vital to Government policy; I think that we ought really to try and establish that relationship.

12336. *Sir John Woods*: Would you put much weight on the qualification "as near as it could be"? Is it because relations with the money market, with foreign central banks and so on must make it slightly more remote?——That was in my mind. I find it hard to judge the significance of that. When all is said and done the Treasury themselves have relations with quite a lot of financial institutions. I think that I am right in saying that the management of the national debt is done in the Treasury. That is highly technical, but it may be that it does not give rise to the same problems as the relations of the Bank with the foreign exchange market. I would accept the Chairman's qualification, because I do not feel sufficiently sure of my ground there; but I would need a little convincing that the fact that the Bank has dealings with other central banks would prevent us from getting at any rate most of the relationship that I think we ought to have.

12337. *Mr. Jones*: In dealing with question 4, are you arguing for a position of lesser independence so far as the Bank is concerned, and a greater degree of accountability

on the part of the Court of Directors and the Governor to the Chancellor himself?——I certainly take the view that the Bank should be less independent. I would not have used the word "accountability", because I do not think that that is the right kind of relationship between the Chancellor and the Bank. That implies that the Bank is free to get on with the job but has to report to the Chancellor from time to time. The whole burden of my case is that the activities of the Bank are so intimately related to Government policy that the Chancellor really needs to be brought into the picture, not necessarily in the day-to-day operations, but a great deal more than he is. Suppose there is a proposal to support the market for transferable sterling. Here is a matter of enormous significance, but it is also a matter on which any layman would find it extremely hard to make up his mind without hearing all the arguments explained to him. To be confronted in a case like this with "the view of the Bank" without hearing the whole thing argued out, and without perhaps having people in the Treasury who have sufficient experience of the operations in the foreign exchange market to give sufficiently expert advice, puts the Chancellor in a very difficult position. I want to see him in such a relationship with the Bank as would come from the Bank's being, in the Chairman's phrase, as near a Government department as is compatible with the other functions of the Bank of England. May I come back to Sir Oliver Franks's three points? I do not believe that a good flow of information is enough. That is certainly necessary, but something more than that is needed; it is really a problem of talking the same language. One has the feeling from time to time that there is not a common language in this highly technical field even between the Treasury officials and the Bank officials, and certainly not between Ministers and the Bank. Confidence is very much in the picture here; confidence again springs from continual contact and understanding each other.

12338. *Professor Cairncross*: Your case seems to me to rest, as you express it, on the difficulty of detaching monetary policy from other aspects of economic policy. As I understand it, you want to see the execution of monetary policy put as nearly as possible on a level with fiscal and commercial policy, and handled in the same sort of way?——Yes, quite.

12339. *Sir John Woods*: We have heard a great deal of evidence on how monetary policy must fit in to a total economic policy, and we have heard a great deal of what is commonly called the package deal. If you envisage getting the working arrangements you have outlined to us between the Bank and the Treasury, would you expect to have advice proferred to you from the Bank about, say, fiscal matters, hire purchase regulations, taxation, and so on; or, even if you did not expect it to be proffered would you in fact ask for it? Would you envisage a kind of meshing in of the Treasury and the Bank of England over the whole economic field?——It is hard to answer that in general terms. There would be some fields of activity of the Treasury on which the advice of the Bank and its officials would not be particularly relevant or helpful. The Bank is not concerned with what happens to the University Grants Committee or museums or that kind of thing; nor is it the business of the Bank to see how the Treasury keeps its control over other Government departments. But certainly the advice of Bank officials concerned with the foreign exchange market would be quite useful in connection with the Capital Issues Committee or something of that kind. One cannot answer this in general terms; one would probably need to review the scope of the Bank in relation to the Treasury if there was a closer relationship.

12340. You would not say their contribution would necessarily be confined to purely monetary and financial matters?——Again it is partly a question of definition. I have stressed rather more than monetary policy the foreign exchange problem, because that strikes me as being something which evidently concerns the Government as well as internal monetary policy. If for the moment we assume that the relationship is going to be one rather comparable to the Inland Revenue's relationship to the Treasury, it might be necessary to lay down rather more precisely, as within any department, who is responsible for what. I do not want you to think that I regard the Bank as having a right as a separate power to give advice on this, that and the other. This would be a matter for the Chancellor of the Exchequer. He may wish to know the views of the Inland Revenue on various matters which are outside the purely fiscal sphere, and he is entitled to ask them. It would be more like that than having the Bank come along and say: "We have the right to tell you our views on what sort of Budget you should produce."

12341. *Chairman*: Would not the position you envisage as the best one entitle the Governor of the Bank to describe himself as an economic adviser to the Government? Would it not follow from the fact that he was directly a part of the Government's activities in the economic field that he would acquire the status of an adviser on the Government's general and economic policy?——I think of the Bank much more as the executor of government policy. Of course any executor of this degree of importance is an adviser as well. The Chairman of the Board of Inland Revenue is an adviser on what sort of taxes should and can be levied, but he does not determine the policy of the Chancellor. He makes his contribution in his own field; so, I think, would the Governor of the Bank.

12342. *Sir Oliver Franks*: There may be a point of difference between the Inland Revenue and the Bank here; it is one which you yourself have referred to: the extent to which particular executive action makes policy. I would imagine that the Inland Revenue in many ways is more a normal administrative department; once its policy has been settled and it has worked out the regulations the action proceeds. But that is not so with the Bank. The Bank, whether in its domestic activities or in its foreign activities, is necessarily, within broad Government policy, itself contributing to and making policy. I should have thought that the people who are doing that, with the expertise that they inevitably acquire in some of these very technical subjects, almost automatically also acquire authority and prestige which gives a qualified independence. If one follows that line of argument it modifies what you were saying to some extent, and I would be grateful if you would comment on it?——I agree there is a distinction, but I think the logic of the distinction, which it may be rather alarming to draw out, is that, if the Bank of England's day-to-day activities are so interwoven with Government policy, its relationship with the Treasury ought to be rather closer even than that of the Inland Revenue. If one can lay down principles and leave people to execute them and that is all there is to be done, then one has something more like the relationship between the Ministry and a nationalised board; and I agree that in a sense the Inland Revenue is like that. If, however, the Bank is really all the time taking these vitally important decisions I do not myself think that the case there is one for more independence.

12343. From the point of view from which we are now discussing it it seems to me that it makes relatively little difference whether the Bank is quasi-Government department or independent institution. What really matters is working relationships?——Absolutely. I only took the Inland Revenue as an example. I do not wish to suggest that it is a complete parallel to the kind of relationship I want, but it is the nearest thing I can think of. Of course there is another possibility which you may have considered, and that is dividing up the activities of the Bank a little in this respect. It may be that certain parts of their activities are much more important for Government policy than others.

12344. *Chairman*: Could you identify the ones you have in mind? From the line you have been speaking on the management of foreign exchange would be one?——Yes, and monetary policy is obviously the other. If you take those two things out, the other things done by the Bank of England, so far as there are other things, would not matter so much.

12345. *Professor Sayers*: In giving examples of consultation with the Governor of the Bank or anybody else at the Bank you have always taken cases that referred to the foreign side, never one relating to management of the debt, for example. When you refer to management of the debt you refer to it as Treasury business. Does that mean that in the Chancellor's relations with the Governor of the Bank you as Chancellor were not concerned, for instance, with the instructions given to the Government broker?——I do not recall ever being consulted on that by the Governor of the Bank; but you

must remember that when I was Chancellor Bank Rate was pegged, and monetary policy in the sense that it has developed since then was not quite the thing that we were concerned with. No doubt the reason for my emphasis on the foreign exchange market was that we were, on the other hand, very much concerned with that. I do not wish to give the impression that I think there is a distinction here in importance. It is probably true that in the management of the debt the Treasury officials, at any rate the ones that I knew, would he rather better skilled than any available to deal with the foreign exchange problem; but that may have been a purely temporary thing which over a long period is not relevant.

12346. If you were Chancellor now, would you expect to have the Governor of the Bank discuss with you the instructions to be given to the Government broker?——I do not know that I would expect him to discuss every single item; I certainly think that it would be necessary to discuss the general policy. But, as I have tried to explain, I do not think that it is satisfactory to hase the relationship between the Bank and the Treasury on the Governor coming to see the Chancellor. There has got to be something much more intimate at official level.

12347. *Chairman*: Then we come to our fifth question?——I am quite against any more direct relationship between the Bank and Parliament.

12348. On your basis the Chancellor of the Exchequer is the effective Minister for the Bank?——Precisely, and there is the added point that a good deal of the Bank's activities are necessarily of a fairly private character anyhow, and there would be difficulties in expecting the Bank to explain exactly what it was doing, even to the Public Accounts Committee two years later. Anyhow the question, as you say, does not really arise, so that disposes of that one.

On question 6, I think there is a general case for more information. The Report of the Bank is a very flimsy affair at the moment. I would certainly like to see more available there. There might possibly be periodical reviews, as you suggest, but I am rather doubtful about this idea of the scope of the public relations of the Bank being extended, because I do not think that any institution which approximates to a Government department should have public relations of its own. That is a matter for Ministers. If we had the Governor or other officials of the Bank appearing on television or broadcasting, writing articles and so on, the danger would be that they might appear to have a separate policy of their own. I have made it sufficiently clear that I do not think that any such thing should exist. The Government should therefore generally speaking take responsibility for public relations, at any rate for anything which is related to policy at all. Maybe we could have from the Bank some hetter explanations of how the financial system works, or something which would be quite independent of policy decisions; but apart from that the Government should take the responsibility.

I pass on now to questions 7 and 8, if I may take them together. I would say from my experience that there is a danger that the relationship between the Treasury and the Bank, as it was when I was Chancellor, might involve an obstruction to contacts between the Treasury and the clearing banks. I do not think it is unfair to say that the Bank of England regarded itself then, as I expect it still does, as a buffer between the Treasury and the rest of the City generally, and preferred all relationships between the Treasury and the City to go through the Bank. We were much concerned when I was Chancellor with trying to restrict advances, particularly certain types of advances, and we were puzzled by the fact that they continued to go up despite requests that they should not do so. I recollect that the Bank of England did not like the idea of the clearing hanks being represented on a committee which was set up under the Financial Secretary at that time to go into this whole matter. One should not be too critical of the Bank for this; someone who regards himself as, as it were, the superior officer does not like the person below him bypassing him. I dare say that there was a good deal of that feeling. That this reluctance existed I do not think there can be very much doubt. I regard it as desirable that the Chancellor should, at any rate on occasions, have pretty close relations with the clearing banks. I remember asking the Governor at one point if he would arrange for me to meet the chairmen of the clearing banks. We did meet, but it was a great big affair, lunch at the Bank with the thirteen clearing banks represented, and all the members of the Court there. It was a pleasant afternoon occasion, but it was not really what was wanted. What should have happened, and I helieve does happen more now, is that, say, the chairmen of the "Big Five", possibly with their general managers, should come and talk policy with the Chancellor. Maybe it is unfair to say that the Bank would have objected to that, but they certainly did not arrange it.

Then, if I may go on to question 8, this is an old problem. Probably the Treasury ought to have a clear power to direct the Bank of England to direct the clearing banks.

12349. *Chairman*: Was that a live question when you were Chancellor of the Exchequer?——No, it was not a live question. Although I think that to keep the thing tidy and put it as I would like to see it there ought to be an amendment to the Act, I do not regard this as comparable in importance with establishing the right relationships. We could leave the Act as it is now and nevertheless get the right kind of relationship between the Bank and the Treasury and the Chancellor; equally we could change the law and nevertheless have the wrong relationship. But I think that on the whole this kind of reserve power is desirable because it establishes quite clearly beyond any shadow of doubt where the ultimate power lies, and there is some ambiguity, to put it no higher, in the Act on the question whether the Chancellor can direct the Bank to give instructions to hankers, or whether it has to proceed only on the initiative of the Bank itself.

12350. The power of the Treasury to give directions to the Bank, so far as I know, has never been put into operation. Is your experience the same?——So far as I know, it has not been used.

12351. Do you think that its existence is relevant in determining the relations between the Treasury and the Bank?——Yes. Most of the nationalisation Acts give the Minister an ultimate power of issuing directions. Such directions are practically never issued because they would imply some kind of clash of view between the board and the Minister concerned, and probably both of them want to avoid that being made public. But the existence of that ultimate power is desirable because it shows clearly where the ultimate power lies, and I think that it does affect the relations between Ministers and public boards. I would apply that to the Bank of England as well. If that was not laid down in the Act, I think that the difficulty of establishing what I would regard as the right relationship between the Treasury and the Bank would probably be greater.

12352. Do you think that it is a power which is capable of leading the Bank to take an action which it would not otherwise have taken; in other words, that it makes it possible to exert pressure which does not in fact lead to a direction?——If there was a situation in which the Chancellor was continually having to issue directions to the Bank, then it would mean that the relationship was very bad indeed and that the whole thing was in a mess. I would guess that, if this were to happen, somebody would have to resign before long. So this is a remote possibility, and it is not the most important thing. I regard it as a symbol as much as anything else, a symbol plus a reserve.

12353. A Minister in his relationship with his own department is continually giving decisions which amount to directions. If you think that the right relationship for the Bank of England is to be as near a Government department as possible in its relations with the Chancellor, should not he be in a position continually to give what are the equivalent of directions?——I think perhaps we must distinguish two kinds of "direction" here. The power to give directions under the Act has been understood to mean formal directions. As Minister of Fuel and Power I gave certain formal directions to one of the public boards. They were not of any great importance; they related to the way in which the accounts were to be presented, or something like that, and they did not in that case emerge from a row between myself and the chairman of the board. To go on issuing a series of notes like that would not be the way to conduct business at all. I would like to see the relationship such that the Chancellor can ensure that the Bank carries out the

policy that he believes to be right; but he would not be able to do that by just sending notes. He would only be able to do that—this is the whole burden of my evidence—by establishing a much more intimate relationship, comparable to that which he has with his civil servants. It is true that he makes the decision, but nobody writes an official note. He may write a minute at the end of a memorandum, or he may say at the end of a discussion: "I think this is what we should do"; but that is quite different from the relationship which would arise when one was basing it on a legal power of this kind.

12354. Do you think that the fact that this legal power has been created, which as you say has been regarded as a reserve power, is capable of strengthening the hands of those to whom it might be directed, because they can say: "If you want us to do that, you must put it in writing as a direction"?——That is undoubtedly one effect of it.

12355. *Professor Sayers*: I am still a little puzzled as to why the power is necessary. Suppose that the Act of 1946 did not exist and that one were making a clean start with this; would not your view be that the Bank should be assimilated as closely as circumstances permit to a Government department? Would it occur to you to insert a power of direction; would not the Chancellor just sign his minutes?——It is not really so clear as all that. The Bank of England exists; there is a historical background to this. In nationalising it we created a new situation, and I think that in that new situation it is as well, for symbolic reasons as well as for the ultimate reserve powers, to make unmistakably clear whose word runs.

12356. It would seem that the real importance of this statutory provision is to deal with history?——With a different history it might not be needed.

12357. *Chairman*: Then may we come to questions 9 and 10?——I do not see any reason for changing the methods of appointment, nor the period of office. As for the range of selection of directors of the Bank, this rather ties up with what I would rather say more generally on question 10. If there is to be this closer relationship between the Bank and the Treasury which I believe to be necessary, there is a case for having on the Court as full-time executives persons who have been Treasury officials. Hitherto I have been talking about staff relationships; now I am talking about the Court itself. I do not on the whole favour the idea of having Treasury officials as part-time directors of the Bank, but I think that there is a case for having some of those who have been in the Treasury as full-time directors. One might have a couple of full-time directors normally drawn from the Treasury, serving their four years in the Bank. There might be some salary problems, but they could, I think, be overcome; the difficulties would not be insuperable. At the same time I would incline to the view that the part-time directors ought to be made more definitely and obviously advisory in character and I would be inclined to draw rather more of them from non-financial circles than is at present the usual rule. There are a number of industrialists and usually one or more people with experience on the trade union side, but I would widen that a bit more. I think that it would be worth having an economist or two on the board, and possibly even a lawyer. I would make it a rather more general affair; I would also make it advisory in character. That would for one thing get over this difficulty which arose recently about information being available to part-time directors, and I think that it fits in with the general picture of the set-up that I would like to see.

12358. On the basis that the Bank is an instrument of the Chancellor, would not the Court be inherently advisory?——I agree, and that is why I would take steps in that direction. The situation in which the part-time members of the Court have to be consulted, as they were clearly in September 1957, about the change in Bank Rate is not really necessary nowadays. I would not have thought it appropriate to modern conditions. This is a decision which the Chancellor should take with his advisers, and, unless he decides that it is necessary to ask other people in the City what their advice is, that should be the normal rule.

12359. *Professor Sayers*: Would you draw a distinction here between consulting them in the sense of ascertaining whether they would support and, on the other hand, consulting in the sense of ascertaining their views on a situation in a general way?——If they are an advisory body the question of support does not really arise. The Chancellor would certainly ascertain their views as he thought appropriate.

12360. *Mr. Jones*: You do not favour a situation where officials of the Treasury might be appointed part-time directors or part-time members of an advisory body to the Bank. You are saying that recruitment to the Court should be on the basis of Treasury experience, and the appointment should be on the basis also of full-time service as executive directors?——So far as Treasury officials are concerned, yes. I do not mean to suggest that the board should consist exclusively of Treasury officials. But I do not think that to put one or two Treasury officials on the Court as part-time directors would achieve in the least the objective which I have in mind. I doubt if it would make very much difference as compared with the present situation. But if there was interchange of staffs, and it was normal for one of the ablest people in the Treasury to become a full-time member of the Court, that would certainly make a profound difference.

12361. *Lord Harcourt*: Do you feel that a high-ranking Treasury official would have the experience necessary to run the Bank? If he is to be a full-time working director he must be an executive director responsible for a whole section of the Bank's operations?——I have already said that I hope that there would be a good deal of interchange of staffs between the Treasury and the Bank, which would in the course of time overcome any difficulty there might be there. In the meanwhile I must say that I have a high opinion of the abilities of the senior Treasury officials that I have known; so has industry, because it frequently takes them and puts them into high executive jobs of which they have no experience at all beforehand. I see no reason why, if industrial companies can recruit senior Treasury officials and give them immense responsibility, we should think them incapable of conducting the affairs of the Bank properly.

12362. *Professor Cairncross*: You said that the problem of access to information might disappear if the part-time directors were purely advisory. I am not sure, if that is so, that I follow just what they would do. Would they have no access to domestic papers of the Bank?——I do not know how much they have at the moment. What the Bank wants from them is the picture, which they give the Bank even now, I am sure, of the general state of industry, trade, the labour market and so on, and information about what they know is going on abroad. I do not think that it is possible to lay down precisely what papers they would have access to. I think that they should be given a certain amount of information, but I do not think that it is necessary to give them the highest and most secret information.

12363. *Chairman*: The relationship you have been advocating means that the operations and activities of the Bank would be governed by political purposes (I do not use that word invidiously); do you think that that would affect confidence internally and externally in sterling, if it was known that that was the constant and regular motivation of what the Bank was doing?——I do not think so, because in theory this is supposed to be the case today; and, quite frankly, any other postulate seems to me to be indefensible. When you say (and I appreciate that the word "political" is not intended to be pejorative in any way) that the Bank's activities would be governed by political considerations, I am bound to put to you: by what else should they be governed? By the personal whims of persons who after all are appointed by the Chancellor of the Exchequer, or by what? Are we to suppose that the directors of the Bank of England know better than the elected Government? This is the issue.

12364. You do not think that a central bank can be an agency at the centre of the economy, which pursues the more limited purpose of monetary stability?——No, I do not think that one can just say that monetary stability is its limited objective. For instance, there is much controversy among economists about the possibilities of having expansion without inflation. There are those who take the view that it is very difficult to have monetary stability without a high level of unemployment. Can a Govern-

ment possibly leave the decisions in matters of this kind to any other body? It must take the responsibility itself, and it must have the power and the machine by which it can carry out those decisions in the most effective and sensible way. There are two possibilities here, once one concedes the Government's responsibility. One is to have an independent organisation like the Bank of England, and inside the Treasury a department or a group of officials who tell the Chancellor of the Exchequer what they think he ought to do in relation to the advice of the Bank. I think that one gets into an awful mess if it is done that way; certainly there is an appalling amount of duplication, and there would probably be rather bad relations between the Treasury and the Bank. The alternative is to bring the Bank closer to the Treasury, so that the necessary confidence and understanding can be established between them. That is why I came to this conclusion that I have been trying to explain this morning.

12365. *Sir Oliver Franks*: I can see the argument for saying that the Chancellor's responsibility for general economic policy means that he must have responsibility for general monetary policies, foreign and domestic. I can also see the argument for saying that there should be close working relations based on mutual confidence between the Treasury and the Bank. In the position which you have put forward, you have also had to say that these two objectives can only be attained if the Bank of England is made more dependent on the Treasury, and assimilated so far as may be to the status of a Government department?——"More dependent" is perhaps not quite the right form of words; I would rather say "less independent," meaning that it was closer.

12366. Does it seem to you a matter of concern at all that, in proportion as you drain power and the power to decide out of institutions in the country and aggregate them in the central Government, the extent to which qualified independence is diminished may itself work against the system by clogging the centre with power?——I do not think so. I agree with you that there are always dangers of this kind, but what I am suggesting amounts to this. At the moment there seems to me to be a situation in which the Bank of England preserves a certain degree of independence and makes these decisions itself. I am not asking for those decisions to be taken continually to a higher authority; what I want is that the Bank of England should continue to take those decisions, but in a manner much more like a Government department would take its decisions in its relations with the Minister.

12367. *Professor Cairncross*: There should be present to the minds of the officials of the Bank of England the same kind of considerations which are present to the minds of the officials of the Treasury and other departments? They should not be looking at things under their control and jurisdiction exclusively from a monetary direction?——I do not think that one can generalise; it depends what official you are talking about. But I certainly think that the general attitude of the officials of the Bank should be similar to that of Treasury officials, in their relation to Ministers particularly.

12368. The kind of issue I have in mind is this. In external policy there may at times be alternatives between using quantitative restrictions on imports or monetary controls over exchanges. The advice that the Chancellor would wish to receive in these circumstances would come both from the Board of Trade and from the Bank of England. Would it be your experience that the two institutions or departments would have got together and discussed the advice to be offered, or that they would come forward with independent advice?——Again I think it is hard to generalise. There are so many questions on which different departments would give advice, as you know, and would give it quite separately to a Government committee of some kind. It would largely turn on how distinct their responsibilities and points of view were. I would not think it right that the Bank and the Board of Trade should get together and say: "We are not going to put up separate evidence to the Treasury." I do not think that that would be correct behaviour.

12369. I am assuming that you would prefer to be presented with two pieces of advice rather than one?——I would prefer the advice to be honest. Where there was a difference of view, I would like to hear people expressing that instead of it being blanketed by the Permanent Secretary. It never is in the civil service, as far as I know; if there are differences of view down the line they are brought out.

12370. The point I had in mind in putting this question to you is that it would be important not just that the advice was honest—we can take that for granted—but that the advice should be based on a consciousness of the lines of action that might be taken and the alternatives which should be considered?——Yes.

12371. And an official in the Bank of England might not, unless his background were a wide one, necessarily think in exactly the same terms as a Treasury official or a Board of Trade official?——In a case of the kind you mentioned all this would come out at meetings, probably at official level to start with, and then at a meeting where the Chancellor himself might be in the chair. If the Bank was taking what you would regard as too narrow a view that would become perfectly apparent. It would have to be weighed as one of the considerations before the Government made up its mind. I would not see any great difficulty there.

12372. *Professor Sayers*: You said a little time ago [Question 12340] that you would not want the Governor of the Bank of England to tell you what sort of Budget to have; but if the Governor of the Bank sat with others on the preliminary discussions during the Budget session and said: "All the signs we can see in the financial world indicate that we are going into a recession and a recession of an order beyond that we can deal with by monetary measures alone", ought not you to take account of this in your Budget?——Most certainly.

12373. In that kind of way it would surely be highly desirable for the Governor of the Bank to be in with the other Treasury top people to advise on the fiscal measures?——I never intended to give the impression I would object to that at all. I do not think that when I was Chancellor the Bank ever offered advice of that sort. That is the kind of advice one got from the Economic Adviser to the Government or the Chief Planner. But I quite agree, especially in this rather closer relationship that I would like to see established, that it would be perfectly appropriate for that kind of advice to be given.

12374. The assessment of how much could be done by monetary measures would surely be a matter on which the Governor should advise?——I entirely agree.

Chairman: We are very grateful to you, Mr. Gaitskell, for a very interesting talk.

(*The witness withdrew.*)

(*Adjourned until* 2.15 *p.m.*)

THE RT. HON. R. A. BUTLER, C.H., M.P., called and examined.

12375. *Chairman*: Thank you very much for coming, Mr. Butler. We have been able to give you an outline list of questions* on which to centre your views, but we do not wish in any way to tie you down to these specific questions. As you know, what you say to us today is for the record and publication. Would you like to start off with a statement from your own point of view, centering round these questions?——*Mr. Butler*: I do not think so. It is always better for a witness to be available for any points that you want to raise; if you want me to refer to your questions, I shall be very glad to do so. The only general observation I should like to make is that I do not intend to give any technical evidence; I think, looking round this distinguished gathering, that you know just as much about the pure technicalities as I do. I should like simply to give such evidence as is of value from my experience on the general issues to which you are devoting your inquiry.

12376. Your special contribution, as you say, will centre around these rather general questions on structure and relationship. As you will have noticed the questions are interconnected, but I think the first four hang together; so could we have your views on the first four?——The first four relate to the structural relationship between the Treasury and the Bank, the power vested in the Treasury by the Act of 1946, the working arrangements for securing co-ordination, and any change in the structural relationship, I should say at the outset that, while the structure of the 1946 Act is clear, namely that whether under section 4 (1) or elsewhere the Treasury and the Chancellor of the Exchequer of the day are supreme and their word is final, I do not think that the relationship between the Bank and the Treasury would work unless it was on a basis of understanding and consultation. Indeed, if you look at section 4 (1) you will see that it has the words "after consultation with the Governor of the Bank"; that relates to any possible occasion when a direction might be given. It would appear to me that there is available every form of statutory machinery necessary in order to make the system work, but I personally would not rely upon direction; I would rely upon consultation between the partners, as has I think been proved. As I hope to say in a moment, there is a recent indication that that is the best way to work. There is, however, one lacuna in the powers, and that is that although the Bank of England can give directions to the clearing banks, there is no power for the Treasury to give the Bank of England direction to direct the clearing banks. That was brought out by Lord Jowitt in the course of the original debates, which I have been studying before coming here to give evidence to you. That is the only gap in the armour in regard to the terms of the statute. If you were to report that that was a gap, from my point of view I would agree that, if the machinery is to be complete, that gap should be filled. But I again repeat that in view of the general atmosphere which I think must persist between the Bank and the Treasury and the Chancellor of the day it will not in my view really make very much difference whether that gap is filled or not.

12377. In your experience as Chancellor, did you find that the absence of what is missing was material to your work as Chancellor?——No, because I really never went by the strict terms of the Act. I depended almost entirely upon consultation and persuasion. I should have thought that, if there were any deficiencies, either at that time or since, in the operation of the clearing banks and their relationship with the Bank, I would have depended in my time, and I would expect people to depend now, upon the influence of the Bank of England upon the clearing banks rather than upon a power to be given in a statute. It is interesting to note that in the preliminary period of the passage of the Bill this matter was never raised, although it did come up latterly in the debates. It is undoubtedly a gap, especially when one examines some of the relationships of foreign central banks to their own Ministers of Finance.

12378. At one stage you spoke of this as a partnership; you were saying that it worked best as a partnership between the Chancellor on one side and the central bank on the other. Do you think that the power to give directions which the Act introduced in 1946 is relevant in determining the atmosphere of the partnership?——I always worked against the background of this Act, and I never lived in a world in which the Act did not exist; we just accepted it as being there. I dare say the partnership could have gone on without the Act; as far as I know the Act did no violence to the partnership.

12379. Did it ever emerge as an element in your discussions with the Bank as to what should or should not be done, or what policy should or should not be pursued, that there was this power to give direction?——No. It seemed to me that, if we were engaged in such vital affairs, the personal relationship between the Governor and the Chancellor was of more importance than anything else. One took it for granted that, if there had not been an Act of Parliament, there would have had to be a resignation from his office of the Governor of the Bank if he was not willing to work with the Chancellor of the day. That was an alternative form of relief or sanction, which existed apart from the Act. But as far as I am concerned I do not take any objection to the Act; I think it forms quite a good basis for the working of the system.

12380. Could you give us an indication of the differences that you felt in your relationships with the Bank in your position as Chancellor, and your relationships with the Treasury itself?——I do not want to be too subjective, as Goethe warned us was dangerous, in giving evidence, but I can only give you the basis of my general experience. When I became Chancellor we reintroduced the use of the Bank Rate as a measure of discipline in dealing with the economy; naturally in the first years when we introduced it there had not been experience for many years of its operation. As you know, the Bank manages the market, the Treasury chiefly the Exchequer and the public debt, and the object of both is, I think, to keep the ebb and flow of money correct. In dealing with such questions as the Bank Rate, if the partnership is to work, it is most important that both sides should be very well informed and equipped, and that the Treasury should not imagine that the Bank is the only expert in the matter. The experience I found was that the more we managed to improve our own equipment in the Treasury the better the partnership worked. It would be wrong for either partner to think that they could, for instance, abandon the section giving them economic advice, or abandon from their own armoury the section giving them advice on the manipulation of the Bank Rate. In the years when I was Chancellor and since both sides have realised that they must be fully equipped if their partnership is to be complete, and that they must both try and get the maximum experience; then they will get the best results.

12381. In one's own mind one necessarily contrasts the idea of a partnership with that of the Bank of England being avowedly an instrument under the directions of the Chancellor of the Exchequer of the day. Have you any views as to the comparative advantages and disadvantages of those two positions?——I would say that it is a partnership, because I think that there are things the Bank can do that the Treasury cannot, and things the Treasury can do that the Bank cannot. The Bank is more instinctively intuitive, and the Treasury is more instinctively deliberative—at least, so it seems to me—and so the two partners rather supplement each other. The management of the day-to-day market, which is the fundamental job of the Bank, apart from their agency functions in relation to the debt, the note issue and so forth, is a different sphere from the more deliberative long-term policy aspect of the Treasury. Therefore I think that it is a partnership, and I do not think that we can choose really any other word. I do not think that one is really necessarily subordinate to the other, except that in terms of the Act it is clear that a direction can be given.

12382. The relationship of partners does connote that no action can be decided upon without the agreement of both parties; do you think that that is an impediment to the conduct of Government?——I suppose that, if one went strictly by the statute, agreement would not be necessary, because a direction could be given, except on this particular question of the Government's relations with the clearing banks, which must at present go through the Bank, because the Bank alone, under section 4 (3) has power to direct the clearing banks. Suppose that a clearing bank were to refuse to operate some advice or instruction

* See page 846.

about the level of advances, for example; then a situation would arise that, unless the Bank chose to direct them, the Treasury would be rather out on a limb. I do not think that such a situation would arise; I am only putting it as a possible one.

12383. *Professor Sayers*: Are you putting it as something which affects the channels of communication now between the Treasury and the clearing banks?——The relationship between the Treasury and the clearing banks ought not in my view to be too close. I think that the clearing banks must look to the Bank of England as their chief and their adviser. There have been connections between the Government of the day and the clearing banks; on at least one occasion I met the clearing bankers informally and had a talk with them, and it was very valuable. I think that there have been rather closer contacts since my day than there were in my day, in order to make credit policy stricter. But I have always regarded the clearing banks as fundamentally regarding the Bank of England as their adviser and father confessor, and I think that that is a healthier relationship than having too close a relationship between the Government of the day and the clearing banks.

12384. Do you think that that position is in any way bound up with the legal position under the Act?——The fact that there is no power of direction in the Act as between the Treasury and the banks was partly fortuitous, as far as I can make out. I have been into it with people who were concerned with the passage of the Act, and I think it was left out partly by mistake. It was noticed by Lord Jowitt, and very much underlined by him with his usual legal acumen; he pointed out that it was not intended, and in fact a comma was altered in the final draft of the Act to make quite clear that it was not intended. The full constitutional and banking significance of it was not understood at the time; that is my view, but that is only a personal view.

12385. *Chairman*: There are two possible positions: one is that the thing works best as an avowed partnership in which both partners by constant discussion have to agree on a policy of action before it is adopted by the central bank; the other one is that the position should be avowed that the central bank must follow policies and conduct operations which the Chancellor directs it to do. Do you think the first is an impediment to the effective handling of Government economic policy?——I think that the most serious impediment to the effective handling of Government policy is a lack of knowledge of what each is doing in either partner; and that, I think, has been greatly improved in the last several years. In the early days of the revival of monetary policy there was no experience. Case law is very valuable in any situation, and experience is even more valuable; now that both partners have improved their armoury in this respect, that has put on a better footing a situation which was not always entirely satisfactory. I would not have said that the defects came from any statutory difficulty, and in my experience they did not come from difficulties of personal relationships, although difficulties of personal relationships must always be taken into account in public affairs, and such difficulties must be brought to an end as quickly as possible in order that better relations may be restored.

12386. Is there any organisational improvement that you think has been responsible for the better exchange of information leading to policy decisions?——I think just the experience of working. I cannot speak for the Bank, but my experience of the Treasury has gone on, I am glad to say, in a fairly intimate manner, all these years, and I remain a senior member of the Government and therefore I know more or less what is happening. I should say that the overseas finance portion of the Treasury has always had very considerable experience and even some ability to have opinions on such matters as exchange control, which are normally and I think rightly regarded as being under the operation of the Bank, though I am sure that the overseas finance section has never attempted to interfere with the day-to-day operation of the exchange control, which is delegated to the Bank. On the home side of the Treasury, aided by the Economic Section, there has been a very considerable enlargement of power; more horsepower has been provided in the new model. That is a good thing and that is derived from experience.

12387. But is that shared with the Bank, so that it leads to the Bank's views and advice being discussed with the Treasury?——As far as I know, it is; and I think it should be. There should be complete interchange of views, so that they work as partners, though not trying to do each other's work, which I have divided broadly at an earlier stage into the more intuitive day-to-day work and the more deliberative policy work.

12388. *Professor Cairncross*: How did the Bank of England communicate its views to you? Was this largely a matter of discussion with the Governor, or would views reach you in other ways?——The Governor has always stressed the importance of his relationship with the Chancellor. That takes the form of conversations, which are mostly of a personal character. Quite apart from that, the senior members of the Treasury in my day, and I understand since, have had the habit of visiting the Bank regularly, occasionally for lunch but quite apart from that for purposes of business; and there was and is a very close relationship between the head of the home finance division in the Treasury and the Bank itself. I think that it is important that the whole of the relation should not be purely personal between Chancellor and Governor but that there should be relationship between the officials on both sides.

12389. But if the Bank of England had come to a view which was the outcome of disagreement within it, would you be made aware that there were two views and of the reasons that led to the final recommendation made to you?——It depends on one's intuitive qualities as a political animal—I do not mean political animal from the point of view of having any particular prejudice or view, but just an ordinary political animal walking about the jungle. Usually when one has been in the jungle for some time one gets some idea what is going on, not necessarily through official sources.

12390. *Sir John Woods*: Were your own contacts as Chancellor confined to seeing the Governor, or did you ever see other officials of the Bank with him?——It is nearly always the Governor or the Deputy Governor in London. I saw other officials of the Bank mostly when I went abroad. I used to see the head of the exchange control almost regularly abroad, and two or three of the senior officials; for example, I was chairman of the O.E.E.C. for the best part of four years, and there was nearly always a senior officer of the Bank available and present to help.

12391. *Professor Sayers*: Were questions of debt management discussed between you and the Governor?——Not in detail. Questions of debt management and new issues and that sort of thing are mostly arranged between the home finance division of the Treasury and the Bank. But the question of a conversion or an issue would certainly be mentioned by the Governor to the Chancellor before it came out. It depends upon the training of the Chancellor of the Exchequer whether he is competent to advise upon the position. It is still possible to be a good Chancellor while not being an expert on the last quarter or eighth per cent., in which case one takes advice from one's advisers.

12392. Would the general line taken in the activities of the Government broker, not on particular days but over the months, be a subject discussed between the Chancellor and the Governor?——Not a lot, in my experience.

12393. *Professor Cairncross*: If there were any difference of views between the Treasury and the Bank of England, you would clearly have access to the views of your own officials, which might not all coincide; on the Bank of England side, would you have access to the views expressed only by the Governor, or would the Governor report to you that be was being presented with different considerations by his officials? Would all these considerations be put before you?——Normally the contact would be with the Governor as head of the institution, because there is a certain respect existing as between the Treasury and the Bank. I would have hesitated from interfering in what I thought would be the internal affairs of another house.

12394. You would not normally summon a meeting to which would come various officials from the Bank of England?——No. I remember meetings at which it was possible to have present the head of the exchange control and perhaps another Bank official, and perhaps the Deputy Governor, and I have known meetings when the economic

adviser to the Bank has come along and given the benefit of his advice and exchanged views with the Economic Adviser to the Government; but normally the routine meetings were with the Governor himself.

12395. *Mr. Jones*: In discussions with the Treasury you would probably be meeting teams of officials in an informal sort of way; in your meetings with the Bank was there the same degree of informality as there was when you were talking to the Treasury, or were the discussions much more formal?——There was a considerable degree of informality in dealing with those representatives of the Bank, chiefly the Governor and the Deputy Governor and the head of the exchange control, whom I knew quite well, because we were dealing with matters of common concern, and it was essential that there should be understanding and agreement before decisions were carried out.

12396. Would there be less pooling of opinion with the Bank than there was with the Treasury, in that in discussing matters with the Treasury you would be meeting senior officials of the Civil Service?——I never found any difficulty in dealing with the Bank. If we made any mistakes or had any successes they were usually made together; if they were successes they were due to good fortune, and if they were mistakes they were due to lack of sufficient information.

12397. *Chairman*: From the public point of view, why do you think that the system of central bank and Government working as partners is preferable to that of central bank being avowedly an instrument of the Government?——Because I think that no Government and Chancellor of the Exchequer either could, or ought to think that they could, run a thing like the Bank of England. First of all they have not the expert knowledge; and above all, which is most important in the modern study of Whitehall, they have not the time. As certain of the operations of the Bank, especially in dealing with the market, require in my opinion a lifelong experience of things with which the heads of Government and civil servants are totally unacquainted and totally unsuited to deal, there has to be a marriage between two different types of institution. If one was made literally subordinate to the other I think that we should lose part of the independence which one gets from a happy marriage. As the talents are different and the day's work is different, it is a very good thing to have a partnership rather than a subordination, and I think on the whole it is likely to work. I would like just to give you one example: the Governor's letter of the 3rd July to the Chancellor of the Exchequer on the subject of the special deposits which he suggested in that letter, following upon a request from the Chancellor on the 1st July, should be called up when it appeared necessary in support of other monetary measures to restrict the liquidity of the banking system and thus the ability of the banks to extend credit. I do not want to go into that in detail, because I am not an expert on the detail of it; but I want to draw your attention to the penultimate paragraph of the letter from the Governor, which illustrates all I want to say. He says this: "The scheme would serve to reinforce the existing monetary instruments and would be employed as a general control of credit in the same way and after the same sort of consideration as Bank Rate". Now the introduction of this scheme in my opinion was an important innovation, produced by the Treasury's partner, namely, the Bank, with the Bank's special knowledge. It takes a form different from that used by the Federal Reserve System in America in restricting the amount of advances and regulating liquidity. It is therefore an important idea. The Governor says that this scheme "would be employed as a general control of credit in the same way and after the same sort of consideration as Bank Rate". That means that he is approached by his friend, the Chancellor of the Exchequer, and told that the Chancellor wants liquidity looked at, wants further control; and he provides this idea. I do not know whether the years will prove that it is a good idea or not; that is partly for you to consider. But here is an idea which will help with something which I found was necessary in my time; it will give an opportunity of dealing with the advances of the banks, and the beauty of it is that it is not enforced by the Government; it is put forward by the Bank, and "would be employed as a general control of credit in the same way and after the same sort of consideration as Bank Rate". I regard that as a good method of the partnership working, and I do not think that a Government department could have produced the idea.

12398. *Professor Sayers*: Even though the idea has been in use in one country of the Commonwealth for some years?——I am aware that that idea is not entirely original, but I still think that the working out of the idea and the relationship between the central bank and the clearing banks is rather better dealt with by the Bank of England rather than a Government department.

12399. *Chairman*: It is not the actual generation of the idea you are stressing?——No; the idea, as Professor Sayers has said, is not entirely new, and I do not doubt that it could have been invented by the Treasury; but the fact that it comes from the Bank and that they are responsible for it, and responsible for the relation with the clearing banks, is I think a better way of conceiving the partnership than having too much centralisation in Whitehall.

12400. *Professor Sayers*: Are you suggesting that this was not discussed with the Treasury very thoroughly?——Of course it was. No final published exchange of letters is ever done, as far as I know, in these difficult and artistic matters without discussion between the partners as to whether the thing will work.

12401. *Sir John Woods*: You are in fact quoting this as a good instance of initiative coming from the Bank, which in final terms is the junior partner?——Yes.

12402. *Professor Sayers*: But have we any knowledge that the initiative did come from the Bank in this case?——I do not happen to know whether it did or not; but, whether it did or not, I would rather have the Bank in its present relationship to the Treasury, because I believe they have people in it who have knowledge of the markets, knowledge of the clearing banks, which we cannot possibly have either in the civil service or as politicians.

12403. *Chairman*: It is possession of practical expertise in the whole field that makes you think its position is more workable as a partner than as an expert adviser?——Yes.

12404. Because it knows so much that the Treasury is not in a position to know, its advice has to be taken; is that putting it unfairly?——Not necessarily has to be taken, but deserves consideration; as the Chancellor made clear in one of our recent debates on this subject, the final responsibility on policy must remain with the Chancellor of the Exchequer of the day.

12405. *Professor Cairncross*: There are perhaps three major branches of monetary policy, one of which relates to debt management, one to external policy and exchange control, and one to domestic policy and the use of Bank Rate and open market operations. If you take the first two, does not the Bank of England act as agent of the Treasury?——As I understand it the Bank is the managing agent of the Treasury in the note issue, exchange control, technical management of debt, and in new issues. In the case of new issues a great deal of discretion is left to the Bank because of their knowledge of the market.

12406. The Exchange Equalisation Account used to be managed directly by the Treasury; has that ceased to be true?——I would not like to get too deeply into technical questions, but my main answer to you is correct. That does not take away from my claim that a partnership is what is wanted, because as the managing agent the Bank is the partner who knows more about these things than the Treasury. The Treasury cannot know everything in relation to these particular matters.

12407. *Sir Oliver Franks*: Could you help me a little in defining the notion of partnership from this point of view? I suppose that the Chancellor as the economic Minister in the Government has a general responsibility for economic policy, and that therefore when he considers the state of the economy at any time, he has to consider whether he will deal with this by fiscal measures or by monetary measures, and whether or not to use physical controls. These may be alternative or complementary to each other in securing a given state of the economy towards which he desires to work. From that point of view the Chancellor must be in a position to say not only to the Treasury but to the Bank what he thinks the broad line should be; the Bank seems to be dependent in

terms of general policy on the view of the Chancellor as economic Minister. But then, when one goes on to say that nevertheless it is a partnership, though possibly unequal in the sense that there is a junior and a senior partner, does this mean that the Bank should be within this broad relationship in measure independent, a centre of initiative, able to put forward suggestions, and within a given sphere to act? It would be quite easy, starting from the assumption of the general control of economic policy by the Chancellor of the Exchequer, to stress the dependence of the Bank. The word "partnership" stresses the relative independence of the Bank. What is it that makes the notion of partnership real and alive, as opposed to the notion of the Bank being essentially a very important instrument of the Government?——I would accept at once that there should be a senior and a junior partner; I think that is a good way of putting it. But, if you get away from the conception of partnership, I think that you are depriving an institution, namely the central bank, of a life and vitality which it should have. If you do not regard this as a partnership you are giving the impression that the Bank is in effect subservient to the Treasury; you are increasing the power of the Treasury and Treasury Ministers, and you may be increasing their power in spheres in which they cannot possibly either have the time or the knowledge to operate. You would be reducing the independence and therefore the character of the Bank; and I should like to see the Bank have character, because the more character it has and the more independence the better its information and the better its advice is likely to be. I am ready to accept your amendment of a senior and junior partnership, but I still think that it is wise to have as much independence as possible in the central bank. I also think that in dealing with the clearing banks and the City generally, which I think the Government of the day ought not to do and certainly has not the time to do, it is very much better if the Bank has authority and is not merely regarded as an agency. The relationship of the Governor to the clearing banks and other houses in the City is very important, because he is in many ways the head of the City; if he was treated too much as a servant and an agent I do not think that he would have the necessary authority to enable him to carry out his important duty.

12408. *Mr. Woodcock*: Leaving that on one side, would you say that there is any essential difference between the relationship of the Chancellor to the Board of Inland Revenue and that of the Chancellor to the Bank of England, apart from this thing which you have just mentioned now?——I think so, because the Inland Revenue, although one of our most distinguished and ancient Government departments, living in its most beautiful building, is essentially a part of the civil service. Although the Commissioners of Inland Revenue have very important duties, the Chairman of the Board of Inland Revenue has not quite the same relationship with outside and independent persons as the Governor of the Bank must have; nor does the Inland Revenue operate in a market. The duty of the Chairman of the Board of Inland Revenue is first to administer and collect the taxes, and secondly to give advice to the Chancellor of the day. I should say that it is inevitable that his status should be more dependent upon the Chancellor than the status of the Governor of the central bank.

12409. If you put out of your mind for a moment the leadership of the Governor and of the Bank of England in the City (which are, I think, important points), for the rest is what you have said essential? Is it not possible, forgetting that at any rate, for the Bank of England to be in much the same position as the Board of Inland Revenue? Are not some of the considerations very much the same?——There are certain considerations, in that the Chairman of the Board of Inland Revenue and as far as I know his senior officers or Commissioners have relationships to their clients, or victims, whatever you like to call them, the ordinary taxpayers, which are confidential. When I was Chancellor of the Exchequer I would never have dreamt of asking about the affairs of a particular victim of the Inland Revenue, because I would have regarded that as being a matter for the Inland Revenue itself. It is respected that the relationships of the Inland Revenue to the taxpayer are not a matter for Ministers, so that the Inland Revenue and its officials have a certain independence of their own which we ought to respect. At the same time, in the collection of taxes they are responsible to the Government, and in the offering of advice on matters like the amendment of the Finance Bill they are essentially advisers of the Government, and I would regard them therefore as in a different category from the Bank. Although in the collection of taxes they have a certain discretion, they have not anything like the discretion of the operator in the market. The Chancellor of the Exchequer, who may be answering questions in the House of Commons or else performing at O.E.E.C. or abroad, cannot possibly be so much connected with the elastic activities of the Bank of England, and therefore the Bank of England must have a certain degree of independence compared to the Inland Revenue.

12410. *Professor Cairncross*: Are you suggesting to us that the activities of the Bank of England in the market constitute central banking policy?——They do not necessarily constitute central banking policy, because they ought to follow a general pattern of policy of which the Chancellor is aware; but the day-to-day manifestations of that could not possibly be followed by the Chancellor of the Exchequer himself.

12411. But any that assumed any importance would immediately be brought to the attention of the Chancellor?——If they were important, yes; and also he would observe them himself.

12412. Do they really form part of economic policy that is in any sense distinct from the contribution to economic policy made by fiscal or commercial considerations?——It all depends what their nature is; but there must be a degree of operation which is not strictly controlled all the time from Whitehall, although if it went counter to Government policy, as Sir Oliver Franks was saying, there would be an intervention by the Chancellor or his advisers.

12413. *Professor Sayers*: Is there any difference there between what happens in the Bank of England and what happens in the public departments?——There is a much freer relationship in the world of the Bank, with the huge City interests with which it deals, and the very fluid market not only at home but abroad, which necessitates in my view more independent action on the part of the Bank than one gets with an ordinary Government department. It is not only a question of the markets at home; I do not honestly think that the Treasury and Treasury Ministers, with the weight of work at present, can possibly know very much about the foreign markets which affect sterling to such a great degree; it is the business of the Bank to be closely in touch with them.

12414. Yet in the thirties, when the exchange business was intricate enough in all conscience, were there not two or three men at the Treasury who did the work?——There were certain personalities in the Treasury, whose names some of us can remember, who had rather wider responsibilities than they have today. We need not mention any names; I think we know who they were.

12415. *Chairman*: The Treasury's power of direction has never been exercised, as far as you know?——I made inquiries before coming here, and as far as I can ascertain it has not been used.

12416. And that means that for one reason or another the policies pursued by the Bank of England are those which are achieved by agreement, and only by agreement, between itself and the Treasury or the Chancellor of the Exchequer; do you think that is right or wrong as a deduction?——I think that it would probably be right, and that the only departure from that would be when there had not been full understanding reached, due to a deficiency of personal relationships or due to a deficiency of official contact, which I think is human. To err is human, and there have been cases when perhaps the paths have not been as closely allied as they should be, but that has been due to either the personal relationship or the official contact not having been correct immediately before. But there are not many cases of that, so much so that I would say that any Minister who has been Chancellor of the Exchequer would always have been glad in recent times to accept responsibility, and the consequences.

12417. Would you envisage it as being part of his parliamentary responsibility to regard it as his duty to answer for operations of the Bank of England, either because he had agreed with the policy they stood for or because

he had not intervened to prevent them?——The Chancellor, if questioned about the state of Bank Rate, answers wholly for policy. I would imagine that he would answer for any operations which broadly were covered by the term "policy".

12418. Suppose that his attention was drawn to the fact that the rate of interest on long-term gilt-edged securities had been maintained higher than might have been expected during the course of the last year, owing to operations on behalf of the Bank in the gilt-edged market; would he regard that as something for which he should answer?——I only wish that the House of Commons would devote a little more time to its classical tradition of governing the financial policy of the country than it has done. If a Member made a speech like that, we should all be delighted that some Member had the wit to raise it, and that the Chancellor had the ability to answer it.

12419. *Professor Sayers*: Twice this last month a Member of Parliament has raised this matter, and I believe that the answer he got was a raspberry?——Only because there was not anything the Government wanted to say on the subject; it is certainly not out of order to raise the issue. Governments have to have baskets of raspberries available in order to survive!

12420. But a change of policy had taken place; the consequences of this change of policy were plain, and had been remarked upon in the press. The change of policy was thought by some people of importance, and it was implicit in your answer that you thought that this would be a significant matter. Yet the answer given in Parliament was completely unenlightening, and by implication denied that there had been any change of policy?——I believe that that was so, though I have not the details with me.

12421. *Mr. Woodcock*: Your point would be that it was a proper question?——I never see any harm in Members of Parliament raising questions on our administration of financial policy in the House of Commons. It may not always be the desire of the Government of the day to give full answers, and there may be market or other reasons why they cannot, but I regard it as perfectly normal (and I speak only for myself, because I am giving evidence in a personal capacity) for these questions to be asked.

12422. You would not think it right for the Chancellor to say: "That is not my responsibility; that is something done by somebody outside"?——I should regard general parliamentary responsibility for these matters as being a responsibility of the Chancellor. There is a question later on which suggests that there might possibly be a closer relationship between the Bank and Parliament. I think that that would be wrong. I always believe in Ministers taking responsibility, and I would rather err on the side of Ministers taking more responsibility than they really choose to, or indeed than they have the expert knowledge to do, than of bringing the Bank into a closer relationship with Parliament. Although it is a junior and senior partnership, to use the words of Sir Oliver Franks, I would say that the responsibility to Parliament must be absolutely the Minister's.

12423. *Sir Oliver Franks*: Could I go back for one moment again to the relative independence of the Bank? Obviously history accounts for some of the existing position, because before the first war the Bank was a fully independent institution; it remained so in the inter-war period, with various practical compromises between its position and that of the Chancellors of the Exchequer of the day; and then when the status of the Bank was altered by nationalisation in 1946 the historical traditions to a very considerable extent carried on. It is, I think, legitimate to ask what, apart from the historical tradition, are the substantive reasons which justify that position. It seems to me that you are saying two things: (1) that the executive and expert character of the activities carried on by the Bank naturally confer on the Bank as an institution a certain quality, character and prestige which should be preserved, and (2) on the negative side, that the quality and nature of the experience of those in Government, civil servants or Ministers, on the whole does not readily give that type of expert knowledge which regular dealing with the various markets does give; and that these two taken together are the foundation in reason for seeking to preserve the relative independence of the Bank. Is this an inadequate account of what you think; would you care to add to it?——I think that expresses very well what I had in mind. It is the negative part, the latter part of your remarks, in regard to the time or capacity or knowledge of Whitehall and the Ministers, and the positive character of the Bank, which renders it important that the Bank should not be completely dependent. On the other hand it is also clear that the Government and the Chancellor must have the last word. That is what makes me accept that it should be a senior and junior partnership.

12424. *Chairman*: Should we pass on from the first four questions, on which we have been centering up to now? I think you have hinted that your answer to question 5 would be an unqualified no?——Yes.

12425. Then we come to question 6?——This is just a commonsense answer which I should like to give. If we start encouraging the Bank in giving justifications of monetary policy in the way of immense informative accounts, we are going to put them then into a position where they are in danger of having themselves to take responsibility for policy. I have looked as well as I can at the practice of some foreign central banks overseas, and they do tend to issue more information than our Bank; but I should be very sorry if we encouraged our Bank to take part in controversy. I have seen cases in which a central bank abroad has actually criticised its own government; that I would regard as quite intolerable. It would break up the whole of the relationship. I would like to draw rather a hard line here, and say that, while nobody can object to the Bank issuing statistical information, graphs or anything else they want to, and telling people what they are doing, because that is a form of good public relations, it should not develop into full-scale reviews or justifications of monetary policy as a whole, or something which competes in the sphere of public relations with the organ which must have responsibility for policy, namely the Government and the Chancellor of the Exchequer of the day.

12426. Does that amount to saying that the Bank can have no independent policy, because if it did it might find itself avowing or explaining a policy that was in some respects inconsistent with that approved by the Government?——No; I think that it is perfectly right for the Bank to have a policy and to put it to the Chancellor and to the Treasury, day and night if it likes; and it is perfectly possible to have disagreements of opinion, which may indeed be very healthy, and which so far have been resolved, and I think are likely to be resolved for some time ahead, without a direction. What is damaging to public relations is if the Bank issues one aspect of the question and the Government another, because I think that that breaks up the internal partnership. I am only referring to the public relations side of it.

12427. *Sir John Woods*: Do you mean that, though there may be differences of policy between the Treasury and the Bank, they must ultimately be resolved through the process of partnership, so that the partners can have a separate policy up to a point in time, but it must then be resolved one way or the other, and you do not want the difference ever to be disclosed?——It would be unhealthy if we were to encourage the Bank to issue its own apologia, because it would lead to undermining confidence in what are euphemistically described in the City as "the authorities". Into this admixture of "the authorities" comes nowadays quite a degree of Treasury advice. "The authorities" has always been an anonymous description, and "the authorities" have been able to get away with anything. If "the authorities" divided themselves up into bits and issued their own apologia, that would break up confidence in the whole system. I would like differences resolved privately rather than in public. That is really why I referred to it as a matter of commonsense. If you have a happy marriage you do not issue alternative views on various occurrences in your life to the newspapers; I think it is undesirable, and it usually leads to a break-up.

12428. *Chairman*: That makes the assumption that the marriage is perfectly happy?—*Professor Sayers*: And that the children are always content?—*Chairman*: Can one make either of those assumptions?——If the marriage is not happy, it certainly is not a good thing to issue your

own apologia to the outside world. If you wish to bring the marriage to an end, then there may be a row. I have never suggested in any of my evidence that there should not be a row between the Government and the Bank. After all, that row can be resolved either by the giving of a direction or by the resignation of the Governor of the Bank. That is quite legitimate; all rows in public affairs are legitimate. But it is better that each party should not issue its own version of the case until such time as there is a break; then, of course, it may have to be done.

12429. Do you not think that the decision by the Government or by the Bank as to what line to persist in might be helped, if the public were to know the two sides of the controversy and were able to express their opinion before the row was final and the Governor had resigned?——I would like to stick to what I said, because I do not think that the system would work if a justification of a line were issued by the Bank in the middle of an action, if I may use a wartime metaphor, because it would not be good either for the troops or for the campaign.

12430. *Professor Sayers*: Is it possible that, instead of issuing a statement of one side of the case, after action had been taken it should be stated what were the reasons that led to this action being adopted? On your hypothesis by that time agreement has been reached?——If you are really saying that it is a great pity for the public not to have full information on matters which are of such vital public concern, because, although we are dealing with matters which are very technical, they affect the currency, which is the blood-stream of the country, and therefore people ought to know about them, I agree; I think that is legitimate. In fact not quite enough information does come out at present. All I want to avoid is the information coming out in such a form that it would lead to controversy between the partners, which I do not think would be good for the conduct of policy. I do not see at present how to resolve that. I am certainly not trying to stop the public getting the information; but I am trying to preserve the integrity of the partnership. I hope that you will be able to think out some answer to that, because I am not at all against information coming out on matters in a democracy; I think that it is very important that the people should know.

12431. *Chairman*: May we go on to question 7?——In my day the relationship with the clearing banks was usually informal, and consisted of meeting the chairmen of the various banks very rarely and on the introduction of the Governor. It is not impossible today for the Chancellor to meet the clearing banks, but I would still take the view that it would be much better, if he does meet the clearing bankers, to meet them on the introduction of the Governor of the Bank. I do not think that there is any obstruction today to his meeting them. As regards meeting bankers privately, he just cannot help it; if he goes about London he cannot help meeting them. On the more formal arrangements, there is no obstruction, but I think that it would be a pity if either the head of the Treasury or the Chancellor organised a meeting with the clearing banks on his own, without the Governor of the Bank knowing. It would lead to undermining of confidence. I think that it would be equally a pity if the Chancellor did not hear from clearing bankers some of the facts of life.

12432. Question 8 you have dealt with already; then questions 9 and 10 fall together, I think?——I think that this is a matter very much for your own report, for which we are looking, and I do not know whether I can help you very much more than I have already mentioned. I would not have thought that there is anything wrong with the method of appointment. I would have thought the period of office, which can be extended and can be resigned from, is reasonable. It really turns on the range of selection of directors of the Bank, on the question whether part-time directors should be included in the Bank directorate, and the weighting of part-time as against executive. Taking the last question first, the executive directors at the Bank number very few; there is a statutory maximum of four. Whether there ought to be more is really a matter of opinion which concerns the Bank more than us. I have no special view about that. But I think that there must be people in the Bank who have outside experience as well as the experts. If you have the honour, as I have had once in my life, of having lunch at the Bank, you see a clock which indicates the wind; that derives from the old days, when it was there to indicate when the ships were coming up the Thames. One can imagine the picture in the old days, of the merchants watching for the ships coming up, because the arrival of ships had an immense effect upon credit and the affairs of the market. We must not turn the Bank of England into an academic place, where people never go out and never know what is happening; therefore, in spite of difficulties which we all recognise, there must, I think, be in the Bank people who are part-time and who bring into it outside experience. Otherwise I do not see how this great institution can represent commerce, how it can do its job of finance and how it can have the requisite experience. So I should certainly say there should be part time directors included. It might be wise to have some intermediate section in between the four executives and the part-time directors, but I should like to see at any rate some merchants in the Bank, telling us about merchandise and what is happening.

12433. You are familiar with public opinion in many sections of the community; do you think that the presence of part-time directors drawn from the field they are drawn from today strengthens or weakens the Bank in the eyes of the public?——Some of the public are ignorant on these matters, and think that a person who is not full-time cannot be doing a good job. They do not reflect that the little piece of extra wisdom thrown off by a busy man is worth just as much as the work of a full-time man who is an overworked official, because he has more experience. I think that, if it was explained to them more, they would understand. On the question of double loyalties I think that one has simply to depend on the personality; if good personalities are chosen, the issue of double loyalties is then answered. It is not surprising that some of the public should be worried about double loyalty, but that, I think, has been answered largely by the personalities of the people involved. It seems to me that the overriding consideration is that without some people who have a knowledge of the market and the world it is very difficult to have a good Court at the Bank. In "the world" I include not only merchants but representatives of organised labour, the T.U.C., and so on; in fact general opinion and experience.

12434. Part-time directors can be persons with various kinds of practical experience; but you think that there is an advantage in having part-time directors?——Yes; I think there is some advantage in having part-time directors, although it is more controversial.

12435. And you put it mainly upon the amount of contact and information they could bring into the Bank?——Yes; it is, I think, of practical value.

12436. *Professor Cairncross*: Would you pay more regard to the advice offered by the Governor because he had a Court drawn in this way, with part-time directors?——The Governor has his Committee of Treasury, and some of whom have long experience in various industries. I know that in the time of the two Prime Ministers I served as Chancellor, if ever we had to meet the Bank we were always very glad to hear what the views of the Governor's intimate colleagues were. On occasion we have met them; and it is obvious that one knows who are the leading members of the Bank; after all, they are appointed by the Government. So we do have contact with them on occasion, which I think is valuable, but we never do it unless they are introduced by the Governor.

12437. Why do you attach more importance to this in monetary policy than you do, say, in fiscal or commercial? There is no corresponding advisory committee of any kind on either of these two sides, drawn from outside the civil service?——The Ministry of Labour, for example, can at once see the British Employers' Confederation or the T.U.C. on the management or the labour side; or the Board of Trade can see the F.B.I., or any of the various trade associations.

12438. Does not the advice you get from the Governor relate as much to the assessment of the economic situation as a whole as to specific monetary matters, so that it has a bearing, surely, on the shape of the budget as much as on monetary policy?——It does, yes.

12439. *Mr. Jones*: You have been talking about the very valuable outside experience that is available to the Bank on the basis of the present constitution of the Court of Governors; have you considered that it might be valuable for the sort of relationship you are envisaging to have somebody recruited from the Treasury, who would sit on the Court of the Bank and on the Committee of Treasury?——It would have to be a retired person; I do not exclude the Government appointing such a person at all. On occasion it might be valuable; the question is whether when a man had served in one stable the other stable would give him a welcome. But I think it is not a bad idea.

12440. *Professor Cairncross*: Had you contemplated any exchange at lower level between the Bank and the Treasury as a possibility?——I did consider that when I was Chancellor. The more experience they can get when young the better; that applies to all organisations. I certainly think it would be a good thing. In Whitehall especially it is most important that people should get out a bit more when they are young, and learn a bit more about how these things are operated. Fancy being appointed head over the home finance division and knowing nothing about the City; it must be very difficult.

12441. *Mr. Jones*: On this question of the part-time directors and the experience they add to the experience of those responsible for administration, could not that experience be available on the basis of an advisory body rather than part-time directors? Would it not serve the purpose as effectively?——It is a question of status. Status is so important. If people feel that they are members of the Court and can attend and take part, I think that they are likely to give better value than if they are just advisers. An advisory panel would not lose all the merit of what I want to see, but I think that we get more by the present system.

12442. *Professor Sayers*: But you have not yet appointed anybody to be a part-time director of the Board of Trade?——No; the Board of Trade is a Government department, and there is a difference between a Government department and the Bank of England.

12443. If the Bank is to have part-time directors selected in this manner, is there any reason why they should not be consulted on questions in the Bank of England that relate to the business it is doing as agent of the Treasury?——I cannot answer that, because I have never worked inside the Bank of England.

12444. You mentioned earlier [Qn. 12396] that any mistakes that have been made have been due, at any rate in part, to lack of information. Did you consider that the information coming up to you as Chancellor on which you had to base your decisions about monetary policy could have been substantially improved?——Since we started to use monetary policy again the information has got steadily better. It improved over the first years while I was Chancellor, and I think it has improved a great deal now. There has been a great enlargement of the provision of information, and very laudable and excellent efforts have been made to improve the experience of those particularly involved in giving advice in the conduct of monetary policy. The situation has progressively improved; and if the partners are to work well it must improve on both sides, both in the Bank and in the Treasury itself. I should say that the situation was now one of considerable satisfaction in that regard. The Prime Minister himself used an expression about last year's Bradshaw; but I think that it is pretty well up-to-date now, and trains are running quite well.

12445. There is still plenty of type missing?——That is a matter of opinion; I would rather not comment on that.

Chairman: Thank you very much, Mr. Butler; we are very grateful to you.——*Mr. Butler*: I wish you well in your labours, and thank you for your hard work.

(Adjourned until Friday, 19th December, 1958, at 10.45 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-FOURTH DAY

Friday, 19th December, 1958

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E. (Questions 12446 to 12506 only)
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

THE RT. HON. HUGH DALTON, M.P., called and examined.

12446. *Chairman*: Good morning, Mr. Dalton. We sent you a list of ten questions*, round which we would like your views to centre themselves. You have been good enough to let us have a memorandum† on those, but if there is anything you would like to put before us we do not want you to tie yourself down just to those?——*Mr. Dalton*: I do not think that I have anything to add, except in reply to questions from you or your colleagues, save for one or two very general remarks. The Bank of England Act, 1946, is one of the legislative acts of the Labour Government which I do not think has been challenged in any fundamental way. I have not become aware of any general feeling in the country that any great change is required in the relationships established by the Act, and therefore I do not feel myself on the defensive about it at all. I think that we did a thing which responded to what was felt to be reasonable, and I think that it has on the whole worked well under successive Chancellors and successive Governors. I feel therefore that the argument for change is one which I would await. I am in this respect conservative.

12447. In the eyes of the public do you think the status of the Bank was altered by the 1946 Act?——I should not have thought much. There have lately come out certain biographies and other writings which have perhaps surprised students of the subject, showing how very strained on several occasions in this century the relations between the Government and the Governors of the Bank were, beginning with Cunliffe and Bonar Law, and ending up for this purpose with Sir Winston Churchill and Norman. I think that this will have strengthened the view of students that it is a good thing that the relationship has now been changed, so that it has been made clear that in matters of doubt it is the Chancellor who has the last word, and that the Governor is broadly subject to his directions.

12448. Do you regard this power to direct, which has never in fact been exercised, as being one that should be resorted to, to use a common phrase, in the last resort, or should it be one which would be currently invoked?——When we were drafting the Bill my view was that that power should be put in as a power of last resort. I assumed that the fact that the power was expressly put there would help the relationships of the Government with the Governor, because the Governor would yield under this Act in the last resort if he could not persuade the Government, and the Government's view would prevail. I think experience since then has justified my view. It was not at all my idea that there would be continual issues of directions. If that was deemed to be necessary by the Government of the day, it would be evidence that the system was failing; but it has not been necessary. I suspect that this power has not formally been used at all at any time.

12449. I believe that to be so.——I am glad that that is so. That has shown that the power in the background, the power of last resort, has been sufficient.

12450. I am asking this primarily because in the general tenor of your answers on the detailed questions I think your approach is that the central bank should be as near as possible equivalent in standing to a Government department?——Not very different, I would say. Different in some respects arising from history and other matters, but not very different.

12451. It would help us, because you have great experience in this, if you could just outline what you mean by the words "not very different". In what respects do you think it should or must be different? Should it, or must it, be different because it may have certain tasks imposed upon it?——There must, I think, continue to be prestige attaching to the Governor of the Bank of England which would not attach in the same overt way to a high civil servant. I have suggested in my evidence that he should not go in too much for what is now called public relations; I think that that puts him and the Government potentially in difficult relationships. But apart from that people will always know who the Governor is, and he will appear on a number of public occasions; he will not be entirely a figure moving behind the scenes, and he should be a figure to whom respect and prestige attaches. In that public respect and prestige he will inevitably differ, quite properly, from the anonymous head of a Government department. Then he has to have international relationships which would not normally be part of the duties of a civil servant in a state department, and there must and should be consultations between him and chairmen of central banks in other countries. For this and other reasons he cannot avoid being rather more in the limelight than a permanent civil servant would be, but I would hope that the difference would not be so great as to suggest that he is an autonomous power moving independently of the policy of the Government who appointed him.

12452. *Mr. Woodcock*: Does your conception of the Governor imply that all the contacts of the Treasury with the banking system in the City of London should be through the Governor?——Broadly speaking I think he should be the channel of communication, but, as I have indicated in my memorandum, if the Chancellor of the day should wish to make his own direct contact with the clearing banks, or with any other group of financial institutions, it should not be regarded as improper or awkward for him to do so. The Bank should be quite willing to agree to that; it ought not to be said that no one except the Governor of the Bank should have official access to the clearing banks. If I may refer to my own period as Chancellor, I not only expressed the wish to see them as a body, but I saw their elder statesman, Mr. Colin

* See page 846.
† Memoranda of Evidence Part XIII No. 7.

Campbell, subsequently Lord Colgrain, on many occasions, generally in the presence of Lord Catto. It worked smoothly; that suggests that a lot of these problems resolve themselves not so much into the laying down of general rules as into the establishment of good personal relationships. That is fundamental in all this.

12453. Were you conscious of any established tradition, that the Governor was the authorised ambassador from the City to the Treasury or from the Treasury to the City?——Very broadly, yes. My relations with Lord Catto were throughout extremely friendly and frank. He would always take it for granted in our talks that, if I wanted any point of view put to other elements in the City, he would be the natural interpreter, and I was quite happy to accept that at that time, subject to my happy personal relations with Lord Colgrain. With regard to the Treasury it would not have occurred to me that any high Treasury official would have had relations with the clearing banks of an official kind at all. But the Chancellor should not be under any disability, or be thought to be acting oddly, if he should say from time to time: "I would like to talk to the chairman of the clearing banks." He would probably ask the Governor to come too; and if, perhaps when the Chancellor was very pressed and he was anxious to convey some thought to the clearing banks, he might say: "Perhaps some high Treasury official could see the bankers and express my view"; that high Treasury official would then simply be the *porte-parole* of the Chancellor. I do not contemplate that that would very often be necessary, but I think it should be allowable within the code of conduct.

12454. *Professor Sayers*: When you were justifying a special position for the Governor you put it on two grounds, domestic and international. I can understand that internationally it is important that this man dealing with other central banks and Finance Ministers abroad should have a special position; but I wonder if you would enlarge on the need for him to have a special position at home, different from that, say, of the Permanent Secretary at the Board of Trade?——I have said that I do not want the difference to be too wide. I do not want to affront the habits and customs which are well dug in and, broadly speaking, have worked well. Reverting again to the time of Lord Catto which I naturally know best, he spoke at the Mansion House dinner when the Chancellor spoke. In fact he would speak with me frankly before, and ask what line I thought it would be useful for him to take. I did not dictate a form of words, of course, but we more or less agreed on the line he would take in his speech. That is one occasion when I would be sorry to see the Governor of the Bank not allowed to speak; and there would be certain others, though I would like to see the number limited, when the Governor of the Bank should be free to give an address which would be reported in the press. But I do not at all like the idea of his becoming a performer on television; that is not desirable.

12455. You put it mainly on the ground that this is a position which historically has had special prestige, and you do not wish to break the tradition in this respect?——Yes; and I go a little further than that. I think that it is definitely useful, provided that harmony is maintained between what the Chancellor is minded to say and what the Governor is minded to say.

12456. In what way is it useful for the Governor to do so whereas it is not useful for the Permanent Secretary of the Board of Trade to do so?——Possibly for the reason that, if it suddenly seemed that the Governor had been muzzled, that would create an unfortunate impression.

12457. *Chairman*: If it becomes realised by the public that history has changed and the Governor's position, as under your scheme it would be, is that in any matter of importance he speaks as an instrument of the Government, then he could not retain the historical position that had given him the importance before?——It is largely a question of degree. It is rather like your own use of the phrase "in the last resort" in the directing power. In the last resort the Chancellor might have to say to him (though if he had to do so it would be evident that things were not as good as they should be): "You are making a speech in such and such a place; I hope you are not going to repeat the unfortunate phrase you used on a previous occasion". But all this, I would hope, is outside the practical possibilities. I do not think that the broad public is aware of what we are discussing at all. The public, in the narrower sense of instructed persons in the City and elsewhere who follow these things, are not, I think, very conscious of a change, although they would be very ready to argue whether or not, as a result of whatever you may decide to report, that is going to have this or that effect on the relationship. But if we have a Governor who is both respected in the City of London and generally, and is an able and suitable man to hold this very important post, and also has the broad confidence of the Government of the day, I do not think that the public would be conscious that anything very much bad happened. I think that we sometimes exaggerate the extent to which even instructed circles of opinion are conscious of changes that we ourselves see clearly, particularly you in the course of what you are investigating.

12458. I was assuming that the ordinary public were likely to have no view about this; but I think the views of the instructed might filter through?——The instructed public are always liable to be critical if they can. I would not be surprised to see paragraphs in *The Economist* suggesting difficulties, but very often I think that they would be wrong or exaggerated.

12459. *Mr. Jones*: Were your discussions and relationships with the Bank much more formal than those with the Treasury?——When I became Chancellor one of the first things we did was to introduce the Bank nationalisation Bill, and therefore I had no direct knowledge of what the relationships were before. I was, as I have said, taken a good deal by surprise when I read in various biographies how very great had been the state of discord between successive Chancellors and successive Governors, but I was not aware of that when I was drafting the Bill and piloting it through Parliament. These biographies also reveal great discords between certain past Governors of the Bank and the high Treasury. There are accounts of Lord Cunliffe's relations with the Permanent Secretary to the Treasury in Mr. Robert Blake's life of Bonar Law, and even more vividly in Lord Beaverbrook's *Men and Power*. The third chapter, called "Nabobs and Tyrants", gives a very remarkable and interesting account; it not only expresses the thing very vividly, but I have no reason to believe that it is not true.

I was anxious, as I have said, to get the nationalisation Bill through quickly, and without undue fighting; I thought that all that might wait for other issues. There was no great opposition to this Bill in principle, and therefore I was inclined to lean a good deal towards conciliatory arrangements. I was particularly anxious that Lord Catto, whom I regarded as a very great public servant, who was at that critical moment working with great public spirit, and I think very efficiently, and had great personal support behind him in the City, should not be embarrassed. That was one reason why we provided the power to direct banks in the way in which we did, leaving it as far as the law was concerned to Lord Catto to be the instrument if ever we should need to issue a direction to the clearing banks; as I have said, I did not expect we should have to, but the power had to be there. For these reasons I was very eager throughout this period that good relations should be maintained between myself as Chancellor, Lord Catto as Governor, and the high officials of the Treasury, and a lot of my minor actions were directed to that end.

12460. *Professor Cairncross*: Had you envisaged the Bank of England showing a good deal of initiative after nationalisation?——They had plenty of initiative in making recommendations to me. You will no doubt find out more from later Chancellors of the Exchequer as to how things developed. In the period when I was Chancellor Lord Catto spoke a very great deal to me about many matters, and sometimes suggested that such and such a change was desirable.

12461. I was wondering about the distribution of initiative between the Treasury and the Bank at that time. There must have been some types of policy where the Treasury inevitably took precedence and responsibility, and others where the Bank of England might more fitly have been expected to offer advice, or demand action. Would you like to say what kind of distribution was

current at the time? Take external policy, for instance; did it rest almost exclusively with the Treasury?——No, I would not say that. I used to see the Governor at least once a week, and sometimes more often, and we felt ourselves free to discuss the whole range of policy, including external policy. Sometimes I thought it useful to have, together with the Governor and Deputy Governor who often used to come together, some of the high officials at the Treasury and to have a general conference. For instance, on the cheap money business I thought it necessary at certain stages to have them both together; I did not think it adequate to have separate watertight discussions with each of them. I was not conscious during the relatively short period when I was Chancellor and the Bank had been nationalised of any very hard and fast distribution of functions. I would always think it perfectly proper for Lord Catto to speak to me about whatever was going on, whether external or internal, and I would not think him barred from discussing with me anything which fell within my jurisdiction. Similarly, if I had the higher officials at the Treasury talking with me alone without the Bank, I would not think them excluded from discussing anything. I might sometimes say to either the Treasury or the Bank: "What you have been saying is not what I have heard from the other side of the house. I think it would be useful if you would confer, and see how far you are in disagreement."

12462. *Mr. Woodcock*: Did the Bank go into matters other than purely monetary matters, say budget policy?——I would not have discussed budget policy with the Bank.

12463. That would be ruled out?——I would exclude that.

12464. *Sir John Woods*: Would Lord Catto have been free, in your discussion with him, to say that he thought that monetary policy as it was developing needed to be supplemented by some other measure, which might be taxation, or something else?——Certainly, perfectly free in general terms. If I were to look through certain records that were made at the time, I think I should find evidence that he did sometimes so speak.

12465. *Lord Harcourt*: You mean that he made suggestions for fiscal action to reinforce action which the Bank was taking in its field?——Certainly. When I was excluding the Budget I was speaking in terms of detail. I should never have thought it reasonable to discuss with Lord Catto whether there should be some change in the income tax rates, nor would he have wished to come into that.

12466. *Professor Cairncross*: When you speak of a conference at which both the Bank of England and Treasury officials were represented, was it only Lord Catto who was present, or were other officials there?——At conferences at which I was present only Lord Catto and often his Deputy, the present Governor. But there were, of course, other conferences going on. I cannot speak in great detail of who came because they were not in my presence, but often certain other high officials of the Bank met high officials of the Treasury. It was fairly common, but not quite common or well organised enough. I think that there is scope for a more regular contact between the high officials of the Bank and the high officials of the Treasury; it might be worth while to have some standing committee, that should not meet too often or sit too long, with some appropriate person, such as a Treasury Minister who had suitable gifts, to preside and report to the Chancellor. There is still a tendency for the Bank and the Treasury to stand rather too wide apart; that tendency has been weakened a bit since nationalisation, but may still be too wide.

12467. In your day was the Exchange Equalisation Account still managed by the Treasury and largely on the Treasury's own responsibility, or by that time was the Bank of England beginning to take the lead in management of the Account?——I think that in practice it was largely the Treasury. I do not recall any case where that was discussed at a joint meeting presided over by me. It may well be that it was discussed at some meetings at which I was not present, at high official level.

12468. Would matters of exchange control have been discussed jointly?——Sometimes; and I personally had talks on exchange control with the Governor quite often.

12469. *Chairman*: Before we go on to any other aspect, I do not know if there is anything more in your mind with regard to the reasons which make it desirable that the Bank should not be really equal to a Government department. You have given us two. The first is the concession to the domestic historical position of the Governor, and I think what is in your mind is that it would be causing a needless shock to the traditional attitude towards him in the City if they thought that he had become muzzled, but that in speaking without his muzzle he should be conscious that he should reflect Government policy?——That is a perfect expression of my view on that point.

12470. Your other point is that externally he needs a special position owing to the fact that he is in a special relationship with other banks which gives him more prestige than if he were a mere mouthpiece?——Yes, I would agree to that.

12471. What should one equate him to: a junior Minister?——It is very difficult to find a precise equation. I would not quite say a junior Minister. I think that when the Governor is functioning internationally in relation to the Governors of other central banks matters should be very carefully discussed beforehand with the Chancellor, and he should seek to plot alternative courses that would accord both with his own judgment and the Government's view as to how things might be handled. If there was some decision that we desired to be taken by the central banks, then the Chancellor could say to him: "I know you will do your best to get this one agreed". It would be very unfortunate if the Governor and the Chancellor did not agree as to where we wanted to get to; it would show that things were not working quite smoothly. But if it was agreed where we wanted to get to, and the Governor had no difficulty in accepting the Chancellor's lead, I would think that there should be rather careful discussion between the Governor and the Chancellor and Treasury officials sitting in on the discussion, to suggest how alternative situations might arise and how they should be handled. I would not put it in further detail than that.

12472. *Lord Harcourt*: You consider it important that when he travels abroad he should not only be but be seen to be on a complete level of equality with other central bankers?——Many other central bank governors are even more subjected to political control.

12473. Some are, and some are not; and he has to deal with both kinds?——Yes. I would wish him to have as much prestige at such a gathering as is compatible with the fundamental relations that are involved in the practical working of the Act.

12474. Prestige, necessarily coupled with a certain degree of executive power; because he will attend meetings where positive decisions will probably be arrived at?——Certainly, but I have just been suggesting that he ought, in consultation beforehand with the Chancellor, to try and foresee situations in which quick decisions may be needed, and arrive, as I would expect he would generally be able to do, at an agreement with the Chancellor as to how in various alternative situations he should act.

12475. *Mr. Woodcock*: He should not appear to be referring back every time?——No, that would weaken his prestige; although in fact in the conditions at a lot of these conferences if he did refer back it would not be generally known. A few days' postponement of an important decision is quite a common event.

12476. *Sir Oliver Franks*: So far we have been discussing the degree in which the Bank may differ from a Government department mainly in terms of the position of the Governor in relation to the Chancellor of the Exchequer. Perhaps what you have said comes down to the fact that he should have certain prestige and authority, which means a certain freedom of action and speech within a general framework of concerted policy. Is there anything in your view in a second consideration which has been put to us, and which affects the Bank as an institution rather than the person of the Governor, whoever he may be? It is this: that the ability and skill to deal in the markets, whether the markets in the City

or the overseas markets, and not simply to deal in them but so to deal in them that policy which will have been agreed is brought about, requires a certain expertise and authority to deal efficiently, which marks the high official in the Bank off from his opposite number in the Terasury or the Board of Trade. Some people attach little weight to this distinction, some people quite a lot, as a natural factor differentiating the work, and therefore the quality, of the institutions. Would you comment on that?——The Bank has, as we all wish it to have, some very expert people standing high in its hierarchy. I think that it is very desirable that those people should have reasonable freedom to buy and to sell as occasion may demand, but it should be something on which the broad lines of policy have been cleared. I do not know whether that is an adequate answer, but I was always conscious that there were very expert people operating in the Bank; I occasionally met some of them and had a very high opinion of them. But I always expected that Lord Catto would give instructions, or hold consultations with his experts, and that they would act in accordance with the broad lines agreed between him and me.

12477. Would you have a view as to whether, and if so to what extent, the quality and character of the work done by the Bank differentiates it as an institution from an ordinary Government department?——It is a different kind of expertise, more mixed up with the world external to the Bank than most forms of expertise which one finds in a Government department; but I do not think this is a very fundamental distinction. Take any Ministry you like: say the Ministry of Housing and Local Government, over which I once presided. There are very many expert people there who carry out relations with local authorities and so on, in the light of a general policy determined by the Minister after consultation with his high officials. The Bank's is a different and rather more outward looking expertise, but I do not think that that is a fundamental difference. The Bank and large departments of state deal with internal affairs; they all have their experts, but the Bank's experts are slightly different in their character and their range, and they deal with a great deal of external factors which are not so prominant in a home civil department. That is as far as I would go on that.

12478. *Mr. Woodcock*: It leaves them with more initiative than an ordinary civil servant?——A bit more; although very often in my experience, once a Minister has determined the broad line of policy, he does not want his officials to be running back to him on every particular case; that becomes a great bore. Certain broad plans, perhaps as a result of a Cabinet decision, are communicated by the Minister to his staff, and the staff are expected to operate in the light of that decision.

12479. The Board of Inland Revenue, which again executes Government policy, has less initiative, less freedom, because it is more a routine matter. There is less expertness in the sense we are speaking of expertness; less precise or fine knowledge of the law?——It is different, but I do not think it is very fundamental. You will find similar differences as between different civil departments.

12480. In your answer to question 5 you are quite explicit about the Chancellor's responsibility to Parliament?——Yes. I think it is, as a general rule, bad that permanent officials should be confronted with Members of Parliament officially. Many Members of Parliament do not understand the rudiments of the thing. They go away very often with very confused ideas, and the official is put in a very compromised and difficult position. That happens even now with the Committee of Public Accounts where the practice is for an official not accompanied by a Minister to appear before a miscellaneous group of Members of Parliament and be questioned. It is quite true that the official can say: "I am not here to answer on policy", but he is put in a difficult position, and I would like to discontinue that.

12481. *Chairman*: I spent weeks of my life in the war each year answering questions of Members as to why I had done something the Minister had decided on.——One is confronted with two very different elements. The Minster after all has a dual role. He normally is, or has been, a Member of the House of Commons, and has moved in that world; then he becomes a Minister and he learns to swim in another pond in relations with officials and in making policy. If you are dealing with a miscellaneous body of M.P.s, I do not think that it is reasonable to expect an official to carry on debate with them; and it is difficult for the official, though the Chairman may help him, to refuse to answer questions that are put. The natural channel of information for M.P.s, is *via* Ministers, either through open debate, or parliamentary question, or private representations behind the scenes and conferences with Ministers. I do not believe in interpolating either Bank officials or civil servants.

12482. *Mr. Woodcock*: The Chancellor will have, on your answer, a responsibility to answer for the expert activities of the Bank officials. Suppose that some member asks some question as to why certain things were done in the market; in your view can the Chancellor answer that?——Certainly. He will say that it is against the public interest to answer the question.

12483. Is that good enough?——I would often have authorised such an answer; there must be over the operation of the central bank, whether nationalised or not, certain veils which must not be lightly brushed aside.

12484. *Sir John Woods*: You say that there should be frequent contact, regular exchange of information, and frank discussion between high officials of the Treasury and the Bank. Of course there will obviously be day-to-day discussions between the head of the home finance division of the Treasury and the Chief Cashier about Exchequer financing, operations conducted by the Bank in relation to debt, and so on; but do you feel that there ought to be exchange of information and discussion continously on a wide front about monetary policy as a whole, and perhaps other things, the general economic trend of the country?——I am inclined to think so. I am tentative about all this, because I do not know with great precision what the present framework of discussion is, how often and how frankly they meet, but I am inclined to think that personal relationships ought to be very firm and frank between the top Treasury and the top Bank officials.

12485. Over the period when you were Chancellor did you feel that there was sufficient contact and close relationship between the Treasury and the Bank over this wide field or not?——My impression was that they were not quite close enough or frequently enough together. I do not want to put this with any great firmness, because it is a question of recalling things which happened some time ago, but my general impression is that I did occasionally try to encourage both sides to meet the other rather more often. I would sometimes say to the Treasury: "Have you discussed this with the Bank?" and contrariwise. I have a general impression that they might usefully see more of one another and cover a wider field than they normally do.

12486. One further question, if I may, which is not within your actual knowledge as Chancellor. The Economic Section now comes within the Treasury and is part of the Chancellor's own responsibility. Do you think that it would be advantageous if there were regular meetings between the Treasury and the Bank including the head of the Economic Section?——Yes, certainly I would bring them in. I am not familiar in great detail with the latest developments. The Economic Section existed in the war; I came in contact with it when I was President of the Board of Trade. Provided that it is well manned and that there are competent people there who have something useful to say, and who are not too distantly academic or too argumentative when time is short (and those are both rather important conditions when you bring outside people in) I would think that the head of the Economic Section and his staff ought to be well in the front of consultations and officially sit in on most important occasions.

12487. *Mr. Jones*: Would this be the right summing up of your idea on the position of the Bank in relation to the Treasury, particularly having regard to what you have said here this morning, that within the realm of the activities of the Central Bank, the Bank should take a course according to its own initiative, but in this it must not be enabled to depart in any way from the over-all policy control of the Chancellor who is responsible for the national economy?——Yes. It is a question of where

to draw the line. There are matters on which the Chancellor must specifically make up his mind, after consultations no doubt with the Bank and the Treasury and other people, and express his mind, perhaps in a minute, perhaps in conversation. Wherever he gets that far, and his mind is positive, my view is that the Bank must conform. In that respect I draw no distinction whatever between the Bank of England and the ordinary Government department. On important issues of policy the Chancellor of the Exchequer must be master, putting it very crudely. Subject to that, there are all sorts of minor or consequential matters on which, once the broad line of policy has been determined, the Chancellor has not the time to be continually arbitrating and giving views. Matters must run at that stage within the framework of policy laid down, and he must leave it to the Bank or the Treasury, or the two combined, to work out how in particular situations the particular policies apply.

12488. Having regard to the responsibilities of the Bank in international affairs, and in the management of sterling, and remembering that Britain is the nerve centre of the sterling area, would you see any difference between the Bank in its day-to-day activities and the position of a Government department in its day-to-day activities?——I do not know that there would be a profound difference of principle. Of course the continual maintenance of the value of the pound is a very technical matter, and a great deal of it must be handled from day to day by expert people in the Bank, subject to discussions all the time with the Treasury, and when necessary with the Chancellor. They have their expert people in the Bank, and this is an example of the kind of thing which they handle with great knowledge. Once the broad line is laid down they do have freedom from day to day to execute it, and it will generally be known that they have that freedom from day to day.

12489. There is very little difference, then, between the position of a Government department and that of the Bank on these day-to-day questions?——No fundamental difference.

12490. *Chairman*: It has been put to us that in the monetary field it is peculiarly hard to isolate policy from operations, that there is some unreality in your picture of broad policy laid down in the Treasury and the execution of it carried out by the Bank, and that, if your general idea is carried out, it means that the Chancellor, or the Treasury on his behalf, has to have pretty well day-to-day control over what is going on. Do you see any force in that?——It is true on important issues of policy. Obviously it is the duty of the Treasury to watch the maintenance of the pound, the fluctuations in the exchange market, and so on; even if the Bank of England experts are carrying out operations designed to maintain the pound, or hinder speculation in sterling, the Treasury must watch it steadily. Quite often the Chancellor may be active, particularly if things are going very badly. I am thinking of September of last year; he would obviously have spent a lot of time every day on that, I would think. But when things are not in a very tense condition very often the thing would run along fairly smoothly. But I do not want to be at all dogmatic about this. I am concerned with the general relationships and where you can draw a line between a political intervention, perfectly legitimate in its own field, and the running of the machine when the Chancellor is thinking of something else, or is away for the week-end. Very often he can safely think of something else or be away for the week-end, but suddenly it may all change.

12491. *Professor Sayers*: These examples, and those suggested by other members of the Committee, have been drawn on the whole from the external side. I wonder if you would comment on the distribution of work between the Treasury and the Bank, and the extent to which there is contact between them, on questions of debt management. Would what you have just said apply to questions of debt management?——Yes. Initially debt management is a Treasury function. The Bank of England in my view is fully entitled to express views from time to time, but it is notorious in the light of history that when dealing with conversion operations the Treasury put high in the priorities the reduction of the total of the debt charge. There have been conflicts from time to time between the Bank and the Treasury, when it has been thought by the Bank that the Treasury was taking a rather too narrow view, thinking rather too much about some slight cheapening of money with a view to reducing the burden of the debt charge. What I say about the need for consultation and contact applies equally here, except that here, as a rule, it is the Treasury which is the primary propounder of policy.

12492. How far in the early post-war years was there a genuine meeting between high officials of the Treasury and high officials of the Bank on questions of debt management? Was it discussed in your presence?——Yes, much more, and more often, than many people might have supposed. It would be improper for me to quote people and occasions, but, speaking broadly, the idea that when I was Chancellor I was pursuing an independent personal policy aimed at cheaper money, and that I was doing this in the face of the united opposition of the Bank and the Treasury, is a complete illusion. On such matters I always thought it right to bring the Treasury and the Bank together into consultation, and I remember several extremely interesting talks in which there was no very great difference at the end of the day between the two of them.

12493. I am interested to know that my teaching on this has been correct! You would say that in that period this was a subject which was constantly under joint review?——Yes.

12494. And would you agree that this is a subject in which it is very difficult to separate policy decisions from day-to-day operation?——Yes, certainly it is difficult; a number of day-to-day operations are relatively speaking so important that they are discussed as though they were policy decisions. If I can make the point that may be in your mind, when the decision was taken to issue the stock now affectionately called by my name in place of the convertible local loans, I thought it necessary to have both the Bank and the Treasury with me for considerable consultations, and that did become an isolated question of policy. I had declared on behalf of the Government that we should have as low rates of interest as, taking everything into account, could be achieved, and that the economies arising from that, and the stimulations of the economic system at various points arising from that, were very important, particularly in a period of transition from war to peace. Not only on the conversion of the local loans stock, but on various other matters affecting rates of interest, and what we did on the maturity of certain securities, I thought it was most necessary to talk it over with both these high authorities. I remember in particular the key consultation which led to the final decision; I had a conference, of which I have a vivid memory, at which high officials of the Bank of England and the Treasury were both present, and at the end complete accord was reached.

12495. You say high officials of the Bank; would that go beyond the Governor and Deputy Governor?——No officials of the Bank of England other than the Governor and Deputy Governor ever came officially to conferences with me. I met some of them off stage or informally, but whenever I wanted to discuss policy it was the Governor and Deputy Governor who came; and whenever I wanted joint discussion, four or five of the principal officials at the Treasury may have come, but it was the Governor and Deputy Governor alone who came from the Bank. It may have been just a transient arrangement in my time. There was no inherent reason why, if I had said: "I would like Mr. So-and-So from the Bank", he should not have come; but in fact they did not.

12496. Do you happen to know whether in the years immediately after you left the Exchequer these contacts and continuous discussions continued on this subject?——I cannot answer that with any knowledge. I would be surprised if they did not. I was immediately succeeded, you will recall, by Sir Stafford Cripps, whom unhappily you cannot call as a witness. The contrast between my policy in the years 1945 to 1947 and Sir Stafford Cripps' policy in the following years until 1950 has been exaggerated by many ill-instructed commentators. In fact he and I (and a close study of the detail will bear this out) were very close together in the policy which we were pursuing, and I would not think that

in a matter like this he would be the kind of person who would have less frequent consultation with the two groups of high experts than I had.

12497. *Mr. Woodcock*: When you saw the Governor or the Deputy Governor could you judge whether the view they were giving you was a majority view, or just their views, or if there was a difference of opinion in the Bank as a whole?——Lord Catto never told me either that he was having difficulties on the Court, or that the Court warmly endorsed his opinion. Nor did I encourage that, because my view was that Lord Catto was the person with whom I was primarily concerned. You can infer from some of my answers to your questions that in my opinion the other members of the Court have from time to time had rather too high a status relatively to the Governor and the Deputy Governor, but not in Lord Catto's time. Though Lord Catto had a very different type of personality from either Lord Norman or Lord Cunliffe yet I think that he dominated his Court pretty effectively in my time. I do not think that, if Lord Catto had made up his mind that something should be done, his Court would have deflected him from it.

12498. *Chairman*: Do you see any drawback in general in the Governor being able to tell you that his view is supported or not supported by people of standing on the Court?——My inclination is to treat the top men, in this case the Governor and the Deputy Governor, as being the primary exponents of the opinion of the Bank, in the same way as in a Government department one would ask the Permanent Secretary for his view, and one would not say: "Does everybody all down the line agree with this?". I think that a Minister should deal with his Permanent Secretary; otherwise there is confusion of contact. I would distinguish between private and informal discussions with officials and the presentation of the departmental view; and I think the presentation of the view of the Bank should normally, and very nearly exclusively, come from the Governor and Deputy Governor. The Governor and Deputy Governor ought to be prepared and able, and it should not be thought wrong or improper for them, to go straight to the Chancellor, without the Court having been fuly consulted and invited to vote on whether or not they agree with the Governor. I am thinking here again of September 1957; I was impressed by the evidence before the Parker Tribunal of Mr. Cobbold, a very conscientious and able man; I say nothing in criticism of him at all. But it seems that a tradition had grown up which obliged him, before putting the very important question whether they should recommend a 7 per cent. Bank Rate, to collect the opinions individually. It would have been "excessively inconvenient", he said*, if there had been a majority against him; I do not think that he ought to feel in that situation. I think that he and the Deputy Governor ought to have the acknowledged right to make direct recommendations to the Chancellor without reference to the views of the Court. The Court should be there to advise the Governor, and he would no doubt see them and ask members whether they took this or that view; but I do not think that their vote should be required to be recorded. I can quote a statement that Lord Catto made, not to me, but to one of the members of the Court who repeated it to me: "You may wonder why sometimes at the meeting of the Court matters which you think very important are not mentioned at all and are not on the agenda. That is because these are matters which I discuss direct with the Chancellor of the Exchequer and I do not mention to the Court". That is quite healthy, assuming a Governor who has discretion and good judgment.

12499. *Professor Cairncross*: You discussed the relationship between the Bank and the Treasury, but I do not think you have made any reference to the relationship between the Bank and other Government departments. Do you envisage that there should be any direct relations between the Bank and departments like the Board of Trade, or do you think they should always pass through the Treasury?——It had not occurred to me that there was very often any occasion for contacts with other departments than the Treasury. Could you help me by giving me an example of the sort of thing you have in mind?

12500. I think it would be recognised today that the problem of inflation is tied up to some extent with the problem of wages, and therefore is a responsibility that comes in a certain direction under the Minister of Labour; and it would also be recognised that the problem of higher economic policy involves commercial policy in the sense in which the Board of Trade deals with it, exchange controls, Bank Rate, and so on. It is in fact rather difficult to form a general view of monetary policy without having regard both to labour matters and to commercial matters. There is not, as I understand it, at present any direct contact between the Bank of England and either the Ministry of Labour or the Board of Trade. Do you think it might be of advantage? To take a specific case, would you see advantage in having on the joint committee of high officials which you propose someone coming from a department outside the Treasury, such as the Board of Trade?——Not necessarily. Once one outsider is let in, all the others batter on the door, as everybody here who has had experience of a department knows, and in the end it may become a public meeting which was not what was intended. But subject to reasonable caution and control of numbers, I do not see any objection to that, though it had not occurred to me that it would be useful to put the Bank and other Government departments than the Treasury into anything like regular close contact. I would have thought that the best course would be for the other departments to get the Bank's view as part of the Treasury view, which would be the view given as from the Treasury, although it may have been modified in its formulation by the view of the Bank.

12501. It puts considerable responsibility on the Treasury official if he has to show insight both into what the Board of Trade may be thinking and what the Bank of England are thinking?——I do not want to be at all dogmatic on this. I had not thought about this aspect. If there was a Board of Trade representative of any joint committee that was set up, that would not be the same thing as having relations between the Board of Trade and the Bank without the Treasury being in the picture; that is something I would be rather suspicious of.

12502. *Lord Harcourt*: Some time ago you said that you would think it perfectly proper for the Governor of the Bank to make representations to you on fiscal matters if he thought that some alteration was necessary to support monetary policy [Qn. 12464]. In view of the interaction of monetary action and fiscal action would you consider it advisable or helpful that the Governor or Deputy Governor should sit in with the officials concerned with the preparation of plans for the Budget in order to inject his views early on in the formulation of policy?——I would not have strong objection to that; but it would need handling with a little caution. I did not discuss the Budget in general with the Bank people. The preparation of a Budget goes through many stages, and this will vary very much according to the habits of the particular Chancellor of the Exchequer and the recommendations of the officials. I would not think it harmful at all; and I am not even sure that it did not happen in my time, in the early stages before one came to the stage of considering detailed tax changes. One cannot be positive about these things, but I do not think that it would work very well for representatives of the Bank below the Deputy Governor to be mixed up in Budget discussions, even at an early stage. It is largely a question of personalities.

12503. *Chairman*: Perhaps we ought to look at your answers to questions 9 and 10, which deal with the part-time directors and the methods of selection. If I follow your plan of what the Treasury-Bank relationship should be, it would not leave very much for the part-time director to do?——They can advise the Governor and the Deputy Governor, attend regular meetings once a week, and be available for luncheon, or for a general talk; but I do not want them to have power to outvote the Governor and Deputy Governor.

12504. And therefore there are quite a few things, following up Lord Catto's line, which in fact would not come before the Court at all because they were so important?——Exactly.

* See *Proceedings of the Tribunal appointed to inquire into allegations that information about the raising of Bank Rate was improperly disclosed* Qn. 8051.

12505. And I suppose that it would follow that he really would not be taking much advice even informally about these things?——That would be a matter for his own judgment; I do not think one can generalise. It might well be that a Governor would have particular confidence in one or two members of the Court, and might perhaps take their advice rather more often and listen rather more attentively to what they said than to certain others; but one cannot lay down any general rule.

12506. They should be at his call and selection?——Yes. I am anxious, as I have said, within the Court to enhance the status of the Governor and Deputy Governor, and there is a reason for this which I have not brought out, but which I might just summarise. I have suggested that it might be better if the Governor's term of appointment was shorter, say two years instead of five. I am very tentative about it; I did not think so at the start, but I think that it might be a good thing. When I have mentioned this to other people they have asked me whether I thought that there might not be a disinclination on the part of able and suitable people to take on the Governorship or Deputy Governorship for so short a term, even although it would be subject to reappointment. I am emphasising the enhancing of the status of the Governor and the Deputy Governor in relation to other members of the Court not only because I think it would be desirable in itself, but also because it would work a little bit against any widespread disinclination to take on the Governorship for a short term. It would be appreciated in the relevant circles if this came into effect that, although the Governor had a minimum period of two years, which might or might not be renewed, none the less during those two years he would have greater powers in some respects than his predecessors have enjoyed, at any rate on paper. It would be a matter of balancing the argument in favour of the shorter term.

Chairman: Thank you very much, Mr. Dalton; we are much obliged to you. It has been very interesting——I am very much obliged to you.

(*The witness withdrew*)

I. J. PITMAN, Esq., M.P., called and examined.

12507. *Chairman*: Good morning, Mr. Pitman. Thank you for coming, and for the paper* which you have kindly prepared for us, which does a great deal to enable us to know what your views are. I believe that it would be simplest if we took it page by page and saw whether there are any questions from members of the Committee. But first we ought perhaps to establish your status as a witness for the record?——*Mr. Pitman*: As you are aware, I am a Member of Parliament; I was a director of the Bank of England for a few years at a period when we were at war and immediately afterwards. No question of a change in the Bank Rate occurred during that time, nor I imagine could it have done; so I have had no experience whatever from that angle. For part of the time during which I was a director of the Bank of England I was also Director of Organisation and Methods at the Treasury, when the job was first set up. So I had a particularly close view of the organisation of the civil service, and I came away with a great admiration for that organisation.

12508. Now would you be good enough to enlarge on your theme in paragraph 4? You seem to me at one stage of your argument to be saying that one cannot have a system under which policy is laid down by one person in charge of one organisation and left to be carried out by another person in charge of another. I can understand the point that in monetary operations it is peculiarly difficult to separate one from another, but are you putting it as widely as that as a general principle of organisation?——Yes, I am. I accept the point that one can give broad and general terms of reference and that those can cover policy, but I think the real remedy, if something goes badly wrong, is to sack the people to whom one has remitted the assets and the job with those limited terms of reference, not to tell them that on the 2nd December they did something that was wrong, or that on the 5th December they should do so and so different. I draw a clear distinction between responsibility and answerability. On the one extreme, take the G.P.O.: responsibility is complete and answerability goes with it. At the other extreme there is the judiciary, where there is answerability, in the sense that the Lord Chancellor would have to answer a question if a particular judge was behaving scandalously in his decisions. In between there are cases like the B.B.C. where there is answerability but practically no ministerial responsibility, though more responsibility than there is for the judiciary. With the Coal Board it goes even further. I would say that the further one goes towards the extreme of responsibility without going the whole hog on responsibility, the worse it becomes.

* Memoranda of Evidence Part XIII No. 32

12509. *Sir Oliver Franks*: Responsibility in this context being ministerial responsibility?——Complete and utter responsibility, as in your position at your bank or in my position in my company.

12510. *Chairman*: You gave two instances which you thought would be an impossibility, of somebody corrected for something he had done before, or directed on some action he should take next week. Does that envisage a situation where the Government declares its responsibility in regard to that branch of the economy which is concerned with monetary policy, and then the Governor of the Bank of England is recognised as overtly responsible for carrying it out? Is that not a vicious arrangement?——I think that one can give to the man responsible terms of reference which are policy; but then, having given him that, the best arrangement is one in which he and his board are held responsible for carrying out that policy. If they do not do it, then they are vulnerable to the sack.

12511. The only sanction is getting rid of them?——Organisationally that is the only acceptable one. The case of the railway fares gives an illustration of what happens when one departs from that arrangement. The view of the Railway Executive was that they ought to put up their fares; they were charged with the overall responsibility of making ends meet, and in their judgment that was the way of doing it. The Minister and Parliament just overruled them. That, it seems to me, tears up the genuine responsibility of the chief executive and his board.

12512. But you would recognise that the sanction of getting rid of the important figure in the whole set-up, and his board if necessary, is a very extreme one, and might well inhibit action which could be achieved by a milder form of control?——I appreciate that; equally I appreciate the difficulty of a situation in which, because they do not like a decision, the chief executive and the whole of his board resign *en bloc*, and get the Minister to move Her Majesty to appoint a complete fresh lot, in a context in which no expert would dream of taking the job because it was obviously unacceptable to his technical peers. Either way the extreme sanction is very extreme. But in this field there is a great deal to be said for the informal. It is only when one comes to these extreme cases, which are always a choice between two nasty alternatives, that anybody is even aware of what is the formal situation behind it. I think that we overestimate the need for the formalities.

12513. Yes; on the other hand, it is for the situation where the crunch comes that one has to provide in advance what the relationships are to be?——Yes, there must be the formal skeleton in the background. It never comes

into day-to-day operations, and it is only brought up very reluctantly when the crunch does come; but it is part of the climate of opinion under which both sides approach the issue.

12514. *Sir Oliver Franks*: It seems to me that the position which you are outlining pre-supposes that one can lay down general but limited terms of reference and then tell the man on the job to get on with it. Are you clear that the sphere of monetary policy lends itself to that treatment? The ebb and flow of demand in the economy, and therefore the risks of inflation or deflation, are always changing in time; and it can at least be argued that one can work against inflation, or expand in a deflationary situation, either by monetary or by fiscal means, and that the responsibility of the Chancellor for the regulation generally of the economy necessarily involves his thinking both about fiscal matters and monetary matters if he is to get his policy right. One could say therefore that, given the ebb and flow through time and the meshing of the different instruments of economic policy, it is very difficult to establish clear terms of reference which enable the Governor of the Bank to get on with his job. The only condition that I can think of at the moment in which it would be relatively easy to establish such terms of reference and let him get on with his job would be if one could say that there was one prime object for which he is alone responsible; for instance, the maintenance of the stability of the currency. Would you comment on this general situation I am trying to describe?——There is one very important element which is essential in your premise, and that is that there shall be goodwill, consultation and day-to-day give and take between two people whose objectives are so clearly very similar. I agree that, so far as inflation is concerned, fiscal policy is tremendously important; on the other hand, I would say that it is secondary to the monetary policy. I believe that we tend to say that a thing is fiscally inflationary or deflationary, overlooking the fact that that depends entirely on the monetary point of view at that time. I have often argued that even an immediate payment of all of the post-war credits need not necessarily be inflationary if the emotional situation is that everybody says: "Let us tuck this away; if we hold it, we shall be able to buy things at much less cost in six months' time, because prices are going down."* So I feel that it is reasonable to say to the Governor of the Bank of England and his Court: "Yours is the job of doing a good technical monetary job. If the public or the Government get emotional and do anything which affects them so that they behave in a way which makes money behave erratically, then it is your job to do what you can within the monetary field to correct that in your particular function. You have the job of keeping the value of sterling reasonably stable so that it can act as a measure of value in contracts over time amongst the people in Britain and the many people overseas who are dealing in sterling.

12515. *Professor Cairncross*: You are pre-supposing that this is a job that the Governor of the Bank of England can do. Suppose that inflation is brought about by other circumstances?——That is where consultation comes in. The Governor has to say to the Chancellor "I have done all I can in my sphere. The baby is now in your lap."

12516. *Chairman*: You were not assuming that the Governor would necessarily be successful in the task allotted to the Bank, but that that was to be his aim, and he was to do what he could. I think that Professor Cairncross is putting it to you that under modern conditions it is likely that his own efforts will not be successful in achieving the objectives that he is given. What is you answer to that?——If I were to accept that, I should have to admit that we were on a slippery slope which leads inevitably to hell, because the forces towards inflation are so great that unless one does what one can to stop them in that way and to bolster up the fiscal with the monetary, we shall have prices rising or the value of money going down at a rate which will be more than the slow walk which people talk about.

12517. *Professor Cairncross*: Is it implicit in your position that there is a primacy in the objective of stable money, and that the responsibility of achieving that goal rests primarily with the Bank of England?——Yes; and I would go further, and say that I cannot see any conflict of interest between the Bank and the Chancellor.

12518. *Chairman*: But one can have a situation in which all the powers which the Bank possesses in the monetary field and which the Government possesses in fiscal and other fields may not be capable of preventing inflation?——I should doubt it, because at that point I feel that the coincidence of interest between the Bank of England and the Chancellor would be so great that all action that was possible would in fact be taken.

12519. *Professor Cairncross*: Would you agree that if the action necessary to stop inflation embraced both what the Bank of England did and what the Treasury did, through the Budget and possibly other action as well, consultation would be necessary which might begin somewhat to blur the responsibilities of the Bank of England?——No, I should have said that the two could be very reasonably separated. They would not however be absolutely separate; it would be like the point where the chocolate ice joins the vanilla ice in a neapolitan ice. I would say that they are as separate as that, and that if the items which are necessary to create the money to finance the inflation were rigorously restricted, it would come to a crisis in which they had to make up their minds on the political side which was to win.

12520. If it were true that all the action taken by the Bank of England and all the action taken by the Treasury to supplement that failed, what you say would follow; but if the action were alternative, and the Chancellor of the Exchequer preferred to see the fiscal weapon used rather than the monetary weapon because he believed it to be quite sufficient for the purpose, would there not then be conflicts of responsibility implicit in the situation that you were describing?——No; immediately the Chancellor took any deflationary action which met that situation, there would be automatic contraction by the Bank of England of those elements which were manufacturing money for the inflation. As I say, there would be constant consultation going on at the same time in a field in which the interests of both are identical.

12521. I suspect that you are turning the job of the Bank of England into something more automatic than it is. If you say that action by the Treasury dispenses the Bank of England from acting, it may in one sense be true; but it does not preclude the Bank from acting nevertheless?——I accept that; but you were postulating a situation in which the fiscal action is so effective that it produces amongst the public a deflationary action of a very considerable nature, in which case I would say that the action of the Bank of England becomes that of a spring which naturally contracts or expands as the pressure upon it is altered.

12522. This postulates that the Treasury is anxious that the Bank should not make use of the monetary weapon in these circumstances; but I am afraid that nothing persuades me that they would not, even though the fiscal weapon might be being exercised?——That is a political decision.

12523. Does it not mean that the responsibility conferred on the Governor cannot be absolute and determined exclusively by one primary aim which is put to him on this point? The consultations which follow are surely of a character in which alternatives have to be considered, and the Governor's responsibility becomes rather indefinite?——This amounts really to a difference of opinion as to whether or not the neapolitan ice can exist without the mixture of the two.

12524. *Chairman*: But you would agree with much of what has been put to you, I think? Consultations are inevitable so that each may know what the other is doing?——Yes, that is the very essence of the thing. I could not imagine anybody being either Chancellor or Governor of the Bank of England unless they did live in that constant happy marriage. Moreover I am postulating that the only difference comes when there are two thoroughly bad courses to choose between, so that one will be very uneasy whichever way the decision is taken. I want to emphasise that I believe there is a case for saying that of the two organisations the ideal is the one where the Chancellor says to the Governor: "You have got the job of deciding this, and I have got the job of sacking you". At the present moment it seems to me that it is the other way round; the Chancellor has the job of making the decision, and the

* *Note by witness*: In such a case the transfer of spending power to those who wish to save from a Government which *pro tanto* can thereby spend less is deflationary, certainly not inflationary.

Governor has to send telegrams all over Scotland asking people whether or not they are prepared to lead a major revolt if they really cannot stomach this.

12525. You put that situation in your paper as if it was a factual one. Are you putting it hypothetically or not?——When I was with the Bank of England we did not have that kind of tussle. But there was all that consultation and circulation in September 1957, when admittedly it was a very big decision to put the Bank Rate up as high as 7 per cent. If it had been just that straightforward issue, I do not think it would have led to all that coming and going. I interpreted that as in effect saying: "We at the Bank have a certain responsibility, and are going to stand together in bringing real pressure to bear to get our viewpoint considered".

12526. In paragraph 21 you say: "nowadays the supposedly top man and his Court, Council or Board takes the initiative to overhear the Minister." How much of that is factual?——None; it is only deduced. There have been two major rows that I have seen, one over railway fares and the other over the Bank Rate, and I cannot believe that major rows of that kind do not arise without some considerable behind-the-scenes friction. I myself, if I was overtly even though not in reality responsible, would feel that the initiative would lie on my side of the fence to organise a revolt against the Minister if I thought that the Minister was doing something, in his ignorance and misdirection, which was wholly bad for the public and for the nation. I should feel obliged to organise this, just as Lloyd George was obliged to organise the conspiracy in the opposite direction. I see no escape from the fact that one has to choose one alternative or the other in one of these really nasty situations where one has to decide between two thoroughly bad lines*.

12527. In paragraph 9 you speak of the

> "choice of two forms of organisation for nationalisation: either the Minister could be responsible for both policy and detail and become thus a full-time No. 1 man, or else the Director-General or whatever he may be called could be given undivided responsibility and informed that though he will be given no directives and will suffer no interference in policy nor in day-to-day administration, he will be quietly replaced if his judgment on policy or his conduct in detail are considered to be not in the best interests of those who own and control the assets and who are moreover so deeply concerned in the nature of the service given by the undertaking."

What have you in mind in the words "quietly replaced"?——Of course there will be a lot of friction behind the scenes; but if he is falling down on his job, then there is a great deal of human nature in his wishing quietly to resign on his own initiative.

12528. It struck me that it is because it could not be done quietly that one would wonder whether it was an appropriate form of sanction?——We have known Ministers who have quietly resigned in just that situation.

12529. *Sir John Woods*: In paragraph 10 you say that you formed a very high opinion of the organisation of the three fighting services. If you take the present situation, except in the case of the Admiralty, we have a system, in relation to the Ministry of Supply, of divided responsibility. For example, on military aircraft the Air Ministry and the Air Staff are very much concerned with what type of aircraft is made, but the Ministry of Supply are responsible for designing and making it?——As you know, this was one of the major problems that we had. The Admiralty took the very reasonable view that their men were going to fight and die in these ships, and they were going to take the responsibility and they would not let anybody else have any say whatsoever in it. On the other hand the Army, allegedly because they took a greater interest in horses than in tanks, did not take the same attitude about fighting and dying in tanks which they hated as compared with horses which they loved, and they put it over to this other type of organisation. The problem was always to get the Admiralty to play when dealing with common units of procurement, like radio valves, which went right through all three services, where there had to be some co-ordination of priorities in those days of shortage. The other problem was that of seconding men from the Tank Regiment to the Ministry of Supply so as to ensure that the type of tank was as it should be. I think there is no solution to that problem; but that is not my point. My point is that, once one has determined the terms of reference of a unit and put a man in charge, he should be in charge. The civil service was very good in that way. It knew precisely where power and responsibility lay, and where powerlessness also lay.

12530. All I am putting to you is that, if you take the case of the Secretary of State for War and the Army Council, they do not have undivided responsibility in the whole field of their activities?——That may be a very good reason for preferring the naval organisation to that of the Army and Air Force.*

* *Note by witness*: Either the machinery is that the Minister organises a revolt against the Chief Executive who is really responsible or the Chief Executive who is not really responsible organises a revolt against the Minister who is.

Note by witness:

I believe I did not make my point sufficiently clear in distinguishing between the "broad general terms of reference" and the "policy" of any undertaking.

As I see it, no responsible authority (the one head man and his Board) is unlimited, and I only hope that I was not taken as saying that it could be otherwise. I hold that the head man is circumscribed and limited by his broad terms of reference (which may well be implicit rather than expressed) and that it is only in the policy and detail which are relevant to his terms of reference that he (and his Board) may regard himself as the repository of responsibility—full and unfettered so long as he and his board enjoy the confidence of those able to relieve him of that full responsibility.

In the majority of cases the terms of reference are more or less as follows: while preserving the integrity of the assets committed to his charge, to employ them competently in the field of function intended. In the case of the Bank of England the field of function would include that of preserving a suitable stability of the currency, just as in the case of my own Firm there would be the field of function of the continuance of the educational tradition of the late Sir Isaac Pitman and his sons.

There are moreover further and over-riding and even broader terms of reference—for instance, among others, that the conduct must be within the Law, that it must be honourable and with respect for human dignity. It would be in subservience to just such an over-riding term of reference that in war-time an undertaking may be supposed to have imported the term that "winning the war" and not losing it is an essential part of the result. After all, without winning such a war it would be impossible for that undertaking (in common with others) to exist at all and so to carry out its broad general terms of reference.

I fear too that I may not have made clear my thinking about "fields of function". I regard them as distinct both from the broad terms of reference and from the policies which the head man and his Board like to adopt from time to time. The field of function is to a large extent, like the broad general terms of reference, a circumscription of the otherwise full responsibility. It would, for instance, not be a change in policy within such a responsibility but rather a jump into a fresh field of function were, say, an engineering firm to start the manufacture of women's fashion wear, and I would suggest that the authority would not cover discretion to make such a jump. In the case, mentioned by Sir John Woods, of the functions of the Ministry of Supply, the Admiralty and the Ministry of Aircraft Production, it is the Cabinet and its Organization Committee which, in the name of the Crown, obtains agreement between Ministries and authoritatively prescribes their fields of function. It may be, and no doubt is, on the part of the Cabinet, "policy" to decide fields of function, but once they are decided it is not so much policy by the Admiralty or by the Ministry of Supply that they keep to their particular functions, but rather the circumscription of their fields of function.

I would thus make four distinctions:

1. The "field of function" is the first circumscription;
2. The "broad general terms of reference" (which will implicitly change somewhat in emphasis and with time) is the next, but within those circumscriptions "policy" is for the authority;
3. "Policy" in turn is circumscribed by "detail", since policy can never in practice be the ideal, but needs to be tempered by what is possible in detail;
4. "Organization and method" circumscribe the detail of what can be achieved within policy; "organization" being how the division of labour is allocated among personnel, and "method" being the circumscription of how the individual carries out his organized duties. The lowest individual "I" has naturally most circumscriptions, but nevertheless he has his own, if very limited, field of freedom of both policy and detail, very minor as they may be.

12531. *Chairman*: In paragraph 14 you come to your essential reasons for supposing that the Bank cannot be equated to a Government department. One reason is that there has to be somebody who can meet on an equal rank with other central bankers, and the Chancellor cannot fill that Bill?——The Chancellor cannot possibly fill that bill because he must from his electoral position be required to take a British and narrower view than that which ought to be taken in this field, having regard to the fact that the City of London is attempting to serve the world.

12532. *Professor Sayers*: In the history of the last five or ten years have not the pronouncements that have bad most impact on the status of sterling abroad been the pronouncements of Mr. Butler at Paris and at Istanbul and of Mr. Thorneycroft at Washington, rather than any pronouncements which the Governor may have made? ——I would not deny that; but the safety to people outside is the feeling that the Governor does have at any rate the appearance of integrity for what the Bank of England is doing in that particular field. It is over-ridden by the Treasury's power to give a direction, but I think that people would be more nervous about sterling abroad if they thought that the Chancellor of the Exchequer was less limited than he is by the independence of the Bank of England.

12533. *Chairman*: Does your experience suggest that in overseas eyes the Bank is regarded as an independent authority today?——I think so. The way in which central bankers come and have lunch with the Governor whenever they are over here, and meet him informally as well as formally, and discuss with him all the matters that are relevant to the two of them, does mean that there is a "feed-back" from this country to the other great financial markets of the world which shows that there is such a things as a Bank of England view, and that that view could be different from the Treasury's.

12534. Your second reason, which is another aspect of the first, is that, if sterling was avowedly under political control, that would in your view have a bad effect on confidence?——Yes.

12535. *Professor Sayers*: This view of the importance of having the Bank of England in this position depends on your belief that people in other centres regard the Bank of England as having not merely influence in the system but very considerable power over the value of the pound, or at least that the monetary weapons at the disposal of the Bank of England are powerful?——Yes. Presumably this was a view which carried very great weight at the time of the nationalisation of the Bank of England; otherwise the Government of the day would not have gone to such great lengths with royal charter and royal appointments and all the rest of it to emphasise the independent integrity of the Bank of England, subject only to the power to direct.

12536. *Professor Cairncross*: Do you know of any major act of policy which the Bank of England performs which is not approved by the Treasury?——No; I would say that that is a very good instance of the way in which consultation does work, and how problems arise only in those most intractable cases where the situation is such that any decision is bound to be wrong. Nobody has any difficulty in choosing between the right and the wrong or between the better and the slightly less good of two good cases, but when everybody is emphasising the obvious nasty points on both sides one is wrong whatever one does.

12537. In what sense do you regard the policy that has been pursued in the past ten years as the work of the Bank of England rather than the Treasury?——There is no factual background to this. My interpretation of the telegrams which were sent all over the place, and the length of time which it took to arrive at the decision, is that September 1957, was an occasion of great difficulty; but by inference I presume that there never have been any other cases where even a happy marriage has not arrived at a unanimous decision.

12538. *Chairman*: In paragraph 24 you reach your theme that the stability of sterling is always and at all times a national interest?——Yes.

12539. Do you think that it is always and at all times of paramount national interest, or are there situations in which for the time being it may have to cease to be regarded as a paramount objective?——Yes; war is the obvious one. I accept that.

12540. What is the Governor's position then? Do you leave him with full responsibility?——There is the reserve power to dismiss at any stage. Cunliffe was technically absolutely right; there was this liability to sell the gold and he was carrying out what was technically right. The fact that the nation was at war and wartime circumstances overruled the ordinary normal straightforward legal and banking ones meant that he had to be overruled.

12541. *Professor Cairncross*: You are saying in paragraph 24 that the interests cannot diverge. The instance that you are now quoting is one in which the action of the Bank of England might have been considered, certainly in wartime, to have been at variance with the national interest?——Interest has to be interpreted by subjects, and is therefore subjective; I am saying that in such cases one can depend on the people of this country to merge their subjective judgment so that in point of fact there is no divergence.

12542. Would you add that there must always be a power in the Government to dismiss, when subjective judgment seems to flout the public interest?——I think that the very presence of those suggested powers of removal adds to what would be naturally the tendency that the Governor would in point of fact equate the national interest with what he conceived as his interpretation of his remit.

12543. You think that the function of the Bank of England is largely a technical one; you do not believe that their actions carry such political implications that they would inevitably be debated in the House of Commons and become the subject of party controversy?——To my mind the more correct view is that any aberrations of money have been brought about by what the community has done, money following suit, rather than that money has suddenly behaved most erratically and has thrown the community into a "haywire" condition.

12544. Is it possible to apply the adjective "technical" to a judgment between alternative aims of policy which may confront the Chancellor?——I am postulating that the policy remains monetary stability.

12545. Might there not be some other objective of policy which might be affected adversely by a monetary policy that was intended to preserve stability in the pound?——That is what I mean by the impossibility of clash; I believe that taking the long run there is no political reason which could be valid justification for a galloping fluctuation. The damage of that result would be so much greater.

12546. "Galloping fluctuation" is perhaps pre-judging the issue. There are courses of action in which risks may run in one direction or the other, and where the risks taken depend on which aim of policy is regarded for the time being as paramount. In those conditions risks might be taken rightly in favour of raising the level of activity of the community, which at other times might be taken wrongly in that direction?——Unless this was a case of a choice between two views both of which were clearly evils, that in my view would be resolved in consultation without any difficulty at all

12547. *Sir Oliver Franks*: That raises what to me seems to be the most difficult issue which may arise. In the proceedings of the Macmillan Committee, when Mr. Keynes and Mr. Bevin were questioning the then Governor, the general impression which I derived from the Governor's evidence is that he felt himself compelled to say that, if the pound was under external pressure, and his job in maintaining the stability of the pound required him to resist these external pressures, he must do his duty to maintain the stability of the pound, though the cost was unemployment. A great deal of the questioning of Mr. Keynes and Mr. Bevin was on the ultimate priorities of these considerations. If you take the situation today, let your theoretical view of the long run be what it is, there is still the practical consideration: given the views that electorates have expressed in their choice of Governments and the views which the Governments themselves of either party have expressed, is it possible for

the Cabinet in peacetime to admit the ability of the Governor to pursue the stability of the currency as paramount in circumstances in which the pursuit of that objective would involve a lowering of demand in the country sufficient to produce a substantial degree of unemployment? This is a social problem, and therefore a political problem, and it seems to me that the view you are taking involves the responsibility to deal with that practical situation as well as the long-view belief that stability of the currency is all-important ultimately in the national interest.——Lord Norman gave extraordinarily bad evidence, I think, in that case; he took the view about finance that it was a matter of art and not a matter, as Keynes rather thought, of science, of turning the right taps to the right degree. I think that Norman very much overstated that point. I would say that any Governor of the Bank of England must take into account that the prosperity of the nation, for which he is responsible in a monetary sense, is dependent on a high and stable level of employment. We clearly lose, and can only lose, if we have people out of work who are capable of producing. I would say that the only type of dilemma which would arise would be in the margin between, say, 2 and 3 per cent. of unemployment, remembering that a great deal of that 2 to 3 per cent. is inevitable and not really an economic loss. I cannot conceive any decision being taken in the long-term interests which would create any major unemployment of any kind whatsoever; but I do say that the real danger is the colossal unemployment which would come about if people overseas ceased to have faith in the pound and therefore ceased to supply us with the raw materials with which this country could employ its people.

12548. *Chairman*: When it comes to his terms of reference, he is not to pursue monetary stability as his sole duty; he is to modify his pursuit of that by an appreciation of current social objectives that the Government is pursuing?——This is where I identify the two. It is very important to him that the motor industry in Coventry should be working flat out and exporting every car it possibly can; therefore he ought, in making any judgment as to how he uses the monetary weapon, to have regard to the full commercial implications of what his monetary decisions are.

12549. *Professor Sayers*: Do you believe that the monetary weapon is of appreciable power, if it is limited to a framework in which the industry of the country is going flat out?——I think it is. I do know the extent to which people let out the elastic of the expansion of credit. Anybody who sees that, and sees that it is going to lead to a raising of prices, goes flat out to increase his credit to the utmost and use it. I believe that, if that is cracked hard on the head, it has the reverse effect. I personally think that the monetary tool is much more effective.

12550. *Professor Cairncross*: Does it not follow from what you say that the work of the Bank of England, so far from being technical, is practically co-extensive with the work of the Chancellor of the Exchequer, in so far as his aim is to maintain the level of demand in the economy and continuing prosperity? If the Governor takes into account general social objectives and the situation of real resources, in what respect does his behaviour differ, especially if he is in command as you say, of the more powerful weapon, from that of a good Chancellor?——In cases where there is smooth consultation I do not think that that arises. In cases where there is a difference of opinion I think that it is positively an advantage to have a Governor of the Bank of England who can say that Ways and Means Advances and the floating debt are really far too high, that he must, as Governor, require the joint stock banks to stop giving credit quite so easily. I believe that the Governor would get the Chancellor to listen with greater conviction if the responsibility was on the Governor's shoulders than if the responsibility was on the Chancellor's shoulders, particularly when it is on the Chancellor's shoulders in a rather muddled form. But of course I do not speak as an economist.

12551. *Chairman*: Is there any major point in the paper which you wish to mention?——I think that the point in the footnote to paragraph 25 is very important, that major directives can be given by the Chancellor without any publication at all.

12552. The existence of the power, whether it is exercised or not, amounts in fact to political control without any overt declaration?——It is secret, whereas the whole intention was that it should not be secret but public. In fact it must virtually always be secret.

12553. *Professor Sayers*: Yet later on you draw an analogy with the courts of justice. In our courts the judges are expected to, and do, go to great trouble to set out their reasons for their judgment. Do you think that a central bank should do so?——It has plenty of opportunities for doing so, and I should think would wish to do so. Lord Norman was over-cautious, and attached great importance to secrecy at the Bank of England. I remember that I put forward a proposal that we should have a "talkie" film done of the Bank of England for the 250th anniversary of the Bank in 1944 and lock it away for two hundred years; it would have been a historical document of very great value. This was turned down on the ground that the Bank is a secret institution.

12554. *Chairman*: That was rather a strange form of publicity?——*Mr. Pitman*: I only introduced that to show Norman's peculiarity. The Bank ought to do its public relations in a proper and intelligent way, but it must have the discretion to know when to do that. There are times when too much publicity might lead to a run on the pound. But I accept entirely what Professor Sayers is saying, that there must be good public relations, so that justice must not only be done but also be seen to be done—*Professor Sayers*: Not just films, but statements of reasons.

12555. *Chairman*: The substance of your answer is that, if one concedes the Bank as independent within the limits you described, and dealing with what is a matter of social importance, it must follow that it must be continually explaining and justifying itself?——It must justify its efforts.

12556. *Professor Cairncross*: A great deal of your paper is concerned with powers and responsibility. Very little, I should say, deals with the type of judgment that is brought to hear on monetary matters and the technical proficiency of those who are advising on it. Is there nothing you would wish to put to us on that? Do you feel that there is no improvement in the domestic organisation of the Bank of England that might be advisable?——I do not know how I could comment on judgments taken within the Bank or anything of that kind, because it can be discussed only in precise cases. I have a very high opinion of them in their judgments. The way they created a foreign exchange control mechanism almost in a flash was fantastic.

12557. Do you feel that any change might be desirable in the recruitment or training or seconding to other work of members of the staff of the Bank?——No. I was on the Staff Committee for many years, and I was very impressed with the way in which they handled recruitment and promotion and training.

Chairman: Thank you very much, Mr. Pitman. It is very good of you to have given us your help.

(Adjourned until Tuesday, 6th January, 1959, at 10.45 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-FIFTH DAY

Tuesday, 6th January, 1959

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*

THE RT. HON. THE LORD BRIDGES, G.C.B., G.C.V.O., M.C., F.R.S., called and examined.

12558. *Chairman*: Thank you, Lord Bridges, for the note* which you have given us putting on record the outline of your views. I do not think that we need work through it in any particular sequence; but we should like you to enlarge on one or two questions. I wonder if you would help us from your experience first of all on this point: what practical difference in working between the Treasury and the Bank resulted from the Act of 1946?——*Lord Bridges*: I should have said very little. The Cunliffe affair in the first World War shows that when the Government really wanted to get on top they could always do so, but in the old days it might mean a good deal of fuss to get there. The Act merely meant that the Government could get on top more easily and *de jure*, without having a fuss. I do not think that it made any practical difference.

12559. You think that the introduction of the specific power to give directions merely formalised the existing position?——I would have said so.

12560. Do you think that it in fact resulted in the Bank's independence being greater because it could formally ask for a direction instead of being generally under influence, as it was before?——I would have thought that it really made very little difference. It really depends on the personal relationship between the people concerned.

12561. Do you think that the phrase which has come into use, that it is the duty of the Bank "in the last resort" to give way to the requirements of the Government, expresses accurately or satisfactorily the relationship?——I do not like it very much, because it rather implies that there is going to be a battle and a dispute; my experience has been that, although the Bank have often felt, and probably still do feel, very strongly on particular points and urged their point of view with great skill and vigour, they have always recognised that their point of view is only part of the whole picture, and that there are other considerations which are more likely to, and should, determine the ultimate decision. So "in the last resort" does not seem to me to be quite the happiest way of putting it. It is not a phrase I would have used in the relationship between a Permanent Secretary and his Minister.

12562. *Professor Cairncross*: Do you see a great deal of practical difference between the relationship between the Bank of England and the Treasury and the relationships between Government departments and the Treasury?——Yes, I think I do see a difference. It is awfully difficult to express. In paragraph 14 of my note I say:

"But that, of course, is not to say that the Bank can have no authority of its own, or that the responsibilities and standing of the Governor are, or should be, equated with those of the Permanent Secretary of a Government department."

First of all, Permanent Secretaries do not as a rule make speeches, and if they do make speeches, their speeches would have to be approved by the Minister in absolute detail. I do not think the Governor is in that position. The Governor in some senses is the leader of the City, and it is right that he should express City points of view, and sometimes say things which will not be exactly what the Chancellor would have asked him to say. He will be careful, of course, to say nothing which will produce embarrassment; but his position is certainly quite a bit more detached from the Government than that of a Permanent Secretary from his Minister.

12563. *Chairman*: Why must the Governor be the leader of the City? Is it inherent in the situation of the central bank?——I would have thought that it was. I would have thought that an important part of the Governor's job was not merely to be on close and intimate terms with the Treasury but to be on equally close terms with the City, to know what the City is thinking, and to be able to represent their views to the Government. I would think that it was his duty to let the Chancellor know what the City was thinking, even on occasions when he may have thought that those views were not one hundred per cent. right.

12564. *Professor Cairncross*: Why do you think it should be the City instead of, say, the industrial community?——One is apt to use the word "City" in a rather loose way; obviously it broadens out to cover industry too.

12565. You would not put it that the Governor of the Bank of England is the spokesman of the industrial community?——No.

12566. *Professor Sayers*: What distinguishes him then in this from the President of the Federation of British Industries?——Although one cannot draw a clear line between the City and industry, there is a particular City and financial point of view. I think that in my last answer but one I went a little further the other way than on further consideration I really feel; it is the City and the financial end which the Governor is responsible for answering for.

12567. *Professor Cairncross*: Does not that make for some embarrassment? It is not the normal situation in other countries that the Governor of the Central Bank is simultaneously the Government's adviser on monetary policy and the spokesman of the financial community?——*Chairman*: You spoke of him as to some extent forced to be in a position midway between the Government on the one side, and "the City" on the other; I can understand that he is a very valuable communicant to the Government of the views of the financial community, but I should have said that, even if he was wholly on the Government side, and in the Government service, he could still communicate what the views were. You put it that he is forced to stand somewhere between the two?——No, I did not mean that. If I have written anything here which implies that, it is not what I intended.

12568. *Sir Oliver Franks*: The phrase you actually used was "a bit more detached" to express this point about the position of the Governor in relation to the Chancellor of the Exchequer, as compared with the relation of Permanent Secretaries to Ministers?——Yes; I think that he would be a bit more detached by virtue simply of being the head of the central bank. I do not think that it is necessary to bring in his function of knowing what the City thinks and reporting it to the Government in order to justify that word "detached".

* Memoranda of Evidence Part XIII No. 2.

12569. *Professor Sayers*: We are trying to find out where in this detachment there is something different from the function of a Permanent Secretary. You mentioned the fact that the Governor makes speeches, and that his freedom in making these speeches is something that could not be allowed to a Permanent Secretary. Is that freedom the only difference, and is it necessarily bound up with anything that lies much deeper?——I think that there is something much deeper, but it is, like all these matters, very difficult to express. I have said in this note how controversial monetary policy is; and a good deal of it at the moment resides in practical wisdom and experience, and not in very clearly thought out theory which has been expressed in a way in which everybody agrees with it. It may be that when you finish your job that position will be changed, but I am speaking of it as it is at the moment; and I think that something of the independence of the Governor's position does spring from the fact that he is the man who in his own person embodies the practical experience and wisdom which resides partly in the Bank and partly in the financial institutions of the City; and it is that which he has to interpret to the Government as Governor of the central bank and as part of the Government machine.

12570. *Chairman*: Are you stressing in this that the Bank is an operational agency, and to that extent would seem unlike any of the main Government departments concerned with the economy?——It is an operational agency, certainly.

12571. *Sir John Woods*: It is not wholly operational; you would not exclude the formulation of policy?——No; but I think that policy springs to a very sharp extent out of the practical experience of the Bank. That is really the kernel of my thought.

12572. *Professor Sayers*: You have said that matters of policy are highly controversial. Does not that make it more necessary that the reasons for decisions should be formulated, and that it should not be just a matter of decision by the hunch of the man who has eminent practical experience and draws on the practical experience of others? Does not the fact that these things are so controversial make the formulation of policy by methods like those followed in Government departments very important?——Yes, it is necessary that it should be formulated, and I think it is formulated.

12573. *Mr. Jones*: Is not the term "independent" a rather dangerous term, particularly when one thinks of the responsibility of the Government for operating effectively and in the interests of the common good the economy of the country?——I do not think that I have used the word "independence".

12574. *Chairman*: You say in fact: "I see no prospect of success for any scheme which would confer autonomy on the Bank of England"?——Yes. The trouble is that the words one uses do not very easily fit this relationship. A Permanent Secretary is obviously not independent of his Minister. Whatever may happen behind the scenes, when it comes to anything outside he can only say exactly what the Minister approves. The Bank of England is not independent, but it is certainly not as near to the Minister as the Permanent Secretary is; so talking a little loosely one could say that it is more independent, but it is not of course completely independent.

12575. *Mr. Jones*: Why should the Governor of the central bank have an authority that is greater than the authority of the Permanent Secretary of a department of State? As I understand it, within a department there would be the closest consideration by a team of officials, and the advice tendered to the Minister would depend upon the co-ordinated consideration of that team of officials. Do you consider that there is a similar position operating in the Bank, and if there is not do you consider that it is desirable that there should be?——It certainly exists.

12576. In the Bank?——Yes, and between the Bank and the Treasury. On difficult matters where there may have been some difference of view between the Treasury and the Bank of England, the question has been discussed with memoranda on both sides and discussions round the table in just the same way as it would be between the Treasury and the Board of Trade.

12577. *Sir John Woods*: Would you say in just the same way?——For all practical purposes, yes

12578. *Mr. Jones*: Suppose that there was some matter of highly controversial policy between the Treasury and the Bank; how would the team of persons considering that question and hammering out policy be constituted?——I think that a joint Bank-Treasury team does not get formed until a somewhat higher level than it would be between two Government departments, but when it gets to the top levels then it is formed in just the same kind of way.

12579. What would happen if two points of view remained wholly divorced one from the other as a result of these talks?——In the end what happens would be that the Chancellor would have a meeting with his high officials of the Treasury and high officials of the Bank, and they would talk it out round his table. I have known it happen.

12580. And the decision?——It would be the decision of the Chancellor.

12581. *Professor Sayers*: You mentioned one difference between the Bank and a department such as, say, the Board of Trade, that, although in the top range the contacts might well be as close, lower down there was probably rather less contact. Is there anything in the nature of the Bank of England that makes that difference inevitable or desirable?——I would be sorry to say anything which appeared to attach a great deal of importance to this. In my early days as Secretary of the Treasury I used to hear this said. My impression is that the thing has pretty well righted itself. I do not see any reason why in the last resort there should be differences, and I do not think that there will be; I think that it is just one of those things which takes a little time to evolve.

12582. *Mr. Woodcock*: I think that your paper makes it clear that the position is one where, in any real sense in which we may use the term, the Bank is dependent on the Treasury, not independent at all; what we are trying to discuss is the nature of this dependence, and how it works out. Has it ever seemed to you in your experience that in these discussions, wherever they may be, at the higher level, or even at a lower level, the Chancellor in exercising his responsibility is handicapped by the fact that he and his staff are not as skilled or as knowledgeable as the Bank people about certain things that the Bank does and by tradition always has done? Does that handicap or limit in some way the dependence, or does it give the Bank a greater autonomy?——Every Minister has to depend ultimately on the advice and experience of people who advise him; provided that the Chancellor has the proper relations of confidence and trust with the Bank of England I do not see that it matters that the Bank of England have greater expertise in certain matters than the Treasury has. They are his servants.

12583. But you made the point that it ought to be the right of the Governor of the Bank of England to represent the City view, even though he himself may not agree with it?——I do not mean that he would say something ought to be done simply because the City thinks it, but one of the things a Governor ought to do is to let the Chancellor know what the City feels about certain things.

12584. But even so, apart from that, his responsibilities as Governor of the Bank of England are special, and intimately concerned with the City, and he would naturally in his discussions with the Treasury and with the Chancellor express the view which was derived from his experience and his responsibilities. It is your view that the Chancellor, who has different experience, and whose responsibility too is wider and more concerned with industry, is likely to be unable to assess the relevance of the Governor's views in these discussions, and is likely to be over-impressed?——No, I would not have thought so.

12585. *Professor Sayers*: Why should we regard it as desirable that the Governor should be able to speak in a way in which a Permanent Secretary should not? And if he should do it, why should he not do it in a very much more large-scale manner, giving very much more systematic reasoned discourses?——I think that the answer to your first question is that, if he either does not speak at all, or does so only like a Permanent Secretary, a great deal of his utility to the Chancellor and the Government is diminished. The mere fact that he can speak with a slightly more detached point of view than a Permanent Secretary, and say things which a Permanent Secretary would not, is of great use to the Chancellor.

12586. What is there about this field that makes it desirable in this field and not in any others?——Because it is a different field from others. Perhaps when this Committee has reviewed monetary policy, and has been able to express clearly how it does work and how it should work, some of these things may not arise; but at the moment there is no doubt that there is a financial point of view, and a financial experience, and a technique, and so forth, which is something quite different from anything one gets embodied in a Government department. As long as that is so there has to be the sort of organisation and arrangements which allows for that, and makes the best use of the situation. You may think that I am simply defending what is, and that everybody after a certain age gets disposed to that; but I sincerely believe that this slightly detached position of the Bank of England, and the slightly greater degree of detachment of the Governor from the Government machine, is the best way to work the thing at the moment. What will happen in twenty or thirty years time I do not know; but to suggest that the whole thing should be turned into a Government department would, I am sure, be a great mistake for everybody concerned.

12587. *Sir John Woods*: Would you attach any importance from this point of view to the position of the Bank of England and the Governor with foreign central banks and foreign governments?——Certainly, a great deal.

12588. Would it follow from that in your view that it is important that the Governor should not be a rather dim, amorphous and anonymous figure like a Permanent Secretary, but somebody with a much bigger and public position with prestige?——Certainly. I think that the same goes with "the City" in this country. I think that, if steps were taken to reduce the Governor to a Permanent Secretary the Chancellor would have much more trouble with the City than he does at the moment.

12589. *Chairman*: How would this express itself in relation to questions in Parliament about something that the Governor has said? I suppose it could be said that since he is in effect a Permanent Secretary under the direction of the Minister, the Minister must be able to answer for views or policies that the Governor has expressed; but would there be a range in which the Chancellor would be entitled to say: "This is a matter which I think it is best I should leave to the Governor"?——Yes, certainly. This cannot be embodied in a statute. There has to be a convention, and if we have not got a convention we have to grow one to fit the circumstances. I would have thought, for instance, that chairmen of the nationalised industries have much more discretion and freedom in what they say than a Permanent Secretary; and rightly so. The thing would not work otherwise at all.

12590. *Professor Cairncross*: You would agree, I take it, that what the Governor has to say on monetary policy lies very much at the heart of economic policy, and so is very much involved in what the Treasury is doing, in a way in which what is said by the head of a nationalised industry is not part of Government policy?——Yes, there is some difference.

12591. Does this not imply that there should be strict limits on the kind of speeches and the number of speeches that the Governor ought to make?——Obviously the Governor cannot start making speeches which say, or imply, that he has a different economic policy from that of the Government, but between that and saying nothing except the sort of thing a Permanent Secretary of a Government department says after showing his draft to his Minister there is a wide gap. It is that gap which I think can be filled.

12592. *Professor Sayers*: What about the suggestion that he should speak in a much more large-scale manner?——I certainly think that wide general surveys of the situation would be very useful, and I would be all in favour of the Governor making them.

12593. *Professor Cairncross*: There is a great difference between making a speech which deals with broad matters of policy which would seem appropriate in Parliament, and making a speech which enters into detailed techniques of financial operations which would not be so appropriate in Parliament, and might be more in place coming directly from the Bank of England (though whether that should take the form of speeches or the form of a more elaborate report from time to time from the Bank of England is perhaps open to question). Would you lay your emphasis on speeches that were designed to build up in the public mind here and abroad the prestige of the Governor, or are you thinking of information and speeches which provide the expert on financial policy with material for judgment that at present he may not possess?——I would have a good deal of the latter, but I would not want it limited to technical things. After all the Governor has a position as Governor which is a special and important one, and there are occasions where he can very properly make some public pronouncement—not setting out Government policy but in accordance with that policy—which I would have thought would be helpful to all concerned. I can see no reason why a convention should not grow up, if it does not exist already, that he should make such statements, and I think it would be to everybody's advantage.

12594. *Sir John Woods*: If he made speeches of that kind, it would be essential that it should be in general line with Government policy?——Yes, but I do not think I said, or intended to imply, that these speeches would be about the broadest essentials of Government policy. Anything like the setting out of broad Government policy would be a matter for Ministers, probably in Parliament, or on some public occasion.

12595. *Chairman*: I am not sure that I quite see this distinction; I would have thought that the main benefit of speeches or public statements and utterances that the Governor made would be to explain what he was doing, and that seems to me to be explaining what policy in the monetary field is being followed by the Bank with the Government's approval?——It is difficult to announce a Government policy which has already been announced by somebody else. It would be a statement of how policy was being followed out, not an announcement of policy.

12596. *Professor Cairncross*: Surely the statements that are made by the Governor, if they are to be of public interest and to deal with matters of public importance, are bound (so long as they are not purely quantitative) to be very like what would be said at other times by the Chancellor in the House?——Like certain aspects of the Chancellor's speech, but not entirely alike. They would be more on technical financial points.

12597. *Professor Sayers*: Could these statements that you envisage the Governor of the Bank making, if they were to be of use, avoid going into matters which, as you have yourself stressed, are matters of great controversy?——So long as monetary policy continues to be intensely controversial the Governor would have to keep on the safe side of the more controversial aspects; but I still think that there is a scope for him to say something on these matters from a more independent position than that of a Permanent Secretary. It would want a great deal of working out; it is not easy to define it in evidence.

12598. *Mr. Jones*: Could not this lead to an impression in the country that the Bank was independent of the Government in matters of policy?——If it did, it would be very unfortunate. The thing would have to be managed in such a way as not to give that impression. I still believe that if the thing is properly worked, and no doubt approached cautiously, there is no reason why that impression should be given. There is an opposite consideration: a good deal of suspicion and doubt and controversy arises from people not understanding what is being done. To the extent that the person who knows what is being done finds it possible to give an explanation as to what is being done, and why it is being done, I would have thought that that would be a help to prevent suspicion and controversy arising. I attach a good deal of importance to that. One of the very distressing facts about this situation is the suspicion which appears to exist in a number of quarters, where one hoped it would not, about the City as a whole. Some people think that earning a living in anything to do with money is a much less desirable way than earning a living in other ways. That sort of thing is not going to help this problem; so far as the people concerned can have the opportunity to talk a bit and explain what is happening, is not that the best chance of getting rid of some of these suspicions?

12599. *Professor Sayers*: Is not this a large part of the case for very detailed exposition of policy?——"Detailed exposition", yes, but I would not say "policy".

12600. Of the operations of the Bank?——Yes.

12601. *Professor Cairncross*: It has been put to us that the Chancellor has not the same access to the staff of the Bank as he has to the staff of the Treasury. Would you agree that this is so?——I have never heard that one. Of course, the Chancellor happens to live in the Treasury and not in the Bank of England, and it is very easy for him, if he wants on any given subject to get information, to get not only the Permanent Secretary, the Second Secretary and the Third Secretary, but the Assistant Secretary and even the Principal who has written the first minute. In the Bank he naturally does not go so far down, but for the sort of discussion which I can remember round the Chancellor's table on really difficult and troublesome and controversial matters my impression is that the Governor would often bring along perhaps three advisers, people dealing with particular subjects under him, and I have never heard it suggested that there was any limitation in this respect which made difficulties for the Chancellor.

12602. *Chairman*: It has been suggested more than once to us that in effect the Chancellor gets from the Bank one point of view presented by the Governor. From your experience how much foundation is there in that?——It is easy to talk in a way which would give the impression that serious differences of view were always arising. That is not so. But I do recollect over ten years perhaps three or four occasions on which there were serious divergences of views on important questions. My recollection is that on such occasions the Governor would come along and say: "This is a very difficult question. There are two possible views. We have had great discussions in the Bank about this; one view is this, and one view is that. On the whole we have come to the conclusion that this view is the better because it gets over this or that difficulty."

12603. *Sir Oliver Franks*: The weight of what has been said to us is that the situation which you have been describing has broadly obtained on the foreign side when problems of the overseas aspects of sterling were being discussed. It does not seem to me that it is true, on the evidence that we have received, in the same degree in relation to Bank Rate, where the impression left on my mind by witnesses is that it is much more actively the case that the Governor, alone or accompanied by the Deputy Governor, sees the Chancellor, and probably sees the Permanent Secretary either on the way in or on the way out, or occasionally with the Chancellor, and that the round-the-table discussion which you have been describing occurs seldom, or not at all. If we distinguish between the different types of question which fall to be worked out between the Bank and the Treasury, is there anything in this difference?——I would have thought that discussions with the Chancellor at the head of the table and the Bank and the Treasury round the table were certainly not limited to overseas questions, but covered internal financial policy as well. So far as intra-Bank views are concerned I cannot answer, but the occasions that I remember where we have discussed views in terms of what has been thought within the Bank are certainly more frequent on the overseas side. Perhaps that is because the overseas side was the most critical and the most troublesome in the ten years that I was concerned with.

12604. *Chairman*: Would there be anything contrary to tradition or precedent in a Chancellor saying to the Governor: "I would like you to bring along to my discussion A, B and C from the Bank"?——I have never heard it suggested that he was deprived in any way from getting a fully synoptic view.

12605. *Professor Cairncross*: If he wanted a memorandum from the Bank before making up his mind on any issue he would only have to ask for it?——Certainly; the view which I gather has been expressed that the Bank does not express itself in writing is not true. They submit a good deal in writing nowadays. That view goes back to a much older tradition. There was a difference thirty years ago, and it may be that some people think that it still exists, but it really does not now.

12606. Would you say that it was as easy to get statistics from the Bank as it is from Government departments?——There again there has been a considerable change. Ten or fifteen years ago it was very difficult to get comprehensive figures out of the Bank, but the statistical organisation has been very greatly improved, and they now have very good figures at the Bank. There is certainly very close contact between the Treasury statisticians and the Bank of England statisticians.

12607. You mention in your memorandum that the Bank have appointed a number of economists and statisticians to their staff in recent years. Do you see some virtue in an interchange between the Treasury and the Bank at that level?——Yes, I think there might be. As a former Permanent Secretary to the Treasury I would see no objection to it. How well it would fit in with the Bank's arrangements I cannot say.

12608. *Chairman*: Are there difficulties from the point of view of the terms of staff conditions and remuneration?——I do not know. I would have thought that it could be managed, but one is always rather hesitant to say that a thing could be done without knowing precisely what would be involved.

12609. *Sir John Woods*: Would you see in principle any advantage or disadvantage in an interchange of staff, not of the economic and statistical kind, but administrative?——I am not sure what the answer to that is.

12610. *Lord Harcourt*: Is the word "administrative" right in that context? Surely one is either on the advisory or statistical or economic side of the Bank, or on the operational side. Can one look forward to an interchange of people from the Treasury who have been used to economic advice taking over an operational function in the Bank of England?——That may be a difficulty. One has also to consider what is the ultimate aim for the set-up and the relationship between the Treasury and the Bank of England.

12611. *Mr. Jones*: In your paper you stress the difference between the Bank of England and Treasury officials in methods of training and experience. You do not say anything at all about general recruitment. Have you any views on recruitment to the Bank?——I have never thought very much about that. That is a responsibility of the Governor of the Bank. They seem to me to be very successful in getting very good people.

12612. *Professor Sayers*: Do you attach importance to the Bank having an income of its own, set aside from the general flow into the Exchequer, the spending of which on the staff and buildings and so on is entirely within the discretion of the Bank?——I do not see any reason why the present system should be changed.

12613. *Professor Cairncross*: I would like to ask you about different aspects of monetary policy, and the distribution of functions between the Treasury and the Bank in each. If you take debt management, there is a general presumption that it is essentially the field of the Treasury. If you take foreign exchange policy, and to some extent transactions, again there have been periods at least where the Treasury did not merely lay down the general lines of policy but had a hand in the operations. If you are taking Bank Rate changes, these are commonly assumed to be within the competence of the Bank of England. These may be distinctions that really have no practical force. Is there any difference between these three areas of policy in respect of the emphasis on Treasury responsibility?——I would have thought the difference was rather less than I would have gathered from your question. On debt management, general policy is discussed fully and frequently between the Bank of England and the Treasury, but the management of the actual operations, and indeed the feasibility of particular operations, to carry it out are obviously a matter for the Bank to advise on. I would have thought that really all three matters were in very much the same position, that they require a great deal of technical knowledge and experience to work them out, but that in all three the Government must have the last word. The Treasury obviously come into discussing all three matters.

12614. I wonder if the difference is not perhaps greater than you have suggested. If you take debt management operations, surely each major change and each major operation reflects Treasury policy and reflects Treasury decisions. If you take the foreign exchange controls was there not a time when the Exchange Equalisation Account operations were directly a Treasury function?——I have no personal knowledge myself of any period when that happened. If you are thinking of the early days of the Exchange Equalisation Account I would have thought that

all the day-to-day work must have been done in the Bank, and that the Treasury only really came in on big transfers from one account to the other, and that kind of matter.

12615. You do not believe that there has been any change there?——I do not know exactly what happened before the second world war, so that I cannot say that I do not believe there is any change. I am saying that I would not personally draw any very big distinction between debt management, foreign exchange and Bank Rate, as to the extent to which the Treasury and the Bank of England were concerned in each of those three matters.

12616. *Chairman*: It has been put to us rather formally that in some respects, such as management of the Exchange Equalisation Account and the control of foreign exchange, the Bank acts as agent for the Treasury, and in other respects, such as management of the Issue Department portfolio and questions about Bank Rate, it has independent jurisdiction, subject to the Chancellor's overriding authority. Do you see any validity in the distinction between operations in those two fields?——I am at a disadvantage on this because none of my pre-war service in the Treasury was on the purely financial side. I never came into these questions until I became Permanent Secretary in 1945, and I have not therefore the detailed knowledge which one ought to have to answer that question. Personally I would not have thought, looking at it in the broadest way, that there was very much validity in the difference between those two branches.

12617. *Sir John Woods*: It has been put to us that in the operations we have been describing in the one case the initiative rested with the Treasury and in the other case with the Bank. In relation to the Bank Rate the Bank seems to regard itself as being the initiating body, although of course it would not regard itself as independent in any sense?——Yes, but I do not think that any of these things are final and absolute. I can remember on one occasion in a serious crisis telling the Governor of the Bank of England that it looked as though the Government would be working up to a White Paper with a whole bundle of measures on a certain date, and saying that no doubt he would be thinking about the monetary side, which no doubt he was doing already; I do not know whether you could regard that as taking the initiative. I do not think that there is an absolute distinction.

12618. *Chairman*: I realise that your hypothesis is not that the best relationship between the Bank and the Treasury is that the Bank should be as near a Government department as possible; but, supposing that one was trying to achieve that, I would like to get your help on some of the practical consequences. One would have to consider, I suppose, whether the Governor's position would be something like that of a junior Minister. Would you envisage him as merely being a Secretary in the civil service under the Chancellor, or having some access to the Cabinet or the Prime Minister, as he has today to the Prime Minister on his own?——It is a new idea to me. I do not think that the junior Minister cap fits; on this hypothesis either he is a Minister or he is a very senior civil servant. Of course I do not like either; I think that the difficulties which this sort of situation presents show how awkward the whole thing would become.

12619. I want your help, because you have unrivalled experience, in what the difficulties would be if you made the hypothesis. What would become of the home finance division of the Treasury? Would there be a place for it still to do the same kind of critical and general survey work that it does today?——This really wants more thinking out than I have given to it; but I think that, if the Bank of England was made a Government department, there would be a case for saying that they should have complete control under the Chancellor of certain things which are now handled between the Treasury and the Bank of England. But this is a snap answer to a very awkward, even if somewhat unreal, question.

12620. You see advantage in the amount of duplication which goes on, with the home finance and overseas finance divisions of the Treasury overlapping to some extent with the Bank of England?——Yes. It is a question of trying to marry up two different points of view. One can call it overlapping, but they have to be married up somehow, and this system, which appears to involve a little overlapping, is in practice a very good way of marrying them up.

12621. *Lord Harcourt*: May not those two points of view be complementary to each other on frequent occasions?——They frequently are. In discussion of this kind one is naturally asked about occasions on which there appears to be a difference of view, but of course in most cases they are complementary.

12622. *Professor Cairncross*: If the Chancellor were trying to make up his mind whether the time had come to be a little less restrictive of demand, or to induce the private sector to spend more freely, whom would he consult on those occasions? The Treasury would be involved, and the Bank of England; would any other Government departments come into the discussion?——The Board of Trade probably would.

12623. Would he have a standing committee to advise him on that kind of issue, or would he be merely depend on specific bits of advice from different sources?——A separate standing committee for each subject would complicate things too much. I think that people in Whitehall are sufficiently alert and flexible to get hold of the right people without having a standing committee.

12624. Some of the departments would expect to be consulted and others not. The Board of Trade, you say, probably would; would the Ministry of Labour normally enter into these discussions?——If it was a question of what particular classes of expenditure to stimulate to deal with particular classes of labour I would think that they would come into it; but I would not have thought that they came into it as much as the Board of Trade.

12625. Suppose that the Chancellor is trying to come to a conclusion about the size of budget surplus or deficit he ought to work to in the ensuing year. Naturally he makes up his own mind; but would he take advice from sources outside the Treasury before deciding on that kind of matter? Would the Bank of England have any standing, for instance, in advising him?——It would be for the Treasury, or those officials in the Treasury who were advising the Chancellor on the Budget, to collect broadly based information from a number of sources, including no doubt the Bank of England and the Board of Trade, on a matter of that kind. One wants to be careful before one implies what consultations the Chancellor himself would have personally before framing the Budget; that becomes rather a delicate question.

12626. *Sir John Woods*: My recollection is that the Bank of England were not represented in the preliminary discussions of officials about possible Budget proposals?——No, they were not.

12627. *Professor Cairncross*: Monetary policy deals in the last resort with the level of demand, but monetary policy is only one instrument for controlling the level of demand, and it may therefore be important to have a regular review of how monetary policy is pulling in relation to the other instruments that affect demand, one of which is certainly the size of the budget surplus or deficit. Are there any standing arrangements for ensuring coordination of views on demand, or was this simply dealt with from time to time as the occasion arose?——You make this question much more difficult to answer by tying it up to the Budget with its special and peculiar secrecies. The point you make is one which is well understood by Whitehall and it is taken into account, but I do not myself know of any standing committee precisely for that purpose.

12628. I was trying to divorce the question from the details of the Budget by limiting it to its association with one single magnitude in the Budget, namely, the eventual surplus at which the Chancellor was aiming, which would mean the disclosure of none of the secrets of the Budget whatever?——You know as well as I do the whole flotilla of White Papers about the financial and economic situation which appears about the time of the Budget, with a good deal of information on demand gathered by economists and statisticians from the widest possible number of sources. Does not that answer your question?

12629. To some extent it does, though I think that the group who prepare the Economic Survey, for instance, would be a lower level group than the people I was thinking of as coming together to discuss what should be done, who would certainly include the Governor of the Bank of England?——I do not think that I can pursue this further; I find it a little awkward.

12630. May I ask you about the position of the Governor himself? He is at present appointed for a period of five years, but in practice the Governor has

in the last generation normally occupied his post for a longer period. Do you think that it would be a useful change to appoint the Governor for life or until some given date?——No. A period of five years can always be prolonged. I do not like the idea of appointing anybody to any job for life. Obviously there comes a point when there should be a change. I would have thought, not speaking specifically about the Governor's post but about any post of this kind where the rest of the board rotates, that a possibility of re-appointment for a further period of five years was a very good arrangement.

12631. *Mr. Woodcock*: In paragraph 15 you say at the end that there are certain respects in which alterations have already been made and in which further progress should now be possible. Is all that you have in mind in that sentence covered in paragraphs 16 and 17?——Yes, I think it is. There is generally a feeling that the relationship between the two has strengthened, has become easier and better understood. I have not any other specific things in mind.

12632. *Sir Oliver Franks*: I would like to go back to the position of the Bank of England in relation to that of a Government department, because this is something on which very different points of view have been put to us on a number of occasions. Nearly everyone who has given evidence to us has assumed that on matters of broad economic policy and therefore on matters of broad monetary policy the Government must decide. This is a change from the nineteenth century. But after that some of our witnesses have said that the nearer the carrying out of broad economic policy and monetary policy is the same the better, and that the Bank of England should therefore be as much like a Government department as possible. People who say that are apt to qualify it a little by saying that there are certain important historical traditions which give the Governor a position in the City and abroad, that these historical traditions are not lightly to be cast away, and that this is why one should say that the Bank should be as nearly as possible rather than the same as a Government department. On the other hand, there are people who, while saying that in the end the Bank of England nowadays is not and should not be independent of the Government in any of its major activities, nevertheless say that it should occupy a position which is rather different from that of a Government department. On this side of the argument the case put before us includes the obvious consideration that nowadays fiscal policy, physical controls and monetary policies may all be alternative ways of getting to the same thing, and that therefore the Government must have a very considerable control over policy which goes further than just the broadest lines of policy if the Bank of England is to occupy its rightful place. So from the two points of view one comes in towards the middle. One point of view is trying to make the Bank of England as much like a Government department as possible; the other point of view is saying that it is important that it remains rather different. It is very difficult to be clear what are the considerations which incline one in one direction or the other. You have been quite clear as regards the position which you take up; can you help us any further with the reasons which lead you to that position?——Of course the foreign position is important; I imagine that that would be fairly generally agreed. So far as concerns making sure that Government policy is fully and completely carried out by the Bank of England I can see the point of arguing that the Bank ought not to be too unlike a Government department, particularly in the top levels which have to deal with policy. I think that there has come to be, to use the expression I use in the note, rather more common ground without losing the distinctive difference between the two organisations. I should have thought that that was about right. To get back to the reasons, I would have thought that from a broad point of view the Bank was more use to the Government if it was rather different from a Government department than if it was a Government department; it will have a better understanding with the financial community, and the fact of this slight degree of independence will enable the Government to have another body, or person, if you like, that can be used in furtherance of their policies and be more use to them than another Permanent Secretary. I think that we have something really valuable there, and that we should lose a great deal if we were to try to turn the Bank into a Government department. The difference between the two bodies is awfully hard to express, because all the words we use are in terms of either dependence or independence; what we want is a sort of half-way house, and my feeling is that that suits us better for internal reasons as well as for external reasons.

12633. Is it possible to get any argument which would support the position which you are putting before us by looking at the nature of the operations which a central bank necessarily carries out?——Yes, I think it is. Whatever may be the ultimate position, there is at the moment in this field a great deal of expertise and experience which is not awfully easy to express in terms of what a Government department does. I should have thought that a body of people who are as near as possible in physical location and in spirit and training to the people who carry out these financial operations is therefore of more advantage than a Government department.

12634. It would be more to the point to look at that characteristic of the Bank of England's operations than seek to divide its functions up into those which it carries out on its own responsibility and those for which it seeks the approval or agreement of the Treasury; you would say that agreement on broad policy is something which the Government must always see is effective?——Always.

12635. And therefore that distinction is not useful?——No, I do not think it is useful. I do not believe that we should get anywhere on that line at all.

12636. How much emphasis, if any, should be put on the traditional factor?——I think, if you come down to that, a great deal. If one may put it this way, I think the Bank of England (it is no secret) disliked the nationalisation Act quite a bit, although in fact I believe it made very little difference. Any further step which tended in the direction of making the Bank of England more like a Government department would go very strongly against the tradition; it would stir up a great deal of animosity, and would not help in getting rid of this strange view which is held about people who make their living in the City.

12637. Would you regard it as a condition of the position of the Bank being what you would like it to be that the flow of information from the Bank to the Treasury was full and complete, in the sense that the papers or the oral arguments which set out the position of the Bank should give the reasons and the opinions of the Bank which led to their conclusions as fully as those which are set out by the Treasury?——Yes.

12638. Whatever has been the position very recently, we have had a good deal of evidence which suggests to us that the degree of fullness with which the Bank's views are set out and argued in detail has not always been the same as that with which the Treasury view would be set out and argued in detail. Without asking you to place a view like that against particular periods, is this not a subject on which there has been a good deal of development over time?——Certainly. I would certainly not dissent from the view you put.

12639. And this development, given the central position of the Government nowadays, is very important if you are making any argument for detachment for the Bank? It would be an absolute condition that the flow of information was complete?——I quite agree.

12640. Therefore, if anybody wished to argue that the point of the Bank having a certain detachment was that it could keep its information to itself, that would be entirely wrong and against your view?——Certainly.

Chairman: Thank you very much indeed, Lord Bridges; you have helped us considerably.

(Adjourned until Thursday, 15th January, 1959, at 10.45 a.m.)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-SIXTH DAY

Thursday, 15th January, 1959

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
W. E. JONES, ESQ., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
GEORGE WOODCOCK, ESQ., C.B.E.
SIR JOHN WOODS, G.C.B., M.V.O.

MR. R. T. ARMSTRONG, *Secretary*

THE LORD PIERCY, C.B.E., Chairman, Industrial and Commercial Finance Corporation Ltd., called and examined.

12641. *Chairman*: We are very grateful to you for your excellent paper*, which we have in front of us and have had a chance of reading through first. It is one of those carefully argued papers that it is easiest to take through paragraph by paragraph. Your conclusion at the end of paragraph 11 is that the machinery of public issue is tending to become less and less available to the smaller industrial undertaking?——*Lord Piercy*: Yes; I think, and experienced people in the City think, that that is true. There are striking exceptions; for instance, there is the success of a concern called Neville Industrial Securities Ltd. in the last year or two in floating quite a lot of small companies in the Birmingham area. If that could be taken as typical, my conclusion would be wrong; but one always has these phenomena.

12642. They are local flotations in Birmingham?——In one or two cases with a London quotation, but substantially Birmingham flotations.

12643. Where you are contrasting this with some different situation in the past, where is the dividing line? Is it the gradual result of forces that began before the war?——The whole industrial issue market, to quite a degree, is a post-war development. In the thirties one or two people thought they had discovered a new line in floating small issues, and a lot of it was done; but for raising new money on issues, whether for large or small companies the minimum amount of issue likely to be successful has gone up since the war.

12644. *Professor Cairncross*: Would that not be the natural consequence of inflation?——It would be connected with inflation; but the real point is marketability.

12645. The Macmillan Committee thought that £200,000 was about the minimum for a public issue; that figure would currently be nearer £1mn.?——One could still comfortably float an issue of £200,000 or £300,000 in the thirties; one could float issues of £50,000, and my General Manager, Mr. Kinross, claims that he floated one or two of £30,000.

12646. *Chairman*: But the main cause for this tendency is the fact that the big source of investment is the large institutions, and that they have specialised requirements of which marketability is an important one?——Marketability is important; and of course the present-day race of investment managers know perfectly well what they are doing. It was rather the private investor who was attracted by these small issues. They had to be very attractive for any institution to take an interest.

12647. Then at the beginning of paragraph 14 you speak of the dying out of the private investor and his influence in this, and you say: "This problem can be approached by asking what facilities for financing investment are available to the small industrialist". You give us a list under five separate heads of possibilities. It would be fair to say that they are scattered and not organised in any picture he could put his hand on at any one moment?——Exactly.

12648. *Professor Cairncross*: Do you draw any distinction when you speak of the small industrialist between the man who is simply expanding and continuing to do what he has been doing, and the man who has got on to something quite new and is assuming risks of a different character? Is the second type of man worse placed?——The second type of man is very apt to be an inventor who has a notion or invention and then thinks that he ought to set up and manufacture and market it. Apart from his personal friends he would find it very difficult to get backing. A person like that who happens to be persuasive as well as ingenious can still often find someone in the City to back him for a few thousands; that is rather an odd feature of this business. But it will be more difficult for the second class of concern to raise money than any other class.

12649. The first class of man already in business and expecting to expand a successful business would be able to quote the profits he has been earning over the past few years and that would weigh a good deal with the various institutions you mentioned?——A very great deal. When a financier sees no profit record, or only a short profit record, he thinks two or three times before he does anything about it; whereas if he sees a profit record going back some time and reasonably solid, that greatly encourages him.

12650. Would you say that most of these institutions, particularly investment trusts, would be likely to insist on a profit record before they made a loan or took an interest?——Definitely. Investment trusts do not really like unquoted shares. The Drayton Group seem to have between £4mn. and £5mn. worth of unquoted securities, and a considerable proportion of that is the sort of stuff we do; but outside the Drayton Group not very much is done.

12651. *Chairman*: Are they enabled to do this work because they have some larger organisation at the centre enabling them to keep an eye on concerns in which they take an interest?——Apart from I.C.F.C. very few institutions have anything of that sort.

12652. *Professor Cairncross*: Are there particular insurance companies interested in the finance of small firms?——One or two; the United Kingdom Provident and, strangely enough, the Clerical, Medical and General, had a department that did it. Since I.C.F.C. have been in existence we have been able to lay off a certain amount with various institutions. Of course they then do it on our backs, knowing that we have money in it and are looking after it.

12653. *Professor Sayers*: In these cases you retain an interest?——We retain a majority interest; that is a condition of their coming in. But there are one or two, such as the United Kingdom Provident and the Clerical, Medical and General, doing it under their own steam.

12654. *Professor Cairncross*: Has this possibility of laying off developed in the last ten years?——Yes. We are rather inclined to lay off a bit of a larger proposition; on the whole that is not very favourably looked upon by some of our shareholders, but we do it.

* Memoranda of Evidence Part XIII No. 30.

12655. If you take the issuing houses which you mention in paragraph 14 (iv), would it be inevitable in those cases, if they were to be successful, for them eventually to float the issues in respect of companies in which they were interested?——Yes. The Charterhouse Industrial Development Company, which rather invented the terminology of "nursing" a small company for issue, lend money and take a bit of equity and see it along for a few years; but their horizon must be limited because their resources are somewhat limited. The Charterhouse business in our field, which today (as far as one can judge) runs into several millions, has been built up since about 1946. Before the war it was practically negligible, though the idea was there.

12656. Am I right in thinking that in some areas an issue house doing this may have great difficulty in providing the additional finance to float off the companies in which it is interested? It is not any use putting in just a little money; it may be necessary to put in a lot before the proposition can be marketed?——Yes, because if there is going to be an issue it must be a good issue, which means that the record needs to be rather pretty and the issue needs to be a certain size.

12657. This is really industrial banking of a certain kind?——Yes, except that that term has been appropriated by the hire purchase people.

12658. It is something developed in other countries much more than here; here it seems to be very limited in scale?——Yes. This has always been rather a rich country in the way of private individuals having surpluses, until the first world war at any rate, and it was not necessary for people to go to institutions. They used to be able to get money rather easily, but it has become progressively less easy.

12659. *Lord Harcourt*: Would it be fair to say that the countries in which the industrial development bank has really gone ahead are those countries with a relatively undeveloped capital market?——With a capital market with a different line of development from ours. There is a lot of it in Germany and Belgium and several other countries; but the tradition in Germany is that there has been a sort of symbiosis between banks and industry. Banks in fact provide much of industry's capital, and it is in the line of that development that they should develop institutions for small companies.

12660. But the new issue market as we understand it has always been comparatively under-developed in Germany; they have developed along different lines?——Yes. On the other hand there is the United States; you could hardly describe their issue market as under-developed, and yet there is a very big continuing effort to provide finance for small companies in various ways. At one time the Federal Reserve was doing some.

12661. *Sir John Woods*: One thinks of the Revolving Fund for Industry; but despite all the invitations it was difficult in fact to find applications which could possibly be regarded as credit-worthy to take up the money?——That is absolutely right, but in fairness to the Revolving Fund one ought to say that they were strictly limited as regards the duration of the loan; it did not suit everybody to take what they could offer.

12662. *Chairman*: What is the limiting period of loans from the Revolving Fund?——*Sir John Woods*: It began by being three years, but under pressure the Americans allowed us to go to five, and in very exceptional circumstances at long last we could go to seven. It would not be fair to generalise from that experience; but does not other evidence also tend to suggest that there is not a very large gap as far as credit-worthy borrowers go?——Yes. It is very striking that the figures of the Revolving Fund tend to agree with our own figures. We have received 6,000 applications and made 1,300 offers. That is a larger proportion than the Revolving Fund, but it is the same sort of picture.

12663. *Professor Cairncross*: Do you think that the average small businessman is familiar with the possibilities you sketch in paragraph 14? Do all the small businessmen who might come to I.C.F.C. know of its existence?——I think that the small man is not familiar with the opportunities; and, although one might think that his auditor would be more familiar and able to tell him, that is not generally true either.

12664. *Lord Harcourt*: How do most of your clients in the I.C.F.C. come to you? Are they brought to you by some adviser, such as their own accountant or bank manager?——Mostly by auditors, firms of chartered accountants, though a good many come direct.

12665. *Chairman*: It is a constant interest with I.C.F.C. to get its services more widely known in the country?——Yes. At the outset for many years we were shy of piling up expenses and the amount of advertising done was very little. Even today it is not large. We relied at the beginning very largely upon going about giving talks. I gave many addresses of that sort, and so did other people in the Corporation; we had a lot of notice in the Press, and accountants took a good deal of interest in us. But I think that we ought to have done more to make ourselves known, and we are stepping up our propaganda now.

12666. *Professor Cairncross*: Do you find substantial differences between different parts of the country in their resort to I.C.F.C. and the need for finance of this kind?——Rather little gets through to us in Scotland because the bankers intercept most of it. We have no complaint on that, of course. Otherwise I do not know that I have any special comment to make. We have become extremely well established in Birmingham where we seem to take people's fancy. We find it very difficult in Manchester. It partly depends on personalities; we sent a man whom we thought very enterprising to Leicester, but he had no success; another man made great business there, and Leicester is by now a small Birmingham. It rather turns on the selling.

12667. You do not think that a good deal depends also on industrial structure? You were discussing the Glasgow area, for instance, which I gather is probably pretty well supplied because there are relatively few requirements, whereas in Birmingham I should expect something different?——I entirely agree. There is a great deal of small and moderate sized industry in Birmingham, and much less of that in Scotland, even in Glasgow and areas round about it. That is perfectly true.

12668. *Professor Sayers*: The geographical spread of the banks and their financial connections with the small businessman would make them very natural points of contact, and you must have thought of the banks as being people who were very likely to bring a good deal of this business to you. Have they in fact done so?——We started with precisely the thought you mention; I think the first literary work I did in the first week or two was to draw up a leaflet that I hoped the banks would send round. One or two did send it to a limited number of branches. We have always found the banks a little sticky about that sort of thing. I think myself that, if there had been a ready co-operation on the part of the banking system locally, we should have done a good deal more business than we did; but you must appreciate that the banks among themselves are of course intensely competitive, and it is always possible to think that we may be treading on the borders of banking business. At the very beginning in consultation with one of my most experienced City directors, Lord Blackford, we invented the formula that we would compete with everyone but not the banks. We have stuck to that, but it is difficult to get that over on the other side. The position of the banks is therefore a little ambivalent. We have a good deal of business put up to us through the banks in certain regions, not much in other regions. We have discovered with rather a shock lately that there are a great many branch managers and bankers of that sort who do not recognise the name of I.C.F.C. or know what it is we do. We are now taking steps to remedy that. You may have noticed the new advertisement in *The Banker* last month. We are starting to carry our gospel to the practising banker.

12669. Do you think that the small business man would be better served if, instead of one I.C.F.C., there were a number of corporations run under individual banks or groups of banks?——The banks would not be good foster mothers for institutions of that sort. There was one in Northern Ireland; according to a former Minister of Finance the banks more or less smothered it. It might happen here, for reasons I have sketched. But one really wants an institution with large resources available, if there is going to be a general facility which will give

anybody money who has a reasonable claim for it, and not pick and choose something profitable to it. An institution has to have a pretty broad back to bear that; the small institution would not do much of it. We are now at the stage when we can back a £5,000, £10,000 or £20,000 proposition and say: "What is that in the wash?"; at the other end Mr. Clayton in Liverpool is saying: "I.C.F.C. is very remote in London, and even in Manchester; we want something of that sort in Liverpool." It is thought that South Wales needs something too. The answer to all that is our branches; perhaps we ought to have more branches.

12670. There seem to be two conflicting points here: first that in the interests of getting closer contact with the small business man one wants a very widely spread institution or number of institutions; on the other hand from the point of view of capacity to take the risks, one wants as big and widely spread an institution as possible?——Yes. A large part of the answer to that would be closer co-operation with the banks. I do not wish to underrate the degree of co-operation we do get. It is the bank's branch manager who knows the customer's account and his form and his business and so on.

12671. If one is looking at the possibility of banks doing more of this kind of business directly, there is very often, as you say, a reluctance on the part of the small man to getting into indebtedness to the bank for medium or long-term purposes. That seems to contrast rather with the comparative readiness of the small business man to take advantage of hire purchase facilities?——Hire purchase is rather a short-term thing; he is not going to take on one of these three or five year contracts and pay a large sum down unless he sees his way. The sort of thing we are talking about is more of the nature of longer term assistance in capitalising his business.

12672. Would it help at all if the banks were willing to have more explicit arrangements for repayments over periods, and to drop their pretence of the advance being repayable on demand?——If you take the term loan idea strictly, that is a big business one as known in America; but a term loan, with fixed repayments, would of course encourage people to borrow from the banks. At present if a business requires £100,000 for capital purposes and hopes to repay in seven years, they can only get an assurance from their bankers that they will do their utmost to continue the facilities without interruption. That is as far as the bank will go, but it is good enough for many people.

12673. Possibly if the banks would go further, and be more explicit in their willingness to wait for their money, the small business man would be more ready to borrow from the banks for longer term purposes?——I agree; but I feel in my bones there should be, and is, a limit to which the banks in practice will go in that direction, because of the overall question of liquidity. I admit that they are more devoted to it in theory than in practice but in practice it still is a consideration, I think.

12674. *Chairman*: You spoke just now of a certain ambivalence of the attitude of the banks towards I.C.F.C. I was not quite clear as to what you attributed this ambivalence of attitude to. You are the bankers' venture on the one hand; on the other they seem not very anxious that you should develop to your full possible potentialities?——It stems from two feelings. The main one is that, with or without justification, a great many bankers, including a number of general managers and even in my experience chief general managers, believe that somehow or other I.C.F.C. competes with them and from that point of view they rather dislike it. Coupled with that, I believe that it was with a certain reluctance the banking community in the City undertook this project, and many of those at the beginning remained believing that the whole thing was unnecessary and that it could not succeed. In that kind of way there was always an attitude that I.C.F.C. was a bit of a cuckoo in the nest.

12675. *Professor Cairncross*: May I put a point to you about the man who has an invention? From the social point of view any innovations carried out either by small or large firms are particularly important to countries like ours, more important perhaps than expansion of a firm doing what a larger firm may already be doing. You do not specifically single out this type of individual in your paper, but you did agree earlier that he had perhaps greater difficulty than most people in raising finance. Do you see anything that can be done for a man of that type, who has perhaps suffered more than others from the extinction of private backers, through I.C.F.C. or through other institutions? As I understand it an inventor would be unlikely to want to part with the equity, and would want a loan. At the same time he would have very little to offer by way of backing for the loan, and it would be necessary therefore to offer money that was at considerable risk, on terms that assumed that it would eventually be repaid. I do not suppose that your interest rates go very high; but do you feel that there may be a place for loans to persons in this position at rates above current level?——We have never done anything explicitly like that in I.C.F.C., because we have been rather forced into the good business in recent years; but I have often thought of it. At the present time we are taking on whatever we can see; a lot of these small firms are starting up in the electronic field. We have backed a few inventions, some on a large scale, some on a small scale, and I would hesitate to say how it has come out on balance. We have burned our fingers on one or two occasions.

12676. *Sir John Woods*: Is not one of the difficulties evaluating the invention?——Yes. D.S.I.R. have given us a good deal of help, and the N.R.D.C. has always been good: but it is difficult. On the whole when we have found an inventor with something that seemed (*a*) to be developed and (*b*) to look good, we have tried to steer him into some friendly bosom where there were facilities.

12677. A financial institution really wants some other body between it and the inventor to make the technical evaluation?——I agree entirely. We have taken what advice we could; Lord Halsbury of the N.R.D.C. amongst others has been extremely helpful.

12678. *Professor Cairncross*: Would you, or other financial institutions, be disposed to make loans in such circumstances if it were possible to lay off part of the risk with some central institution which would, for a commission, accept the risks and stand part of any total loss that resulted, and if at the same time that central institution had at its disposal the technical advisory services to assist you in judging whether the invention were one with real prospects or one not meriting further consideration?——The N.R.D.C. answers that to a certain extent, although their emphasis is on development. We are always on the look out for something we can do in collaboration with them. At one time we had a lot of discussions about printed circuits when they were much less well known than now. We never actually succeeded in finding one, but I think the idea is good. My impression is that the N.R.D.C. in past years has done it in some instances. There was a project for using isotopes, which they laid off among three or four institutions, of whom we were one.

12679. N.R.D.C. are only presumably interested in inventions in which they themselves possess the rights. I am speaking of private inventors who may be rather sensitive about parting with their rights. I would not have thought therefore that would necessarily be the best institution to which to recommend a private inventor to look for further assistance on finance?——If some subsidiary organisation were set up under the D.S.I.R., staffed partly by them and partly by financial people, they could employ them in this way in backing a thing if there was suitable participation from the inventor and from other financiers. It would be worth gambling a million or half a million on that to see how it went.

12680. Is it your impression that the case I have been discussing is one that does arise commonly or that it would be very rare?——I should think it arises frequently. At one time I and another man set up a little company to do precisely this sort of thing. We saw a number of very ingenious things, but we did not manage to make a go of it. I withdrew at a certain stage; my partner went on a bit further but he eventually had to close it down. It is a difficult field. But a central body of some kind, that had people on it really qualified to judge these things, including one or two industrial people on it, might have something to be said for it. Even if it only got one or two inventions a year which would otherwise be lost, it would be very well worth the money.

12681. *Mr. Jones*: Do you consider that you have been provided with the capital required to do the job you were

called upon to do by the instrument of 1944, and have been doing since? As I understand what you say in the paper, there is room for the Corporation to have a good deal more money at their disposal. Is that so?——Yes, I think that is broadly the position, one of the reasons being that inflation has raised the cost of capital equipment and building so much that £45 mn. is a very much less significant sum today than in 1944.

12682. Suppose that you have applications for loan capital which greatly outstrip your capacity to meet those applications, though they may be good and very desirable loan applications; have you any policy in relation to the proportion of the amounts required that you will lend, say a tenth or half of the amount applied for? What sort of situation would he remaining to the small firm in consequence of what you are able to do? In other words, are there occasions when, because of the size of the problem and the limitation of funds, you are not able to fill the gap?——On the broad point as you have stated it, yes. As regards these applications we cannot do, we are of course frequently slicing down applications. I was looking at one yesterday which began at £90,000 and is ending at £45,000. But that is a case of a project that can be rearranged. Broadly speaking we cannot do any good, as a rule, by providing one-tenth of the amount for a particular project. It is no good, if an extension to a factory costs £25,000, to offer £5,000. They would go to the banks for that sort of thing, not to us. What we have tried to do in the past is, when we have had a suitable proposition and our funds were tight, as they have been for some years, to put it in a form in which we can interest some insurance company to take a part of it. Sometimes we have been able to make suggestions which put it in another form and another context. We quite commonly say: "If you make an issue to shareholders we will under-write it and find ourselves 30 or 40 per cent. of it". But we have had to pass by a good deal of business rather on the lines of taking the better and leaving the worse, which is not really very good practice.

12683. If you were able to borrow double the amount of capital you are using now, are there small businesses in the country applying for loans where you would be prepared to make investments rather than provide loan capital?——We make investments extensively. I think that we should be embarrassed if our capital went up to £90 mn. or £100 mn. at once; but instead of lending £2½ mn. or £3½ mn. a year net we could, if we were allowed to spread our wings a little, lend £5 mn. a year net or something like that with great ease.

12684. Are you ever in a position where you have to withdraw funds?——No; but we have our funds upon the basis that they revolve. Loans are always being repaid; even in the share division money comes back.

12685. *Professor Cairncross*: Is there anything that specifically prevents you at present from making an issue to raise more money?—*Chairman*: You say in paragraph 19 (iii):

"The Corporation's resources are to be provided entirely by the shareholders. The Corporation is not allowed to borrow in other directions nor to accept deposits."

and again in Appendix 2, which is your founding charter, so to speak:

"The sponsoring and subscribing bankers deem it essential that the new Company should remain unable, in the legal exercise of its borrowing powers, to borrow money upon the strength of, or the security provided by—

(*a*) the association of the Company with,

(*b*) the paid-up capital provided by,

(*c*) the uncalled capital liabilities of

the subscribing banks. Accordingly the Company is, by the Capital Memorandum and Articles prohibited from exercising borrowing powers other than by means of loans and advances obtained from subscribing banks pro rata to their shareholdings."

——Those were perfectly proper conditions so long as we had £45 mn. in front of us and the banks were willing to lend freely; the point only arises when the time comes that the banks feel the thing has grown so large that it has become rather a burden to them and they do not want to provide more money. Since this paper was written many bankers have rather come to the opinion that it would be sensible at this stage for the Corporation to borrow money from the market if it can, thereby relieving the burden on them. The only difficulty at the moment is that the rate is too high.

12686. Could you give us a firm statement that the banks' policy is not to prevent you going to the market? ——That is the banks' policy today.

12687. *Professor Sayers*: Have you asked the banks, since the credit squeeze was removed, to lend you more money?——Yes; I went to the Chairman of the Committee of London Clearing Bankers and said: "Now that the lid is off, I dare say you will be a bit easier with us", but he did not respond very eagerly. Since then they have gone into hire purchase.

12688. *Lord Harcourt*: Does this shortage of money in your corporation devolve in any way from the fact that you have been unable to turn over your investments at the speed you thought you would?——I was always rather dubious about turning them over fast, but the experience has really been very favourable. Of our invested funds of some £30 mn. odd we are getting anything from £2 mn. to £4 mn. back year by year.

12689. On loans and redeemable preference shares?——Yes. It is rather a remarkable rate of turnover. We are very pleased, and hope it will continue.

12690. But your objective must be presumably to look on yourselves as a revolving fund and not a permanent trust. You are there to get things moving and then relieve yourselves of it?——Yes. We must have a fairly large paying portfolio to defray our expenses and pay interest on capital, and we must be in a position where from time to time we can make some profits; otherwise we have nothing to wipe out the losses that we are bound to incur.

12691. *Professor Cairncross*: Do you make sales from your portfolio, or get participations when you make loans to particular companies?——Our portfolio is not one from which we can make sales. Although we have shares, they are usually issues to shareholders which have been under-written or preference shares which are quoted for death duty reasons or that sort of thing, which we cannot expect to be able to sell. Where there is a perfectly good £1 share yielding six or seven per cent, which is quoted on the Stock Exchange at 13s. 9d. to 16s. 3d., what can one do with that?

12692. What about when you lay off some of your loans and presumably shares with insurance companies? ——A large part of our holdings is redeemable preference shares, and an insurance company will not interest itself in that kind of security unless it is redeemable. Where we lay off part of a loan, the repayment terms would be the same as the portion we retain, usually about twenty years. That is fairly elastic; occasionally an insurance company will take something longer?

12693. On what scale is this done?——That is rather hard to say. In some years we may have laid off £1½ mn. to £2 mn.; perhaps that is putting it a little high. It is marginal.

12694. Do you do it currently as you make the loan? ——Yes.

12695. Do you never do it subsequently?——No. It would be very difficult, just as a practical matter, at a later stage. If some concern wants a large loan which is outside our field and goes to some other institution, and that institution says: "We would like to clear off this loan of I.C.F.C. which we see on your balance sheet", we might be paid out; but even that initially does not proceed from us. If we are laying off, we have to have some regard to the kind of terms and conditions which are acceptable to an insurance company, and they have definite ideas on that which vary from time to time. That is why it has to be done when the loan is being arranged.

12696. You take the initiative?——At that stage. If we have, say a £250,000 proposition, and we think that £200,000 of that is enough for us, we go to the insurance companies and say: "We are negotiating this and the terms are so and so; would you be interested in taking £50,000?" That is common practice.

12697. I am told that in some areas there is a greater difficulty in getting between £50,000 and £150,000 than outside that range. I would assume that, if a firm wanted, say, £150,000, you would be prepared to contemplate this as a joint loan?——Yes; but I do not want to make too much of this laying off. It is marginal; £1 mn. or £2 mn. a year is as much as we do.

12698. *Chairman*: The next point you raise on the difficulty of your position is in paragraph 19 (v):

"A view seems to have been taken by some bankers of late years that the loan part is not capital funds in any sense, but a banking advance, and in principle callable at short notice. As one banker put it recently, I.C.F.C. borrows short and lends long."

How far does that seriously trouble you?——It is more a pinprick than anything else, but it is very disconcerting to be asked, as we were in the autumn of 1955, whether we contemplated paying something back. At that moment we were trying to cut down our outstanding commitments.

12699. It not only reflects itself in a short term rate of interest but leads to suggestions?——I do not put the suggestions higher than a pinprick. The last time we had that sort of thing there was a suggestion that we might meet our current requirements by selling some of our holdings of securities; but I have explained to you how realistic that was. All that is rather a pinprick, but it is a good argumentative foundation for charging us current Bank Rate plus a half of one per cent. We were in a position recently of paying 7½ per cent. on £17 mn. of money. However we have taken all that in our stride.

12700. *Mr. Woodcock*: What is the spread of the rates you charge?——At any given moment the difference between the highest and lowest rates we charge is hardly one per cent.; more like a half.

12701. *Professor Cairncross*: Is that a deliberate decision that you should not have a wide spread of rates?——No. The policy is not to charge high rates. We are regulated very much by the rates of insurance companies; they are really the pace makers in all these rates on loans, particularly on property and things like that. We stick rather close to them. We go rather for the lower end of the market than the higher end as regards rates.

12702. Does it not mean that you take the rather better risks?——It all depends. In the last few years our funds have been somewhat limited and we have had to take the better risks. Broadly we know that we have to accept a certain amount of risk that is not very good, and our shoulders are pretty broad, at any rate for smaller amounts from £5,000 to £25,000.

12703. It has been suggested that you are sometimes inhibited from higher rates because you feel it might give rise to criticism in Parliament or elsewhere?——No. We have never really come under the attention of Parliament, certainly not in the matter of rates, or giving loans or not giving them.

12704. *Chairman*: Your third point of difficulty is in paragraph 19 (vii) where you indicate that the original limits about the range of financing have become rather unreal?——At the present time £200,000 is what you might call the official limit as between us and the banks, with a latitude up to £250,000. It is not really enough.

12705. *Sir John Woods*: Was the limit of £200,000 in any way related to the existence of F.C.I.?——No, I think that it really stems entirely from the Macmillan Report, where they thought issues of less than £200,000 were not really acceptable; that was rather converted into the proposition that anything from £200,000 upwards could be raised in the market. There was an idea that F.C.I. could begin where we left off, but that suggestion, I think, misconceives their business, which has always been medium term finance and bridging finance, with very little exception.

12706. *Professor Sayers*: The two Macmillan gaps did not really join each other?——No; and the first one has been very thoroughly stopped.

12707. *Professor Cairncross*: There is a gap between your upper limit and the lowest figure at which it would be possible or economical to float an issue on the Stock Exchange?——Yes; there is a region where we could profitably operate if we did not always have to be looking over our shoulder.

12708. *Mr. Woodcock*: Where would you put the limit yourself, at the moment?——We should very seldom want to go up to more than £300,000, and we should lay a part of that off. In 1946 or 1947 I thought I had arranged with the then Governor of the Bank that we could go up to a figure of £400,000; but of course he was not the authority on that, and in the long run I found that the bankers rather preferred us to stick to the original £200,000. If we had not got this definite ceiling every now and then we should be doing something which was not right for the issue market, for £300,000 or £400,000, and the odds are we should then lay off a bit. We could do that without trenching very much on business which is easily done in the City.

12709. This limit applies even if you do lay off at the time?——Yes. The suggestion is that we should never entertain any proposition where the requirements are above £200,000. I think that this is, at any rate nowadays, quite unduly restrictive.

12710. *Chairman*: You say in paragraph 20 (iv):

"The fact is that there is the greatest possible repugnance on the part of the smaller and medium sized concerns towards parting with any share of the equity."

That is a well-known difficulty. Could you enlarge upon your views about that? Is this reluctance always justified?——I think that it is nonsense; if a company that wants to expand gets a financial institution as an interested partner it makes it so much easier to go on getting further money. Then of course there is the point that in the long run it is probably to the shareholders' advantage from the point of view of death duties and so forth. But the fact stated there is a noted fact. In the early days when at last we got it agreed in principle that we should have a little bit of equity, we were always asked to name the terms on which we would lend the other shares. That has not appeared in recent years.

12711. *Professor Cairncross*: Do you find that the head of a rapidly growing small business is an entirely normal and rational person? Does one not have to be a little abnormal nowadays to run a business of that kind?——A man has to have a lot of character to build a business nowadays, and to that extent he might be a little onesided, but not so as to make him a bad businessman, or else of course he would not succeed; nor, nowadays, to the extent that would prevent him getting on with his work people and so forth.

12712. But perhaps a little sensitive about parting with rights in a business he is building up himself?——Yes. We do not push this very far. There are a few people in the City who insist on business of this kind, taking a little pinch of the equity and putting a director on the board. We have never gone for either of those things; we are there to help things along, and we try to take a broad-minded view.

12713. *Chairman*: In paragraph 20 (v) you mention your branches; you did say earlier that you thought it would be a good policy if you increased the number of your branches?——Yes. One of the difficulties is finding the people who can run a branch successfully; but certainly we want to increase the number of our branches.

12714. *Professor Cairncross*: In paragraph 20 (vi) you speak of your investigations. You must find, I take it, that it is quite expensive to investigate some of these businesses in relation to the ultimate earnings you make on loans to them?——Yes. Loans of £5,000, £10,000 and £15,000 cannot pay us, but they are part of our business and we do as many as we can.

12715. Do you in those cases recommend a borrower to make use of hire purchase, which presumably economises waste of this description?——I cannot say we do, because we regard hire purchase as extremely expensive. In recent years we have sometimes contemplated placing loans upon an instalment basis rather like hire purchase, thinking that in a context like a development area it would be much better security, but basing it on low rates instead of high rates. On the other hand, we do not necessarily grab every business that comes along. We very often find ourselves steering businesses in other directions; but not very much towards hire purchase.

12716. Do you make a charge to the borrower for the cost of the investigations?——Not specifically.

Originally we did not make any charges at all; now when the business is accepted we make a charge of about one per cent. which covers everything except the borrower's own legal expenses.

12717. *Professor Sayers*: When you deliberately take on these small propositions, knowing that they cannot pay after taking into account the cost of investigation, the *rationale* of your decision, I suppose, is that among them there will be some winners who will grow?——I do not know that we are very consciously swayed by that, although it does sometimes turn out like that. It is rather the feeling that, if there is a need for money which they cannot raise conveniently elsewhere and there is a case for them having the money, then we ought to provide it. Of course, a loan from us of £5,000 or £10,000 makes a concern happier and in turn enables them to get more facilities from the bank. So that in that way we are probably doing more than £5,000 worth of good in loaning £5,000.

12718. The loss you take on it is justified by the fact that you are preserving in good running order a concern that is socially worth preserving?——Yes. Our criteria in social worthiness would be, on the one hand, whether it does show some capacity for making a reasonable profit, having regard to its circumstances, and secondly, whether it is a reasonably decent, well laid out show and the people running it are the sort of people who ought to get a chance of that kind. If I had a philosophy on the subject, it would be that lots of men can be socially extremely useful as leaders in a small company who would not find a comparably suitable niche in larger industries.

12719. *Sir Reginald Verdon Smith*: If a small concern is wanting to develop its business to some extent overseas, such as having a small branch which may be an assembly or manufacturing branch somewhere overseas, would you regard a loan for that purpose as within your compass?——Certainly, so long as the main part of their business is established in this country. I must say that we rather dread it when people want to start up a branch in South Africa or Canada because those ventures so often fail, but it would be entirely within our province.

12720. *Chairman*: Then you give us the financial results in paragraph 21, concluding:

> "it may be broadly stated that the Corporation over most of its history has been operating with a restricted flow of means, and to that extent the aggregate amount of business done could have been greater."

So credit-worthy applicants have been sent away?——Yes. We have selected rather more vigorously on the whole.

12721. Then you go on to the present situation: the feeling on the part of the banks

> "that the undertaking to provide the funds was burdensome, which showed itself early (1948) and in recent years has been a matter of difficulty for the Corporation, and has restricted the amount that could be done".

The point you make at the end of paragraph 22 has to some extent disappeared in view of what you have told us?——Yes. We should like very much to do the things that the T.U.C.'s memorandum of evidence to your Committee sets out.* We should like to have a larger limit. We should like to feel ourselves free to float some issues of our own companies and a few things like that.

12722. *Professor Cairncross*: You refer in paragraph 23 to the Estate Duties Investment Trust. There is a general impression that this has not been as successful as might have been hoped. Do you feel that this is expanding satisfactorily?——Yes, in a modest kind of way. There are two other companies who have started in part to do the same thing, and we have left them a long way behind. I do not know that the business has not built up more quickly. At the moment our portfolio is close on £2¾ mn. When we first started the head of the Trustee Department of one of the big five clearing banks told me that his bank was full of loans to executors which they could not shift, and that "Edith" would be a great boon. But I do not think that we have had more than three cases from Trustee Departments of banks since we started, so evidently they like these loans. Another point is that individual holdings in these cases are small; we do not get larger business offered to us. There is another point which does not appear here, that besides this £2,390,000 that we had on our book last March we must have placed considerably more than that with insurance companies. If there is a preference share on the whole we would rather pass it to our shareholders than hold it ourselves: the equity holdings are more remunerative for us.

12723. But substantially small companies continue to be wound up on the death of the proprietor?——Yes.

12724. *Chairman*: Then we come in paragraph 31 to the specific questions which we asked you to consider.—*Professor Cairncross*: On the second question, what profit record do you regard as a satisfactory demonstration of creditworthiness? I have heard it said that you ask for seven or ten years' accounts?——We always ask for seven or ten years' accounts so that we can see what has been done, but whether we do the business or not would not depend on the profit record. It would be an initial factor, but if it is something that is healthy-looking and interesting we go and see the factory and people and we investigate the business and so on. That is only one criterion among many.

12725. *Sir John Woods*: I take it you would be influenced by the view you took of the quality of the management?——That is quite right. We are really investing in flesh and blood. Other things are important, but they are not really what the future rests on. We are not like an investment trust which can throw out an investment it does not like, even if at a bad price; we are married to the account we take on.

12726. *Chairman*: Unless there are other questions from members of the Committee on this paper, I would like to ask you whether you could give us any views based on your experience in connection with the set-up of the Bank of England. I know that it is a subject which you have in mind because I was able to mention it to you some time ago. What years were you yourself a director?——From 1946 to 1956.

12727. In the years when you were a part-time director how far did you find it possible to make a contribution to what you regarded as the activities of central banking?——For seven or eight of those ten years I was a member of the Committee of Treasury where these matters are discussed. If I had simply been a member of the Court I should have said none at all, except that I might have been called in as a City director for special consultation with the Governor. That might happen once in a couple of years or something like that; not very often. It is more likely to happen in difficult times, of course. On the Committee of Treasury these problems were discussed rather more fully, and we were kept apprised of what the Governor had been saying and doing.

12728. The general atmosphere would be that the members of the Court, in so far as they do not belong to the Committee of Treasury, are in the position of accepting the recommendations of the Governor supported by the Committee of Treasury?——Yes.

12729. *Professor Cairncross*: Would you say that the duties of a part-time director would be very different if no part-time director sat on the Committee of Treasury, and it consisted entirely of the Governors and executive directors?——Yes. The part-time director would not then be in any regular or very close contact with what might be going on as a matter of discussion. The only way in which he would be brought into anything that was happening or likely to happen would be if he were invited, as sometimes happens, by the Governor. The Governor would ask the so-called City directors to come and see him, not very often, but now and then; or he might think that somebody had special knowledge on some point, and he might invite him to go round and talk to him for a few minutes. The Governor and his staff are very skilled at maintaining contact with the members of the Court, and very punctilious in letting them know about things they ought to know about at the proper time. But the Court is not like a board of directors; it is really a highly formal body and its business is done in a formal way, and restricted to rather a limited set of topics as a general rule.

12730. *Mr. Jones*: Was it your experience as a member of the Committee of Treasury that that body was composed of the Governor, Deputy Governor and part-time directors of the Bank with no executive directors on it?——There is always at least one executive director.

* See Memorandum of Evidence, Part VII, No. 15, para 40.

Sir Kenneth Peppiatt sat on it at one time; so did Sir George Bolton.

12731. *Professor Sayers*: In the Committee of Treasury would you say that the really basic matters of central banking policy were discussed, and discussed in a way that influenced the decisions taken?——Yes, I think it would be fair to say that. It is not often the sort of active discussion that you and I and one or two friends might have if we were sitting round a table discussing these problems. It is pretty measured; there is always a certain degree of formality about all the proceedings of the Bank. The Governor, in my time, always took pains to explain the developments that were occurring when he felt that he was in a position to disclose that amount to us, and he would invite everyone to express his opinion; there was no ban on free discussion. To that extent members of the Committee of Treasury were associated with the policy decisions of the Bank.

12732. How long did the Committee of Treasury meetings usually last?——The Committee of Treasury meets on Wednesdays at 12.30 p.m. That was very awkward, as one might get away in time to keep a lunch appointment, but it might happen that one was kept there until 1.30 or 1.40 p.m.

12733. *Chairman*: Would you regard the Committee of Treasury work as that of being advisory to the Governor, or as really taking the decisions?——Advisory to the Governor. One could justly say that the Governor would attach weight to any opinions expressed by any member of the Committee of Treasury; I can imagine that if, say, the three part-time directors on the Committee took a very definite line the Governor would then think the matter over again. I have not known such a thing happen, but if it did happen, I am sure that the spirit of the thing is that the Governor would say: "As far as I have considered the question that is not quite the view here; let us take time to reflect on it a little more fully".

12734. *Mr. Woodcock*: Were the discussions on papers produced or on oral reports put to you?——On oral reports, certainly on these high matters of policy.

12735. You did not get a paper circulated in advance?——No; we did not get a paper of pros and cons as to whether it was time the Bank Rate should be put up or not, or on that class of question.

12736. *Professor Sayers*: Given the functions of the part-time directors as you have described them, have you any views on whether they are selected in the right way for these functions?——I should say that in my time they have been a useful body of men, providing the Governor with a few important points of contact in the City on which he had a right to call. We were, you might say, members of a family. The contacts of the Bank of England in the City are highly organised and extremely good, so there is no question of dependence solely on the knowledge and experience of the members of the Court. But it is extremely useful to have a body of men who belong to the place; even if they only turn up at Court, where the proceedings are rather formal, and are not on the Committee of Treasury they feel they have some stake in the place. There are several other committees in the Bank, such as St. Luke's Committee which runs the bank notes, the staff committee, and the investments committee. It is always arranged that the directors serve on one or more of these committees. They all knit into the ordinary organisation of the Bank to some extent. When I was a new director, like all other new directors, I had to make a tour of the departments of the Bank to get to know the people. Then there is a quarterly inspection of the staff, and any director who wishes can sit in on the quarterly inspection. Also, of course, a director has very free access to the Bank; if there is something he knows which he thinks is important he can see the Governor at short notice.

12737. You have spoken as if the Governor in drawing on advice and drawing on information from the directors was drawing on the City. Do you think that he was able to draw sufficiently on opinion and events in the country at large?——There are the branches of the Bank of England where they have direct local contact. All the directors in turn, including part-time directors, visit one or more branches in a year. They have a very good statistical and information department. I should think that, through the executive directors and branches of the Bank the Bank is well informed on conditions in the country.

12738. So you would say that the part-time directors do not need to provide this. I am wondering whether the part-time directors are superfluous. Do you think that the Bank would suffer from loss of contacts if there were no part-time directors?——I would not put it as high as that, but I think the Bank would be very sorry to lose the element of part-time directors with important connections outside

12739. *Professor Cairncross*: You appear to regard changes in the Bank Rate as being essentially for discussion in the Committee of Treasury. Presumably these were not discussed before 1951. Did you notice any particular difference in the type of discussion that took place before the use of the Bank Rate was revived and afterwards?——Before the use of the Bank Rate was revived and under the Governor of that time it might be thought that the Court had no function, because he took the line that these questions of broad economic policy were matters between the Governor and the Chancellor of the day and not really the business of the Court as such. I do not know that he was as communicative even in the Committee of Treasury as the present Governor. Since the use of the Bank Rate has been revived, it has been a staple topic from time to time in the Committee of Treasury, and the Governor has done what could be done within the limitations of secrecy to inform the Court. In particular, if a change of the Bank Rate was contemplated that day, he would make a careful statement of the reasons why the decision had been arrived at. Before the use of the Bank Rate was revived one of the directors who had paid a visit to America would be invited to make a little statement; or Sir Otto Niemeyer might have been to the B.I.S. or Sir George Bolton to France, and they would keep the Court informed on the international picture; but they were rather frills. The Court is still a highly formal affair, where the agenda is strictly limited and the proceedings on the whole short.

12740. *Professor Sayers*: On at least one occasion while you were a director the Bank Rate was changed on a Tuesday, not on a Thursday. Did the Committee of Treasury meet specially for the change, or did it meet simply on the Wednesday in the ordinary way and be told of the change?——I do not remember the precise detail, but they were told of the change before the change was actually made and the question of making a change on a Tuesday was discussed with the Committee of Treasury. The Governor has always been extremely punctilious in keeping contact with the members of the Committee of Treasury; if there was anything that was happening which they ought to know at once, he would telephone or send for them to go and see him.

12741. *Chairman*: Would you say that the Court of Directors as you have described it imposed any check upon the Governments wishes with regard to monetary policy?——No, I would not say that it does, except in this respect: where one is dealing with a very difficult set of operations where a great many factors can only be judged by experts and where every step is very responsible, then the operator must be expected to have views on policy and to put them forth with some degree of force. Of course, the Chancellor would be advised by highly skilled people in the Treasury, who know their text-books very well and can produce the answers, but they might not have a quite realistic feel of the factors which are operating; that arises out of experience and flair which intellect will not provide. They have plenty of intellect at the Treasury. Somebody might say that the Bank takes too dominant a position in framing the policy; or it might not be true at all, and the policy might be the result of all the streams of advice which the Chancellor receives. I cannot claim to have been to any extent on that edge of it; I do not think any director could be, except one or two executive directors who may have been privy to the sort of discussion that went on between the Chancellor and the Governor, which is very often a two-man discussion. But, while I believe that the Bank has been quite uninhibited in explaining its views, I would not have thought that the Bank has claimed or held or been able to obtain any undue position in the framing of policy. That is my view, although I know that on the political side there may be some other views. Of course, the Treasury may have views, and it may be that the view

differs with different divisions of the personnel of the Treasury.

12742. *Mr. Jones*: Could there be a circumstance where at a meeting of the Committee of Treasury the Governor made a recommendation for a change in Bank Rate and for the Committee of Treasury to discuss that and put forward a policy for something other than that which was recommended?——The Committee of Treasury is not executive in any sense; it is a very high ranking and responsible advisory committee to the Governor. You cannot put it higher than that. But theoretically it could happen; there is nothing to stop it in the manner in which the proceedings are conducted. The part-time directors might say that they did not agree, that they thought it a wrong policy. It is very unlikely to happen for two or three reasons. One is that these decisions are based upon a very complicated balance of factors, some of them not easily judged. I do not want to put that too high; but there is all the practical side and members of the Committee of Treasury would weigh that very well. They would attach a great deal of weight to the view of the decision as given by the Governor supported by the Deputy Governor and the executive director who might be there. It is my experience that the Governor would never come with a half-baked proposal; it would have been thought out and discussed inside the Bank and carefully studied. So although there is nothing to prevent it happening, it would be rather unlikely. If you ask me whether in those circumstances the Committee of Treasury really exercises any influence over the making of these decisions, I would say it does, in a rather undramatic way, over a period of years, play a part in ensuring that policy is carefully weighed.

12743. But in theory is not their position rather of approving decisions already taken, rather than influencing the taking of decisions?——That might be a fair statement. It depends a little upon the point at which one places the actual taking of the decision. The Governor might come to the Committee of Treasury when there might be action to be taken the next day or on the Thursday of the following week. He might not at that stage even have said decisively to the Chancellor: "This is what we think." He might have made up his own mind; but the Governor, in my experience, would consult the Committee or Treasury before the fatal decision was taken, before he tied himself up with the Chancellor. He might say to the Chancellor: "This is what I want to do, but I must put it to the Committee of Treasury."

12744. *Mr. Woodcock*: Then he would be discussing immediate circumstances, and what he should do this Thursday or next Thursday. Would he ever discuss with the Committee of Treasury what he would he likely to do six months hence if he did not do something now?——No, I do not think that discussions of policy are projected as far ahead as that. Indeed it would be difficult to do that about exchange problems.

12745. *Professor Sayers*: Between 1946 and the present there have been six major turns in domestic monetary policy. Of those, four were during the period when you were a director of the Bank. Would you say that on any of those four occasions the part-time directors made a serious contribution to the decision that was taken?——Yes, I would say so; at least in the way of throwing out some idea which was adopted.

12746. *Sir Oliver Franks*: If we say that decisions of policy are really about ends and therefore matters of judgment, and decisions about means are on the whole matters for experts, one can look at a decision on Bank Rate from either of those points of view. If one looks at it as being one of the ways in which a certain desirable state of the economy is to be produced, it is taken up into the ends and viewed as a decision of policy and matter for judgment. If one looks at it simply as a movement of the rate of interest affecting the market it becomes highly technical and very expert and a question of means without very great regard to the end. Would you say that the discussions which take place in the Committee of Treasury are on the whole of an expert character or of policy and judgment character?——I think that the ends are rather taken for granted. There is not much difference of opinion or discussion about the ends; they are really discussions on the technological side. There the non-expert members of the Committee of Treasury must to a large extent take their facts and their view of the situation from what they are told.

12747. It could be argued that the significant aspect of moving the Bank Rate is as a constituent of monetary policy and therefore its relation to the economy and the way in which the Government desires that the economy should be affected?——I should have thought that it was primarily a technological thing. The end being given, it then has to be decided if this particular means will proceed to that end. If the object is to reduce inflation, the question is whether putting up the Bank Rate will do something towards that. That is a technological point, surely, given agreement upon the policy to reduce inflation.

12748. If the ends of Government policy are harmonious then what you say is true. If the ends of Government policy are not necessarily harmonious they have to balance out opposing ends; then a decision, whether of monetary policy or of fiscal policy, cannot be simply technological; it imports into itself what I am calling a judgment of policy?——Take the question of putting a ceiling on advances, and the related question as to how the authorities will get the bankers to honour that, and make it practically and psychologically possible for them to observe it; I should have thought that was a technological question. Assuming that they want to reduce inflation and think that that has something to do with the volume of credit, then the question whether to rely simply upon the Bank Rate or whether to put a ceiling on bank advances, which is a form of direct intervention, is technological, I should have thought. On the whole my feeling is that in the Committee of Treasury in my day, perhaps owing to the great prestige of the Governor, there was considerable harmony in the ends to be attained, so that we listened to the technological exposition brought forward on the judgment we had to bear on this and either demurred or agreed or whatever it might be. But I do not want to exaggerate the influence of the Committee of Treasury. I merely conclude that I believe it a valuable instrument for the Governor; he can at any rate try it on the dog, on some experienced people with some sense of responsibility.

12749. *Professor Sayers*: You are satisfied it is the right dog?——Yes, I think on the whole the dog is all right. It is an "outside" dog to a large extent; that is what one wants. One does not want all these things to be excogitated inside.

12750. *Professor Cairncross*: You made some reference to the importance of the right feel and flair in the Bank of England in its handling of a day-to-day operations, and implied that the Treasury might be full of wild young men who had been trained on textbooks which were out of date. Did you not feel at times that in the Bank there might be an absence of speculative interest in possible turns of events which might not be immediately on the map?——Yes, I would think so. When I was a backroom boy on the discussions about the International Monetary Fund I used to think that the documents which came from the Bank were rather like that. But that is a long time ago, and the expert personnel of the Bank is very much more powerful and intelligent than it was in those days.

12751. Do you feel confident that, if a theoretical issue emerged about floating or fixed exchange rates, the Bank would he much more competent to argue the matter now than it was at an earlier stage?——Yes. There is Mr. Maurice Allen, who is no mean economist; I have no doubt that they get some enlightenment on that side. How much it penetrates is another thing.

12752. Would you feel that some reinforcement on that side might be useful to the Bank?——I think that it is strong enough nowadays, with Mr Allen there.

Chairman: Thank you very much Lord Piercy, for a very interesting morning. We have not raised any questions on your note about unit trusts, hut we are very grateful for the information you put in.

(The witness withdrew.)

(Adjourned until 2.15 p.m.)

SIR NUTCOMBE HUME, K.B.E., M.C., Chairman, Charterhouse Industrial Development Co. Ltd., called and examined.

12753. *Chairman*: Good afternoon, Sir Nutcombe. I sent you a list of the questions we wanted your views to centre around, and you have kindly let us have a note* which gives us the substance of your views. May we get clear the range of the activity of the Charterhouse Industrial Development Company? Your primary concern is in bringing businesses forward for public issue, although you may be related to them for a long time before that happens; is that right?——Yes. The Charterhouse Industrial Development Company was formed in 1934. Since 1925 I had been conducting an issuing house, and it was distressing to have to say to applicants for capital that they were not large enough and must go away and get the capital they wanted somebow else, and then perhaps come back in five years' time as an eligible client for an issuing house. That practical experience, plus the Macmillan Report, stimulated me and my colleagues into forming a company which might be called a kind of holding company, a greenhouse in which the more tender plants were allowed to grow under our supervision until they were big and sturdy enough to face a public issue.

12754. You would not be concerned with providing finance unless at the end of the story there would be a public flotation?——That was our belief when we started. In fact it has not panned out that way. There is still a number of concerns in the family party (if I may use the word we use amongst ourselves) that have been there for a long time and are unwilling to move out. Since we do not normally hold the control of these companies we can only exercise persuasion if we think some form of public flotation would be good for us and good for them; but, though it may sound boastful to say so, they are very happy where they are and we are very content with them. We have so organised our business that we can afford to go on holding these investments whilst providing them with the capital they need. There are now some ninety investments in the family party.

12755. Where do you draw your additional resources from in the way of capital?——We have worked the same principle from the start. Lloyds Bank and the Midland Bank are our bankers, and they are also shareholders in my company to a modest extent. We have had the happiest relations with them throughout, and an arrangement has gone on, for twenty-five years now, by which they place credits at our disposal which we use to the extent which we agree with them is right and proper. We have been successful up to date in making capital issues to fund the bank indebtedness, thus enabling us to *reculer pour mieux sauter*. We have gone through that operation five times.

12756. In the concerns you nurse, or which you find yourself ultimately making part of the family, have you any limits of size that you work to?——No. In fact the biggest individual investment that we have today is about £850,000.

12757. *Professor Cairncross*: And the smallest?——The smallest is a residue of our investment in the British School of Motoring of £3,000.

12758. *Professor Sayers*: What is the smallest initial investment you would make?——That has varied very greatly because of the changing value of money. Twenty-five years ago £10,000 seemed quite a formidable figure. Today the smallest we would willingly look at is between £25,000 and £50,000.

12759. *Sir Reginald Verdon Smith*: Why do you say "willingly"? What are the inhibitions against the small ones?——I have mentioned them in my paper. They are expensive; they cost more to service than we get out of them. We are not very receptive of an application for a small amount of money; none the less we examine it, and, if we come to the conclusion that it is an exception, then we will take it into the family party, even though it may be quite unrewarding for four or five years. If we really spot a good young man we are prepared to back him for a smaller sum.

12760. *Chairman*: The cost of the service is the initial cost of the investigation plus the cost of keeping an eye on the running of affairs and management?——Yes. We must attribute a certain amount of our own overhead to each investment, to cover the initial cost of the investigation and of maintaining contact. A man in our own employ sits on every one of these boards of directors; not the same man on every one, but a member of my staff, who gets no personal reward whatever from doing so.

12761. *Mr. Woodcock*: Is that a condition of making a loan?——Yes; but I would rather not have it described as a loan, because the great bulk of our money is not loaned. We would not make an investment in a company without introducing machinery for looking after that investment. Nearly all these companies are dependent very largely on one dominating personality. One can be wrong in one's judgment of that personality; personalities can change; illness, mortality, and everything else is a risk we run which is inseparable from this business. Unless we have a man on the board who is in close touch, and able to deal with a crisis before it develops, we can come some very nasty croppers.

12762. *Sir John Woods*: Do you find in many of these cases much degree of reluctance to join the family party either because you are taking an equity interest or because you insist on having a director on the board?——I do not think the director has ever caused us to fail to come to terms. There have been cases, but not many, in which the applicant has refused to part with any equity.

12763. *Mr. Jones*: Must it always be an equity interest? Do you never advance loan capital on the basis of a twenty year loan?——I am hesitant to accept the word "never". There are recorded cases where we hold preference shares only; but for all practical purposes the answer is that we must have an equity interest. We must have swings to look after roundabouts, and the only way we can conceivably make money is by having an equity interest and trying to spot winners, because there are losers, whether you like it or not.

12764. *Professor Cairncross*: What kind of record of profits do you normally insist on?——It is difficult to say. If you wanted a short answer I would say three to five years. We do not count ourselves as clever enough to judge good management until it is able to show some evidence of management. If a man were to say: "I have been the works manager of Rolls Royce for the last ten years; now I want to set up on my own and make a motor car", we should not accept that. That is not what we call a record. We must, by physical inspection by our own people, by engineers and accountants, be able to see some evidence of this management working as management. The actual record of trading results may be very patchy. There have been cases in which we have made an investment in a company which has roughly speaking done nothing but lose money, but the losses have been diminishing.

12765. You would not put money up because you were satisfied that you were dealing with a man who had real prospects of making a success of the company?——There has been one case only in which we have done that.

12766. You would normally expect that he had been in business for a time and had proved himself capable?——Not just "in business" in somebody else's employ, but in the business he is asking us to finance.

12767. If you were dealing with someone who had an invention, and had perhaps very little business experience, you would not be disposed to take him on on his own profession, but you would want to see how he had done in business, and in that particular business?——There is another answer to that question: our family party is now large enough for us to be able nearly always to find a niche into which to put a man of that kind; but that entails his consent to going in with somebody else.

12768. Do you not find reluctance on the part of an inventor to accept that?——We have remarkably little to do with inventors. It is quite extraordinary how few applications are from an inventor himself who has no more to offer than his invention.

* Memoranda of Evidence, Part XIII, No. 16.

12769. *Chairman*: Does he go to a big established concern?——I do not know; but I would say that on the whole he goes to the big organisations, who he knows will treat him fairly. Many of the great companies in this country have now such a reputation for fair dealing that a man can go to them with confidence.

12770. *Mr. Woodcock*: We have rather been given the impression that a lot of these people do not like to part with any part of their equity; but that is not your experience?——Not a large number; a small number refuse. They put up a bit of a fight nearly always, but in the end they see the reasonableness, and in fact the advantage to them, in bringing us in as a partner in the equity. It is a much greater incentive to us to stay with the business and go on helping it thereafter.

12771. *Professor Cairncross*: Suppose that you are dealing with a business which has made a success in one line, and is thinking of a new departure in a different line, and of setting up a subsidiary planned for the purpose; when you say you want to have proof of success in the line of business in which the interest is based, does that imply that a new company of that kind would not engage your support?——The support we would give in such cases would be canalised into the new company through the parent. Obviously if we have confidence in the management of that parent and they say: "We want to go into a new product", it is not for us to dissuade them from doing so; but if it is going to involve a lot of new capital we are probably the only source from which that money can come, and therefore we should have a careful look at it. But we have a predilection to agree with the management we are already backing.

12772. *Lord Harcourt*: You avoid taking control of these companies; you hold a minority interest; so I suppose that when you put the director on the board, apart from helping in the day-to-day management, probably his most important function is to try and secure a future management, in that if these companies are one-man companies one of his principal things is to see that there is a successor in view. Your real interest is building up management and seeing that there is continuity?——Our man does not take part in the daily management of these businesses. We reckon that one of our young men can sit on eight to ten of these boards and successfully do the job he is set to do, plus a certain amount of work in the office in going out and investigating new proposals as they come along. Subject to that I absolutely agree with what you said. We believe that management is the real asset we are looking for.

12773. *Professor Cairncross*: In the business of nursing companies to the point at which they can justifiably be floated, do you work in association with other financial institutions, insurance companies for instance, to develop a market in the shares that you want?——The issuing house, the Charterhouse Finance Corporation, is another member of the Charterhouse group. It may proceed by way of placing, introduction or offer for sale; many methods are open to it.

12774. What has been your experience of that market? Has it become progressively easier to float issues?——It has become progressively more difficult to unload small investments. When I first went into the City after the first world war an issue of £50,000 by public prospectus was not uncommon; today such a thing is impossible.

12775. If you correct for a change in the value of money, would you think an issue of £150,000 feasible?——It is very difficult to do it economically. It is very costly to sell shares by public prospectus. The placing of shares with institutional investors is an alternative, but they have not a great appetite for unmarketable shares; a quotation on the Stock Exchange does not always mean that a share is marketable.

12776. Do you think that the market for the unquoted share is growing?——Probably yes, because the funds at the disposal of these institutions are growing so quickly, and they have to find outlets.

12777. But not sufficiently rapidly to offset other contractions because of the diminishing interest of private investors?——No; and there is another difficulty. The institutional investor, such as the insurance company or the pension fund, has not the machinery for supervising his investments which we have set up by trial and error over the years. They may buy a redeemable preference share, provided that we go on retaining our equity interest and servicing the company as we do. That is an expression of faith in us, I suppose. The solution to this is, I think, that the corporations doing this kind of work should themselves issue capital in a form attractive to these big funds, so that there can be a continuing flow of capital into the corporations which they in turn deploy over these smaller investments. I believe that that is the right way to tackle it; it is in fact the way we have tackled it.

12778. *Chairman*: There are not many of you in this field?——No. Possibly the movement will grow as the years go on. We were alone in 1934; there are, I suppose, half a dozen institutions today, of which the Industrial and Commercial Finance Corporation is the biggest.

12779. When you are talking about the tests of creditworthiness, you say:

> "No one but the financier himself can make the decision and it can be claimed with certainty that the damage caused by a wrong decision—i.e. the provision of finance to an uncreditworthy borrower—is by no means confined to the loss of the capital involved".

What are you thinking about there?——I am thinking of placing fixed assets, in the shape of land, buildings, plant and machinery, and the lives and employment of workpeople in the hands of people who are not able to turn those assets and those employees to good account. The trail of wreckage that is left behind when a business goes to the wall is not confined to the loss of capital.

12780. *Professor Cairncross*: You would agree that the opposite situation can arise where someone might have a useful type of business to build up, and not be able to find the capital. The value of the business to society might be many times the profit to the person engaged in it?——I would agree with that, except that I contend that there are not many people with good business, or good prospects of business, walking about empty handed. I think that today they are sufficiently served by the capital market in some shape or form.

12781. *Sir Reginald Verdon Smith*: Do you find that you are actively canvassing and searching for new business, or that there is a pressure of demand upon you?——We find that we need to keep drawing attention to our existence by advertisement, and by the use of a little booklet which goes mainly to professional people. It is, on the whole, the professional adviser to the principal who comes to us in the first instance: the banker, the solicitor, the stockbroker, the accountant; but above all personal recommendation given round a table at a trade association meeting, or something like that, is the best source of business for us.

12782. *Chairman*: In the field of the kind of professional adviser you are speaking of you would say that the services available by your organisation are very widely known in the country?——I think so; although we are shocked at times to meet a man who says: "What is your business? Are you connected with Charterhouse School?" But by and large after twenty-five years we are fairly well known up and down the country.

12783. On this difficult question of whether there are creditworthy small concerns which are going begging it very much matters whether everybody who might be concerned knows the possibilities open to him?——The average industrialist of the size we are talking about is dependent on some professional adviser. If he asks his lawyer where he can go for capital, and the lawyer does not know, he can turn to his banker, accountant or friend; between the lot of them they ought to be able to put him on the right lines. I think the bankers know about us; the managers of Lloyds Bank have all had it dinned into them that we exist.

12784. *Professor Cairncross*: Is it not surprising how ignorant small business men and frequently all their professional advisers are as to possible sources of finance?——I find it difficult to answer that. We get surprises occasionally. What is not surprising is the fact that the

average industrialist is an absolute babe in the woods when it comes to talking to people like ourselves. He has not the slightest idea what he really wants, or what is good for him, on the financial side. We turn a good deal of business away by telling people that they need not come to us, and that they can get on on their own, at any rate for the time being.

12785. *Sir John Woods*: What sort of proportion of cases do you accept out of the total number that you investigate?——Today, when what we do and what we are is so much better known than it was at the start, about five or six per cent. finally get through with us. The percentage was much less in the first instance.

12786. *Mr. Jones*: Does that mean that over 90 per cent of the applications for this assistance are rejected?——Yes.

12787. *Sir John Woods*: Because they are not creditworthy, or because they can get along without you?——Normally the former. There is one other source of rejection as far as we are concerned. Unless we think that a business has growth prospects it does not appeal to us very strongly.

12788. *Mr. Jones*: You indicate in the final sentence of your reply to the second question that of the proposals that are rejected as uncreditworthy you find that not more than a mere handful were wrongly rejected and subsequently succeeded in obtaining their money from a competitive source. You have told us about the existence of the I.C.F.C., and you have indicated that there are one or two other organisations. How many other sources are there, and what are they?——There is one under the wing of the Pearl Assurance Company and London and Yorkshire Trust Ltd., called Safeguard. There is one in the Schroder group, called Leadenhall Investments and Finance Ltd. I think that half a dozen is about the measure of it. Then there is some evidence that the Prudential Assurance Company, despite the fact that they are large holders of capital in my own company, occasionally go into this kind of thing on their own account.

12789. *Chairman*: Apart from what the banks do, which is rather a separate point, the two big figures in the field are yourselves and I.C.F.C.?——Yes.

12790. *Mr. Woodcock*: Do you do much laying off?——Not in the Charterhouse Industrial Development Company. We do not need to, and we do not like having partners. We like to hold the whole of a class of capital. Take, for instance, a redeemable preference share, which is a very favourite way with us of providing the weight of money. If we hold the whole class, we can vary the terms; we can forgo the dividend for a half year or a year, or make some other change which is necessitated by something unexpected happening. If we have partners it is a question of getting them together and having possible differences. We much prefer to hold the whole class of capital, though of course we do not always do so.

12791. *Lord Harcourt*: Have you any idea of the average time it takes from where you take a company into your nursery to the stage when it is ready for a public issue?——It varies enormously. I could not give you an average. The whole thing was distorted by the war, which came in the middle of the life of my company.

12792. *Mr. Woodcock*: You seem quite happy to keep them in the family; would you not perhaps be doing good public work if you were to encourage them to get out when they are satisfied that they can do so in their own right?——We do encourage them to get out now and again, but they do not want to. They say that they like being there. I do not think that there is any public disservice in our retaining our investments as long as it does not monopolise capital which we might use elsewhere; and that has not happened with us.

12793. *Professor Cairncross*: Is not this the lack of demand more than anything else? Does it not mean that you are approximating far more to an investment trust than the continental idea of a development bank?——I cannot wholly accept that. The weight of the money we put into these undertakings is in the form of repayable capital or loan; it may be and often is a redeemable preference share. In the course of business that is redeemed, and our residual interest in the business is the original slice of equity, which we hold. You may say that that begins to savour of being an investment trust, and ask us why, if we have a lot of these residual equities, we keep them. We keep them because they are a very good investment. I do not believe that it would give any advantage either from the point of view of public duty or to the company concerned for us to sell those holdings. One of our choicest holdings is in a company of which I happen to be chairman myself. A man who runs one of these holding companies recently bid me a handsome profit for our entire holding. In that case I said no, because after making some inquiries I came to the conclusion that I should not be doing the company any good by letting it pass under the control of that man. We get a certain number of opportunists who come along and think that they can sandwich themselves between us and a flotation.

12794. Is there a certain scale which you assume that any of your companies must reach before you contemplate urging them to make a public issue?——As we are today, maintainable profits for the future of not less than £150,000 a year; capital value, therefore, of £500,000 or £600,000.

12795. It is sometimes put by other institutions that are doing on a small scale what you are doing that they lack the finance to make their companies grow sufficiently to float them off. Do you think that this is a common situation?——It has arisen quite recently owing to the credit squeeze, but otherwise I am not conscious of that difficulty. Certainly so far as we are concerned it has never arisen.

12796 Do you find that when you take on a company you want to put in a fair amount of additional capital to make it grow? That is presumably why it has come to you?——It has come to us for one of two reasons. It may be a question of selling out owing to a death. A widow inherits the capital and her son wants to get it out of his mother's hands and into more businesslike hands, and then himself to develop the company. The other reason is the need for additional capital for expansion. We naturally prefer the latter, because our money works for the company instead of going to a vendor; but we do not exclude the former type of transaction.

12797. If you take the second type of transaction, you presumably prefer to see a good push given to a firm in that position?——Yes; but the push does not come from the capital. It comes from the management.

12798. But you are presumably approached for a fairly large slice of initial capital?——It varies very much indeed. Our average investment today, over the companies I have mentioned, allowing for the original amount put in and taking out of the calculation redemptions in the meantime, is of the order of £100,000.

12799. *Chairman*: In your answer on the effect of the credit squeeze on your activities, you say the two corporations mainly concerned in the finance of small businesses, I.C.F.C. and Charterhouse, are mainly dependent upon bank loans for their own capital:

"Neither has suffered any embarrassment therefrom until the credit squeeze began in 1957. . . After that, these corporations, having themselves been asked to limit their drawings, necessarily had to restrict their own activities. It was the limitation of the volume of available resources rather than any increase in the rate of interest which was the limiting factor."

That is the result of your observation as to what choked off the activities of people who might be coming to you?——Lord Piercy said so publicly in one of his annual statements, and that is what happened with us. Our limits with Lloyds Bank and Midland were cut back, with our agreement; that simply meant that we had to say no to people who came to us.

12800. *Sir John Woods*: You say quite categorically that it was the limitation of availability rather than any increase in the rate of interest. Does it follow from that that in your experience even at a 7 per cent. Bank Rate the cost of money has little effect, if any, on medium or small businesses?——Yes, little effect.

12801. *Professor Cairncross*: Would you go beyond that and argue that creditworthy people who did not get

money from you failed subsequently to get money elsewhere, or do you think they found something else?——It turns on the interpretation of "creditworthy", of course. I remember that one man to whom we had to say no was able to go to somebody who had money. I suppose that there were other cases, because there were private individuals and others who were not affected at that time. They may have had to pay very dearly for the money, not so much because the rate of interest demanded was 10 per cent. instead of 7 per cent. but because the individual concerned took a much bigger slice of the equity than he ought and bought it cheap. He might also have said: "This is a chance to get my son a nice job. Put him in as your works manager and pay him £2,000 a year". That kind of duress used to be applied in the old days; I think that that is one thing my company has helped to solve. Whether there was anything of that between September 1957 and September 1958 I am quite unable to say.

12802. *Professor Sayers*: Do you know of any case where you had to say no because of the credit squeeze, and the firm as a result spent less on buildings and plant and so on?——Yes, not only with new applicants, but with members of our own family who came to us to say: "We are planning an extension to our factory; we cannot embark on it unless we know you are going to provide us with more capital". If we said no, the expansion did not happen. That happened also in public companies of which I happen to be a director. I suppose that it was one of the objects of the credit squeeze.

12803. You know cases where this actually occurred?——Yes.

12804. Many cases?——Judging from the several I know in my own experience, I should say that there were many cases the length and breadth of the country.

12805. *Professor Cairncross*: In those cases it was not the rate of interest?——No, the non-availability of the money.

12806. Would it also be a judgment based on the fact that the demand for their product itself was going to lessen in the immediate future rather than literally not having the money?——That was taken into account. The signs in the sky were that demand might fall, at home or overseas. I can think of two or three cases where development was arrested.

12807. *Professor Sayers*: Two or three cases?——In my own immediate knowledge. I am only a tiny little potato in an enormous basket.

12808. *Professor Cairncross*: Arrested specifically and primarily because of the unavailability of money?——Yes; that happened with at least two public companies of which I am a director.

12809. *Sir John Woods*: I think you mentioned a few cases where development was arrested, not particularly because of the non-availability but because of "signs in the sky"?——A combination of the two, in fact.

12810. Did "arrested" mean finally arrested, or delayed?——We have hardly got out of the difficulty yet. I do not think I can say with certainty that a decision which was put aside because of the credit squeeze has been brought forward again and agreed to go on. Although I am sure that there must be such cases, I cannot readily call one to mind.

12811. *Sir Oliver Franks*: Do you know of other cases, from the first hand knowledge of a friend or acquaintance who is a director of a company of which you yourself are not a director, and who has told you in relation to his company that the same sort of thing happened?——At least two friends of mine who habitually come and talk to me about their business affairs asked my advice at that time whether they should go on with some development or not, and as a result of the conversation decided against going on. I suppose that that is about the extent to which I would ever get to know of these things.

12812. *Professor Sayers*: In these and the other cases you mentioned within your own family, would you say that the developments that were arrested were primarily bricks and mortar developments, or were they the purchase of new plant?——It is very often a combination of the two. If a man is thinking of installing new plant, he is probably thinking of improving or rebuilding some part of his bricks and mortar. I should not be justified in attempting to distinguish between those two.

Chairman: Thank you very much, Sir Nutcombe. We are very much obliged to you for helping us.

(The witness withdrew.)

THE RT. HON. C. F. COBBOLD, H. C. B. MYNORS, ESQ., and A. W. C. DASCOMBE, ESQ., Governor, Deputy Governor and Secretary respectively of the Bank of England, called and examined.

12813. *The following statement by the Governor was sent to members of the Committee before the meeting*:

I. STATUTORY POSITION OF THE BANK OF ENGLAND:

1. In evidence on 11th July, 1957, I made a statement about the working relations between the Bank and the Treasury.

2. To summarise, I said that the principal relationship was that of banker and customer. The Bank advise and assist the Treasury over a very wide financial field; in the formulation and management of monetary policy each has its immediate responsibilities, whilst the Treasury has an overriding responsibility for ensuring conformity of policy. As this evidence was given some months ago, I repeat words which I then used (Qn. 260) about the division of immediate responsibilities—

"In the field of domestic monetary policy the Treasury and the Bank each have their own responsibilities. The Bank have the first responsibility for the management of the money market, including the fixing of Bank Rate and the management of Issue Department securities. By statute this responsibility lies with the Bank unless they are given directions by the Treasury: in practice, in recent times both before and since the Bank Act, it has been the policy of the Bank to accept this responsibility but to consult, and in the last resort to defer to, the Government. At the same time many decisions which directly affect the management of money (e.g. Government borrowing and debt management, the finance of public bodies and local authorities, control of hire purchase terms) are the direct responsibility of the Government. In these circumstances it is clear that the Treasury and the Bank must act (as in fact they do) in the closest consultation and in absolute confidence."

3. I have no doubt that in modern conditions it is proper that Government should have the final word on policy and that the central bank should not be free to pursue a completely independent line. At the same time, if the central bank is to perform a useful function, it must be a separate entity capable both of dealing professionally in markets and of forming its own views and giving independent advice to Government. Contact between Bank and Treasury must be close and continuous, but Bank and Treasury should speak to each other as separate institutions, forming their opinions from different viewpoints and different backgrounds. The Bank must be in and of the market, must enjoy the confidence of Government on the one hand and of the market on the other, and must be in a position to interpret market opinions to Government and Government opinions to the market.

4. In a totalitarian state, with private enterprise and markets more or less eliminated, it would make sense for central bank operations to be handled under direct Treasury control, both as to policy and as to detail. For any country operating to a great extent with private enterprise and markets, and working with other countries similarly placed, I should regard direct Treasury control over central bank operations as a major weakness. For a country as dependent as the U.K. on international trade and confidence, it could be a disaster.

5. The business of the central banker is different from that of the Treasury official. Apart from the physical impossibility of the same men handling such different businesses, the necessary attitude and approach are not the same. The senior civil servant must always be concerned with his Minister's responsibilities in Government and in Parliament. The central bank should not concern itself with political or parliamentary questions. Its concern

should be with the general economic and financial situation and with the day-to-day market situation, both in its own country and abroad: only if it is in intimate and continuous touch with markets and with business opinion can it efficiently carry out its twin functions of advising and operating.

6. It would, in my view, be a mistake to blur the identity and the separate responsibilities of the two: with the two institutions working so closely together, there is always a tendency in that direction unless it is resisted. A policy of fusing the two by interchange of staff or otherwise would gradually but inevitably lead to a blurring of responsibilities and functions; and, as a matter of practical administration, fusion and "cross-fertilisation" would, in my view, tend to prejudice rather than improve relationships.

7. Arguments can doubtless be advanced for variation, in either direction, in the degree of formal independence of the central bank from Government and in allocation, either by statute or in practice, of responsibilities between Bank and Treasury. But the fundamental question is whether the central bank should be a separate entity, albeit the servant of the Government of the day, or a sub-department of the Treasury. I hold that, in present and foreseeable economic conditions in the Western world, the former is undoubtedly right.

8. I base these views on twenty-five years' experience, under Conservative, Labour and Coalition administrations, of the Bank of England's working relations with Government; and also on a fairly intimate knowledge, over the same period, of the problems and developments in this field in the United States and the principal countries of the Commonwealth and of Europe.

II. DIRECTORATE OF THE BANK OF ENGLAND

9. The question of the directorate and the position of part-time directors is fundamental to the existence, the standing and the efficiency of the central bank as a separate entity.

10. The first responsibility for formulating policy, for tendering advice to H.M. Government and for market operations naturally falls on the Governors. They have at their disposal advice and assistance from the executive directors and the permanent staff of the Bank. But under the present system they have also the great advantage of being able to consult the part-time directors individually or collectively, on general or particular matters, with secrecy and continuity, and with the directors knowing that they may have to share responsibility for decisions based partly on the views which they individually express. The directors of the Bank cover between them a very wide range of interests in banking, industry, commerce, trade unions, shipping and insurance. They are all practical men, with a wide and up-to-date knowledge of events at home and abroad. It is quite invaluable to the Governors to be able to draw on this fund of knowledge and experience in formulating and executing policy and in tendering advice to Government.

11. The functions and responsibilities of the part-time directors vary in the different activities of the Bank. There is no field in which general knowledge of their views, and often particular consultation, is not of benefit to the Governors.

12. In the domestic affairs of the Bank, both on the Court and in sub-committees, they play a very active and continuous rôle, which has been described in detail in a memorandum submitted by them to the Committee.*

13. In the field of monetary policy, the Court is directly concerned with those matters which are the Bank's immediate responsibility.

14. Bank Rate is the decision of the Court.

15. On the general control of the money market, though no formal decision is normally asked of the Court, reports are regularly made to the Court and the Committee of Treasury; it is open to either body to query the Governors' policy.

16. On the Issue Department the Court and the Committee of Treasury are informed from time to time of details of the portfolio; they are entitled to query its composition and to be consulted if a change of policy is envisaged. Profit and loss of Issue Department being for account of H.M. Government, the Court have no commercial interest in the Department. In fact the general policy governing Issue Department management has remained unaltered throughout my term as Governor (see Qn. 1762) and I have had no occasion to raise it with the Court; though there have been occasions when I have informed and consulted the Committee of Treasury about the progress of discussions about the Issue Department portfolio between the Governors and H.M. Government.

17. The Court are not concerned with the Bank's activities in the foreign exchanges, where the Bank act as agents for H.M. Treasury and where no statutory obligation lies on the Bank. But, here again, as in every activity of the Bank, the Governors continually bear in mind the general views of their colleagues and frequently ask for individual or collective opinions on particular situations.

18. The strength and the independence of thought of the Bank derive largely from a Court constituted on present lines, taking an active and continuous part in forming policy. The Bank owes much of its standing and of the confidence it enjoys at home and abroad, to the knowledge that the actions taken by the Governors have the support of the wide experience and integrity represented by the Court of Directors. If the nature of the Court were to be altered so that it were not to be composed of active practical men of business, or if directors were to become mere figure-heads divorced from the real affairs of the Bank, the standing of the Bank throughout the world, and its ability to perform its public duties efficiently, would both be gravely prejudiced.

III. INTERNAL ORGANISATION OF THE BANK OF ENGLAND

19. Fundamentally the Bank needs an organisation similar to that of a purely commercial concern, but adjusted to deal with the wider policy questions which do not present themselves in the purely commercial field. So far as concerns recruiting, staff selection, departmental organisation, etc., its methods and practice are on general commercial lines: in various matters of organisation, including such questions as mechanisation, we keep in close touch with commercial banks and institutions.

20. It is accordingly to be expected that the Bank's practice and methods should show the same sort of differences from those of the civil service as are to be found in any large commercial concern.

21. Without going into detail or blue-prints, the general picture of day-to-day internal organisation is as follows.

22. The Governor and Deputy Governor are the chief executives, and are responsible to the Court. The Governors and the executive directors work in very much the same way as a full-time chairman and deputy chairman and other managing directors work in the normal commercial company.

23. Below the executive directorate, the Bank is organised functionally in departments, each under the control of a head of department who is responsible directly to the Governors (who may delegate supervisory responsibilities in various fields to one or more executive directors). The principal department is the Cashier's Department, responsible for the Bank's cash and banking services; the Chief Cashier ranking traditionally as the senior permanent official.

24. There is, at policy level, an extra-departmental body of advisers of various categories. They are recruited partly from outside the Bank, at differing ages and with differing experience, and partly from the departmental staff; the source depending entirely on where the needed experience and knowledge can be found. They give their whole time to the Bank and are members of its permanent staff.

25. Most of these advisers are concerned with the Bank's overseas business and relations. Their work is supervised by the executive directors concerned and co-ordinated by the Chief of the Overseas Department. These advisers spend a lot of time abroad in the areas with which they are concerned, and are frequently made available (as indeed are members of the departmental staff) to assist and advise H.M. Government, both at home and abroad.

26. Other advisers are concerned with more general aspects of monetary and economic policy, working directly with the Governors and the executive directors.

* Memoranda of Evidence Part I No. 15.

27. The advisers draw mainly on the services of the Overseas Department and the Statistics Office. The Overseas Department numbers 94 men and 106 women (this does not include the operation of Exchange Control and the E.E.A which falls under the Chief Cashier's Department) and the Statistics Office 62 men and 67 women. On questions with specific practical aspects the advisers are of course in close touch with the senior departmental officers concerned.

28. This organisation, especially in the overseas field, is intentionally maintained on a flexible basis, without rigid blue-prints, so that demands either for the Bank's own work or for technical assistance to H.M. Government can be met as effectively as possible. It will be appreciated that, in addition to more or less foreseeable semi-permanent demands (e.g. high officers for central banks in the emergent territories, assistance to H.M. Treasury at the International Monetary Fund, the Organisation for European Economic Co-operation, etc.) there are frequent sudden demands (e.g the recent European currency exercise, where many of the advisers as well as the heads of department concerned were in direct action simultaneously).

29. That is the general basis of organisation; its working may be briefly described as follows.

30. Staff matters are handled by the Establishment Department under supervision of an executive director, with reference to the Governors where necessary. Other domestic matters are handled in a similar way. Departmental co-ordination is maintained through a Head of Departments' Committee, under the chairmanship of the Chief Cashier.

31. In the execution of policy in such matters as open market operations, discount, Issue Department transactions and foreign exchange, operations are carried out under the Chief Cashier and his deputies, who report regularly to the Governors or to the executive directors concerned and seek instructions as they judge necessary, from day to day, hour to hour, or minute to minute. Similarly an executive director will refer to the Governors as he judges necessary.

32. There is a daily meeting of Governors and executive directors, with the Chief Cashier. They also hold regular weekly meetings with senior officials and advisers to review domestic questions and overseas questions, respectively, with more comprehensive monthly meetings to consider statistical and economic reports.

33. There are also naturally frequent *ad hoc* meetings to discuss general or particular matters of policy. These may be called by the Governors or one of the executive directors and will usually be attended by officials and advisers concerned.

34. For example, when a major aspect of monetary policy is under discussion, the normal "team" would be the Governors, one or more executive directors, the Chief Cashier and his deputy, and the advisers who specialise on economic matters. On major questions of overseas policy the team would be the Governors, one or more executive directors and the heads of departments and advisers concerned with the problem at issue.

35. In order to keep theory and practice as close together as possible, frequent contact is encouraged, and takes place, between heads of departments and advisers; and both heads of departments and advisers always have access to Governors and executive directors to put forward suggestions or comments.

36. The foregoing statement refers only to day-to-day internal organisation, with particular reference to the level of the executive directorate and just below. It does not seek to cover the relationship of the Governors with the Court or with individual part-time directors, or the relationships between the Bank and other bodies.

12814. *Chairman*: Mr. Governor, we have your written statement on the subjects we wanted to discuss today, which we will regard as on the record as part of your evidence. I think that you can take that as read, because we have all seen it in advance.——*Mr. Cobbold*: If that may be taken as read I should be quite happy. I should like to make one addition, on a point which I thought might be of interest to the Committee, on the practical relations between the Bank and Whitehall. I have had a record kept of meetings, correspondence and conversations between the Bank and Whitehall (mainly H.M. Treasury) during the last quarter of 1958. During these three months the Deputy Governor and I between us had over 60 personal discussions with Ministers or with officials of H.M. Government. Attendances by executive directors, officials and advisers at meetings in Whitehall numbered over 300; in addition over 400 letters were written by the Bank to Whitehall and some 1,300 telephone conversations took place on policy matters. This does not take account of the large volume of routine communications (amounting to several thousands) on banking, exchange control and statistical matters.

12815. There are one or two points in part I of the statement that I would like you to enlarge upon. The first is your view that as between the Bank and the Treasury the principal relationship is that of banker and customer. In my own mind I have some difficulty in seeing how that relationship, as a principal relationship, can be consistent with what I know you accept otherwise, that the policy of the monetary operations which the Bank is to conduct must be taken at some stage, to use your wording, in the last resort, from the Treasury or the Chancellor. How can you combine the relationship of the banker and customer, which is essentially that of two independent parties, the banker being free to accommodate the customer or not as he wishes, with the second consideration?——You used the word "accommodate". This is not mainly, of course, a question of advancing money. I regard the banker-customer relationship as the principal relationship on two grounds. The first is that in relation to the banking services we carry out, including exchange control services, it is a purely banker and customer machinery. Then there is a much wider field, which is largely a matter of advice, but partly also of operation. Perhaps something like nine tenths of the Deputy Governor's and my time, so far as we are dealing with Government and governmental questions, would be considering what advice to give the Government as their bankers, in very much the same way as any large bank would advise its customer over a pretty wide field of domestic and external finance. There is, as you say, a number of fields where the Bank is operating as a principal subject to these final questions of direction; but where the Bank is operating as a principal that is a rather different field. The main historical relationship is first and foremost very similar to the relation of a banker with a very important customer; of course in this case the customer is clearly more important than any customer of any commercial bank.

12816. Is the aspect of the relationship that you are stressing that the Bank is there as expert adviser to the Treasury on the financial operations that the Bank is going to carry out on behalf of the Treasury?——Not entirely. In a very much wider field, anything which touches on finance, the City, overseas financial questions, both in terms of personnel and in terms of policy, all those matters would normally be discussed by the Treasury with ourselves in a banking relationship, the relationship of a banker as an adviser to his customer.

12817. I thought that those things were perhaps matters upon which your advice would be equally valuable but would not have any direct connection with your position as a banker speaking to a customer?——We may be talking slightly at cross purposes about the banker-customer relationship. I regard it as the function of a banker to be prepared to advise his customer on any branch of the customer's financial activity, and the financial activity of Government is an extremely wide activity. I am using the term in its widest sense. For instance, if the Treasury wish to be advised on a financial appointment of any sort which they have in mind, they would normally turn to us for advice and assistance.

12818. It is the ability and the readiness to offer expert advice on all these subjects that is the main aspect of the banker-customer relationship?——Yes. At the same time there is a tremendous routine operation going on the whole time. The Cashier's Department are very busy the whole time; the Accountant's Department deals with the stock registration. All that is in a sense part of the banker-customer relationship between the Bank and the Treasury.

12819. Those are all services the banker is currently from day to day affording for his customer?——They

cover in terms of numbers of staff a very high percentage of the staff of the bank.

12820. *Professor Sayers*: The ordinary banker and the private customer mostly discuss business that they are going to do with each other. As between the Government and the Bank of England much of the time must surely be occupied in discussing not their business directly with each other, but the business of the Bank with third parties?——Not with individual third parties.

12821. Not with individual third parties, but with important sections of the community?——Yes. You say that the banker and customer discuss what they are going to do with each other; I would rather say that they discuss what the banker is going to do for his customer in the general sense. I agree that in our case a great deal of the background of the advice that we are likely to give to the Government comes from our relations with other parties.

12822. *Professor Cairncross*: I wonder whether you are not getting us off on the wrong foot with the use of this phrase "banker-customer relationship". It implies a relationship in which one party is likely to say to the other from time to time: "No, I am not prepared to do that." Is this the kind of relationship which you think should prevail between the Bank and the Treasury?——That is rather a different point. I really do stress this banker-customer relationship. Speaking quite personally, if I were asked my main function in life, I should say that my main function is to be Her Majesty's Government's banker. I regard myself as being there largely in order to give the Government such financial advice as I can, out of my own head or out of my colleagues', in very wide terms.

12823. In that are you laying stress on the banking operations that you conduct on behalf of the Government?——No, on the financial advice which I give to the Government.

12824. *Professor Sayers*: Do you not mean that you consider yourself primarily as the financial adviser to the Government, and that the banking operations you do for the customer are part of the work, but what you talk about is the Government's general financial policy?——I have said: "The principal relationship is that of banker and customer. The Bank advise and assist the Treasury over a very wide financial field." It is perhaps slightly different at different levels. I was talking there of the Bank as a whole. The Bank as a whole in terms of the proportion of people employed and man hours spent is largely devoted to carrying out operations on behalf of the Treasury. At the policy end we naturally talk more about policy and advise on financial matters generally rather than carry out detailed operations.

12825. And you discuss with the Government the fixing of terms on which you as a banker will do business with other customers, which is something a banker does not do with his private customers?——You are taking me a little far on that particular question. I would not have said so exactly, unless you regard the terms on which we sell securities to the market as one of the terms on which we do business with other customers.

12826. I was thinking of fixing of Bank Rate. That is something that has no parallel in the ordinary banker-customer relationship?——None at all. I do not include the fixing of Bank Rate in the banker and customer relationship.

12827. *Chairman*: If that does not come in your conception of the principal relationship, which you say is that of banker and customer, how many of the accepted things do?——As I said in answer to Qn. 260:

> "The Bank have the first responsibility for the management of the money market, including the fixing of Bank Rate and the management of Issue Department securities."

Lower down I say:

> "At the same time many decisions which directly affect the management of money (e.g. Government borrowing and debt management, the finance of public bodies and local authorities, control of hire purchase terms) are the direct responsibility of the Government."

Those are places in which we have our direct responsibilities, and they have their direct responsibility. There is a great deal, as I have said, of discussion and collaboration about them, but I am not including them in the banker-customer relationship.

12828. I do not think I have ever quite understood what the significance of "first" is in your phrase "first responsibility". It is not "first" in point of primacy, if I understand the matter, because you accept ultimately the policy that the Treasury wish to have carried out?——Perhaps a better phrase might have been "direct responsibility". I used "first responsibility" in the sense of its being our job, as I regard it, to initiate, consider, and have continually before us these points which I have detailed as our responsibility. I should not necessarily expect the Government to have those points always before them, and it would be normal, and is indeed the practice, for us to take the initiative on those points.

12829. That would mean, as I follow it, that it would be your constant care to think about them, to have views about them, and to have the material about them?——And the initiative would normally lie with us.

12830. Normally you would expect any proposals with regard to them to come from you, but you do not deduce from that that if the Government were worried about any aspect of the matter there would be anything wrong in their making a suggestion and considering it?——We are in continuous touch and always talking about these things, and I should not be at all surprised if they raised them at any time.

12831. Why is it that you are allowed to divide the management of the money market, the fixing of Bank Rate, and the management of the Issue Department portfolio, from other activities which you carry out, such as the management of the E.E.A., exchange control and your contribution to debt management? What does this distinction originate in?——We have no statutory responsibility for the Exchange Equalisation Account; we are purely acting as agents for Her Majesty's Treasury on that. There I would say the phrase "banker and customer" comes in very much; we advise on that and operate, but the statutory responsibility clearly lies with the Government and not with ourselves. In the case of Bank Rate and the Issue Department portfolio the statutory responsibility clearly lies with the Bank.

12832. What is the responsibility by statute?——The Bank Rate is the Bank's business; unless anybody directs it to do anything else, it is clearly the Bank's responsibility to fix the Bank Rate.

12833. Is that an interpretation of the words "the affairs of the Bank" in the 1946 Act?——*Mr. Cobbold*: Yes. It certainly covers Bank Rate; fixing Bank Rate cannot be anybody else's business.—*Mr Mynors*: The Issue Department is covered by a reference in the Currency and Banknotes Act of 1928, under which the Issue Department continues, as it was before, a department of the Bank, but a statutory duty is laid on the Bank to inform the Treasury of the state of affairs of the Issue Department. That shows negatively, as it were, that it is a responsibility of the Bank, or they would not have an obligation to tell the Treasury about it.—*Mr. Cobbold*: So far as buying and selling Treasury Bills, that is to say money market operations, are concerned, that is an "affair of the Bank" within the terms of the 1946 Act.

12834. That is the weight you give to the section of the 1946 Act which says that the affairs of the Bank should be managed by the Court, subject to direction?——Yes.

12835. But when it comes to a question of any of these agency operations or affairs of the Bank being co-ordinated with Government policy, do you distinguish between your relationship to the Treasury in the case of agency operations and the relationship in the case of affairs of the Bank?——Yes, I should distinguish. I regard the Bank institutionally as having a much greater responsibility for Bank Rate and open market operations which are its own affairs than for Exchange Equalisation Account operations, which we handle purely as an agent. In the event of a difference of policy the Bank would take a difference to much greater length with the affairs which they regard as their own than they would where they are acting purely as agent and the responsibility lies clearly on the Government.

12836. What would be the effect of the practical difference between the two positions? In both cases

obviously you are fully consulted and your expert opinion is invited and has great weight?——Certainly. We should regard ourselves as having greater responsibility towards the public in the first case because there are responsibilities laid on us by statute. As I have said earlier, we are normally able to iron out any differences of opinion in the ordinary methods of discussion; but it is conceivable that we might in various circumstances come to a more or less serious difference of opinion. In matters which are our own affairs I would conceive it as quite possible that the Court might wish to take a definite view, which would have to be thrashed out with the Government. There are obviously varied possibilities of different solutions when things have got to that point. I cannot see that arising over an exchange matter, where we are acting as agents and where the Bank have no statutory responsibility towards the public.

12837. But what you call your statutory responsibility with regard to the affairs of the Bank is subject to any directions which may be given you; so it would seem that if you invited a direction your duty would be done towards the public. Or would you not accept that?——I can conceive circumstances where we should ask for a direction to be given. I can also conceive circumstances where the question of resignations might have to be considered.

12838. But you would never envisage such a situation arising over such matters as the Exchange Equalisation Account?——I cannot conceive a case where directions under the 1946 Act could apply to Exchange Equalisation Account operations. We take instructions as an agent from the principal there. I cannot conceive how it would work that the Treasury would issue directions to the Court to do something in connection with the Exchange Equalisation Account.

12839. I understand the formal difference that is in your mind, but you might be faced with some instruction from the Treasury in that field which you thought was seriously inimical to public interest. Would not the same issue arise as with what you regard as the affairs of the Bank?——The issue of directions under the Act could not arise, because we are acting as an agent for a principal and we could therefore not get to the pitch where the Government issued directions. I do not think that it is constitutionally possible.

12840. Given your interpretation of "the affairs of the Bank", it is only something which is an affair of the Bank in that sense that can be altered by a direction?——Yes

12841. I was thinking of the larger question what is the real difference between the Bank's position as between itself and the Government in these different fields, because they both may raise questions of public interest and policy?——They may, certainly, and I could conceive circumstances where E.E.A. policy or operations might involve questions of resignation of Governors and the executive directors It would be much more difficult to see a position in which they could raise questions of the resignation of the Court as a whole. Since the Court as a whole is not concerned because of the statutory position with the E.E.A.

12842. In your view would it make a substantial difference from the point of view of the public interest if your relationship to the Government was avowedly the same with regard to these different activities, which all bear on monetary policy?——They do all have a bearing. It is perfectly conceivable that the statutory position of the Exchange Equalisation Account could be assimilated to the statutory position of the Issue Department portfolio in the management of Issue Department securities, for example; I do not think that that would make very much difference in the day-to-day handling of the thing, because it is done by agreement and negotiation. In the event of a major difference of opinion that would put the same amount of weight upon the shoulders of the Court, and therefore on the Bank as an institution, about policy as now lies on it in respect of the Issue Department portfolio. The administration of exchange control, which is another thing that we handle for Government, would, I think, be very difficult to put statutorily on the Bank. That is an activity which affects the liberty of the citizen, and which is subject to very frequent individual and detailed parliamentary questioning. So far as the Exchange Equalisation Account is concerned, I should myself see no difficulty in that being assimilated to the Issue Department position.

12843. *Professor Cairncross*: If you leave aside statutory responsibilities and look at it from the angle of policy, do you regard it as possible to delineate the field of monetary policy in a way that puts debt management on the one hand and open market operations on the other?——I should find it difficult to delineate more than I have done in my answer to Qn. 260. Government borrowing and debt management in the sense of deciding the terms and the requirements of new issues, conversion issues, and that side of it, is separate from, though closely connected with, the daily management of the Issue Department portfolio.

12844. *Professor Sayers*: Can you even separate them in your own mind?——Yes.

12845. *Professor Cairncross*: The course which you are setting as agents for the Government in the management of the debt surely must be linked very closely with the course you are setting in your open market operations and in fixing the Bank Rate; it would really be impossible to conduct two policies simultaneously, one in respect of debt management and one in respect of the money market?——I have always maintained that view, and have always said that in my view Government must have an overriding responsibility for policy.

12846. But you attach more importance to some aspects of policy than others, because a specific decision has to be taken within the Bank of England? This is not a matter of importance, surely, but of the formal way in which the decision is taken?——Certain things are our daily business. I find it difficult to see that the fixing of the terms of Government borrowing and repayment can or should be the central bank's business. That must be the business of the Treasury.

12847. Surely it is just as reasonable to suggest that the fixing of the Bank Rate is Treasury business?——With respect, I would not concur with that. The fixing of Bank Rate affects the things that we are doing the whole time all day.

12848. But it equally affects the price of Government securities, which may be an important matter?——That takes us back to the whole question of the relationship between short-term and long-term rates of interest, which we have discussed very fully.

12849. *Professor Sayers*: Would you not agree that it affects the problems of debt management?——Yes. I have always said that these things dovetail and need the closest coordination at all points.

12850. That is why we are finding it so difficult to draw a line between them.—*Chairman*: What is troubling me is whether the point of view which you are putting very clearly and forcibly is due to the fact that the statute as you interpret it is in the form it is, or whether you think that, even if the statute had not been drawn that way, the thing would still have required this kind of division?——*Mr. Cobbold*: I think that the practical division is pretty well bound to fall more or less where it does, if one accepts the major premise that the central bank should be an independent entity within the general overriding responsibility of Government. One could perhaps draw the line between the Bank responsibility and the Treasury responsibility slightly differently in places, but I think that this is by and large the way the day-to-day working of the practical delineation would occur, whether the statute were a bit more one way or the other way. As a practical working I should expect it to fall much where it does. —*Mr. Mynors*: I would agree with that.

12851. The significance of these different fields of responsibility, if I understand you, is that they indicate from which side it would normally be expected that the proposals about policy would come?——*Mr. Cobbold*: I think that that is correct; but I must make an exception for the Exchange Equalisation Account. It is more our business all day to be thinking about exchange operations than it is the Treasury's business. Major policy would be for discussion, but the ordinary day-to-day operation of the Exchange Equalisation Account falls much more within our purview than the Treasury's purview.

12852. *Lord Harcourt*: Those are really operations in a previously agreed policy?——Yes. The general policy is previously agreed. There is a great deal of what I may

call tactical policy; that I would regard as normally entirely for us. We do not feel it necessary to ask our principals whether we are to let the rate go down one-eighth and then bring it up one-half.

12853. *Professor Cairncross*: Those operations are continuously occurring, and you are under the necessity of deciding from day to day what to do. Where the decisions are discontinuous and there is ample time to consider, you are in general taking a slightly different view. Do you accept that movements in Bank Rate fall into this category, and regard them as primarily the responsibility of the Bank of England?——If the Bank of England is handling the money market the primary responsibility for Bank Rate must lie with the Bank.

12854. Is there any logical distinction between the relationship of the movement of Bank Rate and day-to-day money market operations and the relationship between settling the terms of new issues and the day-to-day handling of market operations, about which you were speaking earlier?——Is not debt management much more nearly a budgetary function? I may not be using the right phrase, but it is a Treasury function; these are the Treasury's borrowing and repaying arrangements. Although they may take, as they do, continuous advice from ourselves, and we may handle a great deal of it, the terms on which Government borrow and the details of the Government borrowing programme and operations must, as I see it, be a Treasury responsibility.

12855. These issues concern the Budget very directly, but I find it difficult to draw a line of distinction?——I would have said they were two branches of the same subject. I entirely accept the view that the closest co-ordination is necessary and one affects the other, but I would regard them as two branches of a subject which are inter-related at every point.

12856. *Chairman*: It is in your mind that the volume and terms of the Treasury short-term borrowing is directly affected by Bank Rate decisions?——Certainly.

12857. There is another phrase upon which I want to be quite clear as to what your thinking is, and that is the phrase "in the last resort", which you used when you spoke to us before and which you quote again in this statement. Like "first", "last" may perhaps be a little ambiguous in this phrase. It does not mean last in point of time exactly, I imagine; would that give a wrong impression of what you have in mind?——Yes, it would.

12858. What then is the nature of your deferment to the Government? If one envisages the thing from the point of view of economic planning, naturally these things would be discussed in advance rather than at the last moment?——Yes; I do not mean last in that sense.

12859. It is not a question of your going ahead and then being pushed back?——Certainly not. I did say something when we were talking about this earlier. There is consultation at every stage of proceedings, more or less continuously. In giving evidence earlier I said that one can never be quite certain where ideas start, because one is always consulting on these matters, and an idea may have started from one person's head or another person's head. But in the parts that we regard as our first responsibility, at the same time as we are keeping in general consultation with Government we should be making our own arrangements, working out our own plans, forming our own policies, and at the more or less final stages we should seek governmental agreement. If we were to come to a position where agreement was not possible quite a lot of things might happen between that stage and the final stage of deferment. I do not want to put this as if it was something which regularly happens, or which I envisage as likely to happen at all frequently. I can foresee a position where I should have to say: "I am afraid that the Court would not agree to that", and the Chancellor would have to say: "I am afraid that the Government would not agree to that." In that event I imagine that one would go back and have another talk. I can envisage circumstances in which the Court might say: "We are not quite happy about this, but if it is made clear that this is the Government's responsibility we will execute on that basis." That would mean that I would call for directions. If it came to that point (it is a little bit difficult to envisage the exact circumstances) the Court would probably wish to have those directions made known, so that it would be clear to the public that they were acting under governmental direction and were not assuming responsibility. I can conceive circumstances where the Court or the Governors would regard that as satisfactory to their consciences and no further action was necessary. I can conceive cases which might involve resignations, either of the Governors or of the Court; but there are all those steps which are conceivable possibilities before one comes to that extreme point.

12860. But that last extreme crisis of resignation is not "deferring in the last resort" to the Government?——It would mean the Bank deferring to the Government in the last resort, because the Government would in the last resort make such arrangements and appointments that their policy was carried through.

12861. I thought you were saying that these were subjects as to which the Bank had immediate responsibility, but recognised that they must defer to the Government in the last resort?——That is how it has worked out in recent times both before and since the Act of 1946, because we have not in fact come to that extreme position.

12862. *Sir Oliver Franks*: Would you agree (I am trying to put what I think to be your thoughts into words) that the background to the phrase "the last resort" is this? First of all, you conceive the Bank as an independent institution within the whole working of Government. Secondly, you conceive that there are certain matters within all the things that the Bank does which are the Bank's affairs. You interpret the phrase "the Bank's affairs" to cover the things which you list in this statement, and because these are the affairs which are properly the Bank's you think of the Bank as initiating and acting in these, and therefore being responsible for the action taken. "In the last resort" means that if the Government is not willing to accept the Bank's action it has to take the responsibility of the Bank away and substitute its own. That, I think, is the meaning of a direction in these matters which on your interpretation of "the affairs of the Bank" are the Bank's; "the last resort" means substituting governmental responsibility for the Bank's responsibility. This cannot happen in the same sense in the matters where the Bank acts as agent for the Government, because the responsibility is the Government's throughout, and therefore the Bank's cannot be taken away, it never having been theirs. Is that a fair way of putting your thought?——Exact.

12863. The process of direction is essentially the substituting or the taking over of responsibility by the Government?——Direction, or in the more extreme case substitution of personnel.

12864. So that the ultimate weight of the argument turns on the right understanding of "the affairs of the Bank"?——That is correct.

12865. *Chairman*: In practice it means that in your view, where you are dealing with "the affairs of the Bank" a special weight must be given to the Bank's views by the Government before a direction is issued. Is that a right deduction?——Yes

12866. *Mr. Woodcock*: The ordinary individual might well look upon that as a description of the position of the House of Lords before 1911. Do you think that?——I am not a constitutional lawyer. I would have doubted whether the House of Lords could have had directions issued to it.

12867. There would have been a creation of peers?——Yes; that is my extreme case. It would not have had directions, I think.

12868. *Sir Oliver Franks*: If we were trying to find language to describe the ordinary working relationship between the Bank and the Treasury it would not be difficult. Your statement seems to be trying to dig behind that to the basis on which the daily work and co-operation rests. When I look at all that from the angle of Parliament, it seems to me that over time the position of Government has changed and that Ministers are expected to answer for more than used to be the case; so that, for example, it is now quite normal to find the Chancellor of the Exchequer explaining the movement of Bank Rate in the House, referring to it, or even making a speech about it, just as he would do on these other matters where the Government is responsible and the

Bank is its agent. It seems to me that in a way the realities of day-to-day working and co-operation do not any longer quite fit with the statutory distinctions which one can find out of the history and the language, and that in a way it is perhaps forcing it a little if one simply stands on the distinctions which you make in your answer to Question 260. Would you be prepared to agree that the way in which co-operation has to be worked out depends not simply on the history of the legal origins of powers, but also on the more positive decisions which Government has taken on all these matters of economic and monetary policy since the war?——Certainly I would not rely overmuch on the history of powers in this at all. I regard this largely as a practical proposition, and how the thing works best in modern and present-day conditions. I fully agree with you that in present-day conditions the Chancellor of the Exchequer has much wider responsibilities in these fields, partly because the Government as a whole does so much more in these fields; that is a fact of life. It is certainly now quite normal, and quite proper, for the Chancellor to justify a change in the Bank Rate, even though that is part of the Bank's affairs, because as I have made clear in earlier evidence it would be inconceivable, and would not make sense in present-day conditions, for a Governor to recommend to the Court a change in the Bank Rate which he did not know that the Chancellor would approve, and it would be equally inconceivable for the Court to make a change in the Bank Rate of which they knew the Chancellor did not approve, if only because he could issue directions for that act to be reversed. In fact, it would be very foolish. Therefore, on these major policy questions, even though they are the affairs of the Bank, on the point of high policy they require the approval of the Government of the day, which approval is normally expressed by the Chancellor of the Exchequer. That appears to be the position which exists, and that appears to me to be the proper and correct position as far as I am concerned. That does not detract from what I regard as our responsibility to do these things, provided that what we do is approved by the Chancellor and provided that they do not take over that responsibility from us.

12869. *Mr. Jones*: In paragraph 7 of the statement you say:

"Arguments can doubtless be advanced for variation, in either direction, in the degree of formal independence of the central bank from Government and in allocation, either by statute or in practice, of responsibilities between Bank and Treasury."

Having regard to the fact that the Bank operates on the monetary policy front, but that monetary policy is not the only instrument used in operating the economy, does this not mean the Treasury, as being responsible for the economy under the Chancellor, requires to lay down the lines of policy, and that these lines of policy might reach to some detail? Wherefore, then, or how, is the independence or the detachment of the Bank to be?——I think that it should be in running its affairs within the general responsibility of Government for the whole of the economic picture. I think that the Government should have, as they have, an overriding responsibility to coordinate the various sections which are affecting the economic position as a whole.

12870. The phrase you use here is "the degree of formal independence of the central bank from Government". Can there be any formal independence of the central bank from Government, having regard to the fact that monetary policy is only one part of the operation of the economy for which the Chancellor is responsible?——I think that there is a degree of formal independence under the present Act, though the Bank is finally subject to directions. I was seeking to say that there are arguments for moving the delimitation of this in one direction or another, giving more or less power to the central bank; I was not seeking to suggest that at the moment the Government have not the final overriding responsibility; they clearly have.

12871. Can you talk in terms of formal independence, or could you refer to the position in terms of detachment, having regard to the overwhelming responsibility in the running of the economy of the country of the Government itself?——I have said earlier that in the field of domestic monetary policy each has its immediate responsibilities, while the Treasury has an overriding responsibility to ensure conformity of policy; that, I think, is what you are saying.

12872. *Chairman*: Is there any distinction in your mind between the Bank's responsibility for managing the portfolio of the Issue Department and its responsibility for managing the portfolio of the Banking Department?——In paragraph 16 of this statement I say that the Court and the Committee of Treasury are informed from time to time of details of the Issue Department portfolio; they are entitled to query its composition and to be consulted if a change of policy is envisaged. In fact the policy has remained the same, as I have already said, and I have not had occasion to raise that with the Court, though there have been occasions when I have informed or consulted the Committee of Treasury about discussions which I have been having with Her Majesty's Government about the composition of the Issue Department portfolio. The distinction between the Issue Department and the Banking Department is that the profit and loss of the Issue Department is for Government account and the profit and loss of the Banking Department is for Bank of England account; the Bank as an institution and the Court have no responsibility to their stockholders for and no commercial interest in the management of the Issue Department portfolio because they cannot make a loss or a profit out of it; the profit and loss is for account of Government.

12873. That means that the Committee of Treasury and the Governors consider the management of that portfolio, but part-time directors otherwise not?——Not normally, unless it came to a major issue of policy or a possibility of serious disagreement between the Governors and the Treasury. But the Court is responsible finally, since the Issue Department is a part of the Bank, and I should make certain before I proposed or agreed a major change of policy that the Court was behind me.

12874. *Professor Sayers*: May we take this as a correction of the evidence given to us by the part-time directors?——I believe that Sir Charles Hambro made it clear in his evidence to you that it is the job of the Securities Committee, of which he is Chairman, to look at the Banking Department's securities, the pension fund securities, and the securities in the various trust funds where the Governors are concerned, from the commercial aspect and to advise the Court whether those are proper investments for those funds to hold from the commercial point of view. That naturally does not arise with the Issue Department portfolio.

12875. Does that mean that in the handling of the portfolio of the Banking Department your operations are on occasion influenced by considerations other than the proper conduct of the monetary market?——No, it does not; but at the same time we like to have a professional committee looking at the maturities and the spreads. They look at them twice a year and advise us whether the maturities are properly spread. Of course the main decisions on open market operations and so on are taken for quite different reasons.

12876. *Professor Cairncross*: It seems to me that you have put two rather different views of the distinction between the various responsibilities of the Bank and the Treasury. At one point you rest the distinction on historical and constitutional factors, and on your statutory responsibilities as distinct from the responsibilities which do not rest on you by statute. At other times you have spoken to us in terms of the operations on which you are engaged from day to day, and have seemed to make the distinction rest much more on where you are actively in the market, even in the case of foreign exchange transactions, which at one point you thought should be regarded in much the same way as the "affairs of the Bank", although you have no statutory responsibility. It makes a considerable difference to us which is the basis of the distinctions you are drawing, because if it is a statutory responsibility it carries with it an apparent implication of a division in policy between the matters where your views should be listened to with particular respect and those where the Treasury's views should somehow be formulated and given precedence?——I was trying in this paper to clarify what I regard as the statutory position. I agree with you from the operational point of view; I think that the Treasury are just as likely to listen to our advice and opinions about exchange operations as they are about operations in the domestic money

market and the management of Issue Department securities. All I was seeking to point out was that I think the statutory requirement for them to do so is of a slightly different nature. I think that there is nothing secret or improper if I say that we carry out the operations in both fields, keeping the Treasury advised, and if any serious point of policy looks like emerging we discuss it with the Treasury, if possible before it emerges, but certainly when it emerges.

12877. In practice there is no distinction?——In the practical handling of operations I could not claim that there is a distinction.

12878. *Professor Sayers*: And in your feeling of responsibility?——It is a different order of responsibility. I feel the same responsibility to the Treasury for any advice that I give to the Treasury; but I think that institutionally the Bank has a somewhat different responsibility because the statute lays formal responsibility on it in certain fields and lays it on somebody else in other fields. That is an institutional difference; I think that my personal feeling of responsibility for advice that I give to the Chancellor of the Exchequer is the same in either case.

12879. *Chairman*: You say in paragraph 4:

"For any country operating to a great extent with private enterprise and markets, and working with other countries similarly placed, I should regard direct Treasury control over central bank operations as a major weakness."

That is partly, I think, a technical criticism of that situation. Would you care to enlarge upon why you say that? ——Partly for the reasons that I go on with in the next paragraph: I think that it is necessary for the body of persons who are dealing with these operational problems in a free enterprise society to be in extremely close day-to-day contact with markets, right up to the highest level, and for the people who have the final responsibility on that side of the house (the Deputy Governor and myself in this instance) to be primarily concerned with the market side of the business, with business contacts and business opinion in our own country, and to be in touch as far as possible with the people who are carrying out the same responsibilities in the Commonwealth and other overseas countries, who are in turn in touch with their own markets. It seems to me essential that the body which is carrying out those responsibilities and operations should approach its duties and responsibilities from that angle and not from the more parliamentary and administrative angle of a Government department.

12880. That is, as you say, what you say in the paragraph that follows. You have said in paragraph 3:

"The Bank must be in and of the market, must enjoy the confidence of Government on the one hand and of the market on the other, and must be in a position to interpret market opinions to Government and Government opinions to the market."

How much stress do you lay on that point?——A great deal. It is very important for whoever is handling these operations, which in the present position is the central bank, to be on terms with the major institutions in the market, the banks and a great number of financial and commercial institutions, where they will come and gossip with the central bank and meet central bank officials and chief executives all down the line on equal terms as one of themselves. It is immeasurably more difficult to conceive that as happening with a Government department, however competent. In fact the practice is that the central bank as constituted, with its background of experience and with the type of work it is doing, is, as I have here put it, in and of the market. We are talking all day at many levels with the clearing banks, the overseas banks, the foreign exchange market, the Stock Exchange, and a great many other people in the City and in the business community on equal terms, as one bank to another bank. I believe that that is of immense assistance to us in doing our job properly, and that if that quality and possibility were prejudiced we should lose enormously merely from the point of view of efficiency and doing the job properly. I attach very great importance to that point.

12881. In the second part of your statement you deal with your views on the position of part-time directors. How much can a part-time director who is not a member of the Committee of Treasury take part in any of the decisions which are relevant to the work of central banking, excluding the administration of the bank as an institution?——He is responsible for the formal decisions at the Court, such as Bank Rate decisions, and he is kept currently informed at Court, but I would attach far more importance to the process of continuous consultation and the seeking of his views more privately. I or the Deputy Governor probably see him twice a week, and this helps to keep abreast of his views about the general development of the things in the field about which he happens to know a lot.

12882. So it would not be unfair to say that what he contributes depends upon the use that you or the Deputy Governor like to make of him?——Certainly. I assume that it would be open to us never to speak to him except at meetings of the Court; but it does not work like that.

12883. And the use that you make of him is primarily directed to drawing upon his current knowledge of some aspect of information which you think is relevant to the decisions of the central bank?——Certainly.

12884. *Mr. Jones*: Could you draw on these personalities in some other way?——We could to some extent; but I think that with a corporate body one gets a sense of continuity; we are all colleagues. I find it very much easier to get a continuous use of people's experience like that. There are obviously a great number of other people on whom I rely for advice, in the City and elsewhere, and they come in and see me. In those cases one is usually looking for something specific or what a particular section of the City feel about a particular matter, and one does not get the same advantages of continuity and sharing of responsibility as one does from colleagues whom one sees regularly and as a matter of course.

12885. Would you say that there is continuity and nothing much else?——I would regard it as sharing responsibility. I have in the course of my life to take a number of decisions on a number of difficult problems, and it is a great comfort to me to feel that the responsibility is shared with others.

12886. You regard it more as an anchorage?——I regard it first as a help and second as an anchorage.

12887. *Professor Cairncross*: Suppose that the Governors were themselves to decide upon changes of Bank Rate without bringing the matter before the Court or the Committee of Treasury; would the situation be essentially different?——It would remove a good deal of what Mr. Jones calls my anchorage.

12888. You would still be able to consult individual directors freely?——It would remove the anchorage without doing much else.

12889. *Professor Sayers*: Do you feel greatly in need of that anchorage?——I like all anchorages.

12890. *Chairman*: You say in paragraph 18:

"The Bank owes much of its standing, and of the confidence it enjoys at home and abroad, to the knowledge that the actions taken by the Governors have the support of the wide experience and integrity represented by the Court of Directors."

It does not seem to me, in view of what you have just been saying, that in fact the actions which the Governors take are supported by the Court of Directors, except in a sense that they join in the formal decisions of the Bank? ——If they did not support them they would not join in the formal decisions.

12891. But they are not really put in the picture in a sense that they could be participants of the decision?—— The Committee of Treasury, as the Court's chosen representatives, are very much in the picture.

12892. You lay it on the Committee of Treasury?—— I lay the formal decision largely on the Committee of Treasury. It is conceivable that the Court would reverse a decision of the Committee of Treasury, but that has never been the practice, and I cannot easily see it happening.

12893. It is neither the atmosphere nor the practice? ——It is neither the atmosphere nor the practice.

12894. Could I re-translate what you say in paragraph 18, so as to say that the Bank owes the confidence it enjoys to the knowledge that there are some part-time directors

who are members of the Committee of Treasury?——No; I am sorry, I would not accept that. It is all part of Mr. Jones's anchorage. It certainly is known or assumed that any change in the Bank Rate or any action taken by the Governors does have the approval of the Court, even though as a matter of working the Court may delegate their consulting processes to the Committee of Treasury. While it would be very extraordinary for the Court to reverse a recommendation of Committee of Treasury on an important matter, it is perfectly conceivable that the Court might say that they did not like it and were going to have a different Committee of Treasury. The opinion of members of the Court as a whole is a very relevant matter, which any Governor will disregard at his peril.

12895. *Professor Cairncross*: The person who in the last resort has to defend the decision of the Court is the Chancellor; he takes the responsibility?——If you will forgive me, I think that it is his own decision of approval that the Chancellor has to defend. The decision is the Court's decision.

12896. But at the same time the Chancellor has to review the decision that the Court favours alongside a great many other matters in which it has to fit, and he is not taking a single decision about each of these matters; he has to decide them all simultaneously, so that it is in effect impossible for him to accept one view on Bank Rate and another on monetary policy. He has then to defend to the House of Commons the whole complex decision. It would be impossible for him to shoulder that responsibility readily without going the whole hog on the Bank Rate and taking responsibility for it. Is it not rather an uneasy division?——I think you must ask the Chancellor that.

12897. I wondered if you had views?——My view is that this works all right as it is.

12898. *Mr. Jones:* Would not decisions taken by the Committee of Treasury on Bank Rate be more or less formal decisions? Have there been occasions at any time in the history of the Bank when recommendations have been made to the Committee of Treasury that have not been approved?——Not in recent times when it came to the stage of a formal recommendation; but there is normally a great deal of to-ing and fro-ing with the Committee of Treasury before it comes to the stage of a formal recommendation.

12899. Would that result in some delay?——It might do, or we might have three meetings in a day, or sit for five hours. That is the ordinary process of committee consultation. But the Committee of Treasury do consider the points arising and issues very thoroughly.

12900. But there is no history to prove that they have amended any recommendation?——Not when it comes to the stage of formal recommendation; but ideas and suggestions are frequently considered in the normal machinery of consultation of any body.

Chairman: Unless, as a result of these questions, you would like to add anything, Mr. Governor, I think that exhausts what we wanted to ask you?——No, my Lord Chairman, I have nothing to add.

(*Adjourned until Thursday, 22nd January, 1959, at 10.45 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-SEVENTH DAY

Thursday, 22nd January, 1959

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
W. E. JONES, ESQ., O.B.E. (Questions 12982 to 13044 only.)

PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH

MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The following note was sent to the witnesses examined at this sitting:*

The Committee is anxious to learn more about the reactions of customers of the banks, particularly of medium and small industrial and commercial concerns, to the credit squeeze and the movements of Bank Rate between 1955 and 1958; the following questions give an indication of the points on which the Committee would like to draw upon the experience of those managers who come to give evidence:

1. Did the restrictions on bank advances of July 1955 and July 1956 prevent any customers from proceeding with investment or stock-building plans for which they wished to borrow?
2. Is it thought that customers who were refused the full overdraft facilities for which they asked were generally able to, and did in fact, satisfy their borrowing requirements from other sources? If so, was any impression gained of what were the other sources upon which they drew?
3. Was the demand for overdraft facilities in 1955 and 1956 affected by the increase in lending rates consequent upon the increases in Bank Rate in those years?
4. Did the reduction of Bank Rate from $5\frac{1}{2}$ to 5 per cent. in February 1957 cause customers to take a more optimistic view of business prospects and to seek extended borrowing facilities?
5. On 19th September 1957 the Bank Rate was raised to 7 per cent., and the banks were asked to keep their total advances during the following twelve months at a level no higher than that of the preceding twelve months. The Committee has heard evidence which suggests that the decline in advances which followed was largely spontaneous, in that customers were themselves taking steps to reduce or pay off overdrafts rather than being requested by their banks to do so. Is this evidence confirmed by the experience of the bank managers?
6. If the decline in advances after September 1957 was largely spontaneous, the causes for the decisions by the customers concerned might have been:
   (*a*) the high cost of borrowing,
   (*b*) fears of a downturn in business and reductions of profits, leading to deferment of investment decisions and a pause in accumulation of stocks,
   (*c*) the decline in commodity prices, reducing the cost of carrying stocks of materials, or
   (*d*) decisions to defer fixed investment projects taken in 1955 or 1956 as the result of the governmental measures taken in those years.

   Were bank managers able to assess the relative importance of these factors to their customers at the time (bearing in mind that the same factors might not be decisive for all kinds of borrowers)?
7. Did it appear that medium and small businesses were at a disadvantage compared with larger concerns as regards the restrictions of bank advances, as regards increases in rates of interest, or in the ability to find and make use of other sources of finance when refused bank credit?
8. Did customers generally regard dearer money as a purely temporary phenomenon, and therefore as something that could be disregarded in their planning?
9. Was there a noticeable tendency for customers to transfer funds from current to deposit account upon a rise in the bankers' deposit rate, or *vice versa* upon a fall in the rate?
10. Was there a noticeable tendency for customers with funds on deposit account to move those funds into other forms of short-term investment (e.g. Treasury Bills) when Bank Rate was raised, or *vice versa* when it was reduced?

The following witnesses called and examined:

L. G. MILLHOUSE, ESQ., Manager, Lloyds Bank Ltd., Leicester,
G. E. SPEED, ESQ., Manager, Williams Deacon's Bank Ltd., Newcastle-upon-Tyne,
H. R. SUTTLE, ESQ., Manager, Martins Bank Ltd., Bradford.

12901. *Chairman*: We are very glad to see you today, gentlemen, and to have the opportunity of drawing on your experience on these questions that we have sent you. I think that it would be convenient to take the list of questions, because they were carefully prepared from the point of view of what we want to know and what we thought that you would be able to help us on, and work through them, inviting each of you to contribute his own personal experience. The first three questions relate to the period 1955-56; that involves looking back a bit over earlier years. Could you now, each in turn, give us any answer you can on question No. 1?——*Mr. Speed*: I think that the restrictions on bank advances of July 1955 and July 1956 did prevent some customers from going ahead with expenditure which they had planned, but one has to bear in mind that, while the official request of 1955 was quantitative in terms, the qualitative restriction of earlier years was still in force, so that if customers were in an industry or trade that the Government wished to be supported they would stand a good chance of getting their requirements. Another point is that they were probably not so much prevented as discouraged by the publicity of the credit restrictions. As far as stock building went, it would depend whether the stock building was regarded by us as seasonal or purely speculative stock building. If it was seasonal, they would probably have had no difficulty; but if it was speculative they would.

12902. If they were in the favoured classes within the qualitative directives, your recollection is that you did not find yourself turning people away?——Not if they came within a favoured category.

12903. But among the people who did not come in those categories you did find that there were some customers who wanted accommodation, but you could not supply the full amount, or any at all?——We could not.

* *Note.* The witnesses examined at this sitting were selected by the Committee of London Clearing Bankers in response to the Committee's request to be allowed to draw directly upon the experience of branch bank managers as to the influence of credit conditions upon the reactions of the customers of the banks.

12904. What do you think happened?——They could already have made the necessary arrangements for the finance before the publicity of the July restrictions; or, if they were working on an agreed overdraft limit, it might well have been that the reduction that was made of that limit still left them sufficient margin for their requirements.

12905. Did you get the impression that they could look elsewhere if you could not meet them? Had they other means of finance open to them?——At that time, yes. It rather depended on the size of the requirement. You mention particularly medium and small industrial and commercial concerns; I would like some indication of what you mean by "medium and small".

12906. What would strike you as being reasonable? ——I would say a medium sized business was one with an annual turnover of, say, £500,000 to £1mn.; below £500,000 I would say it was small.

12907. That is the sort of size we had in mind.——As far as my experience is concerned, in the north-east, if they had made up their minds to go ahead even if refused by us, they did in fact find the money.

12908. Can you indicate the kind of alternative sources to which they went for that purpose?——It rather depends whether they were in commerce or industry. Industrial concerns could still go to the hire purchase companies instead of to us to finance the purchase of plant, machinery, vehicles, etc. At that time the insurance companies were still in the market for finance, for larger amounts, down to about £5,000. I do not think that the insurance companies had any official directive for some time after us, and at that time they were lending quite considerably either directly on mortgage or, if it was a large amount, buying whole properties and leasing back. A certain number of building societies were still in the market for commercial lending. Merchant bankers were still providing funds to quite a large extent, I found.

12909. *Professor Sayers*: Did you see instances of all these kinds in the range of your customers?——I saw some of them and was advised of the others. I certainly saw the building societies, the insurance companies and finance houses.

12910. *Sir Oliver Franks*: This is a thread that will run through all the questions: the point that Professor Sayers put is that what we are looking for from you is direct information of what you yourselves either experienced or knew on advice; actual fact as opposed to the generalisations which one might get from a textbook or whatever other source.——Those I have mentioned were either from actual experience or advice from the customers concerned. There was quite a large amount, although possibly more later on when other sources were tight, from private financiers locally.

12911. *Chairman*: Local people who were willing to lend money?——Yes.

12912. What sort of scale of financing are you speaking of there?——Probably up to £20,000.

12913. What was your experience, Mr. Suttle?——*Mr. Suttle*: My experience in the Bradford area is coloured by the principal trade which is the wool trade. In Bradford my commercial customers are dealing mainly at the primary end and require little or no capital investment. So far as my experience is concerned, therefore, I have not much evidence of capital investment being affected. If it came within the permitted object, then I was able to give it consideration; if it did not, it probably did not apply in my case. Regarding the stock building plans, I must also separate speculative stockholding from normal seasonal stockholding, which is such a feature of the wool trade. The seasonal stockholding was not in my experience affected at all.

12914. What exactly do you mean by speculative stockholding: an attempt permanently to increase the line of stock the man intends carrying?——No; the attempt of a particular merchant who feels that prices are going to move upwards to have a greater stock than his normal sales turnover would justify. The branch manager would be able to form an opinion as to whether the stock acquisition was greater than his normal usage.

12915. *Professor Cairncross*: In deciding whether to refuse accommodation for stock building in 1955-56, did you in fact take a more severe line than you had done previously?——Not if it was in the normal course of the intending borrower's business. At that time, you will realise, the emphasis was still that there should be nothing done to endanger production.

12916. Were there some requests for advances which you refused in 1955-56 but which you would not have refused in 1954-55?——Only in so far as they would relate to speculative stock piling or capital investment outside the permitted objects.

12917. *Professor Sayers*: At the beginning of your first answer you said that you had not much evidence of capital investment being held up. Did you have any specific cases where it was held up?——There may have been one or two cases, but they were only small and not significant; as I endeavoured to emphasise, so far as my branch business is concerned capital investment is not a material factor. Most of the customers work on stock and debtor positions.

12918. *Chairman*: You do recollect in that period disappointed customers from the point of view of wanting money from the bank with regard to stock increases? ——Not if they were within the normal seasonal trade.

12919. But there were some who were not?——There may have been one or two, but they were not many or significant.

12920. If they were disappointed in not getting anything from you did they get it elsewhere?——They were able to get it elsewhere if there were such cases. We understand the seasonal nature of the trade, and such borrowing as occurs is for a limited period in line with the seasonal market.

12921. *Professor Cairncross*: Was there a change of policy in respect of speculative stockholding in 1955?——No. In the normal way the bank would inquire very closely into a request for borrowing for speculative purposes.

12922. Would that not mean that people who were disappointed in 1955 would have been disappointed if they had made an application a year or two previously? ——Quite probably.

12923. *Sir Oliver Franks*: The point of the question is whether your practice as a lending manager was the same in 1955-56 as it had been in 1954-55, so that the Government policies in the second period did not make a practical difference to the decisions you actually took? ——Excluding the particular types of lending that were precluded by the credit restrictions, anything for trade and export (and export incidentally plays a very large part in the area from which I come) they all received the same consideration.

12924. *Professor Cairncross*: Was there any type of customer who was denied credit from the middle of 1955 onwards to whom you had previously been in the habit of giving credit?——It is difficult to generalise, except for those who were seeking to borrow for purposes which had been definitely excluded under the emphasised credit restrictions of 1955: the holding of speculative stocks and the speculative holding of property, for instance.

12925. *Chairman*: Were not those standing instructions on which you were already working?——Yes; so there was really, generally speaking, little difference.

12926. *Professor Cairncross*: Quantitatively it could not have amounted to very much?——No.

12927. *Chairman*: What was your experience, Mr. Millhouse?——*Mr. Millhouse*: As far as my area is concerned there were definitely restrictions on the provision of funds for capital purposes. As far as the provision of overdraft facilities for stock were concerned they were provided in the ordinary course of business, Leicester being almost wholly a manufacturing area, as distinct from a stock or warehouse area, where people do not carry stocks but make against firm orders as a general rule; there is little in the way of speculative manufacturing and, therefore, little in the way of speculative stockholding. So the ordinary overdraft facilities which might have been taken for stock building were self-liquidating in that the stock went out in the ordinary way. If finance was specifically requested for new machinery it was usually turned down as being capital investment; but it is extraordinarily difficult particularly when one realises that the industrialist is usually very well informed. If he knows that he is coming along to request facilities for capital purposes which are specifically forbidden, he can very readily turn his request

another way round and do it within the framework of his fluctuating business. There were one or two cases, not much at all, where the hire purchase houses provided the finance for machinery. That applied in the sphere of nylon hose knitting machines which are very expensive: £20,000 or £25,000 each. It is very difficult for a man to disguise that amount in the ordinary run. If a nylon hose manufacturer wanted new machinery it was usually for a fairly large amount, and at that time there were hire purchase companies who were ready to provide it. Indeed, a good deal of that was done.

12928. How far did the restrictions of July 1955 and 1956 set up any new relationship between yourself and your customers? Were you not already working a system of qualitative restrictions?——Yes. The new restrictions worked in this way: in the ordinary way we should have been prepared to finance the purchase of new machinery in the ordinary course of a customer's business, but with the restrictions imposed in 1955-56, if the request was put to us specifically for that purpose, we were bound to say no.

12929. *Professor Sayers*: Do you remember any case in which as a result of your saying no to such a request the customer did not proceed with getting his machinery?——Not at that time.

12930. *Professor Cairncross*: None of you has told us whether your advances did in fact fall from the middle of 1955 onwards. Would it be true to say that advances were fairly constant after that date?——*Mr. Millhouse*: In my particular case advances are never constant; there is a tremendous seasonal swing and even the comparison of the peak high and peak low would not give a true indication of any effect of downward pressure. What would have a more considerable effect on the peak figures would be the speed with which the businesses were being conducted at that time, in other words the rapidity with which the money was provided and came back again, and the extent of trade in the area.—*Mr. Suttle*: The Chancellor had made a request for "a positive and significant reduction" in the overall lending of the banks, so that the effect of that was felt at the branches and we had to endeavour to reduce limits.

12931. I was asking whether in your branches you did find that your advances in fact fell?——*Mr. Suttle*: Yes; they fluctuate seasonally, but in certain categories they definitely fell.—*Mr. Speed*: The first and the greatest impact of the quantitative directive was on the personal and professional classes, at least as far as the branches were concerned. The question of making this quantitative reduction was, in my case at any rate, a matter for Head Office; hence if the requests came within the favoured classifications, they did at that time have a reasonable chance, provided they were creditworthy and would have been agreed to previously. The level of advances at my branch was indeed down, but a lot of that was due to the personal and professional classes which suffered quite a severe cut at that time.

12932. *Chairman*: What would be your answers to Question No. 3?——*Mr. Suttle*: My answer would be no. —*Mr. Millhouse*: Mine would be no.—*Mr. Speed*: Definitely, no; it did not make the slightest difference.

12933. I think we can leave it at that; those answers are very positive! What about Question 4, Mr. Speed?——Indeed, yes. The reduction of Bank Rate in February 1957 had a psychological effect. In my experience some customers got the impression that it was a green light in spite of official warnings to the contrary. I think that the Press publicity in the manner of its wording gave them that impression.

12934. How did it reflect itself in your dealings with them? Did they come in using that as a handle for saying that they wanted some more money?——Yes. There were quite a few tentative approaches as a result of that reduction.

12935. *Sir Oliver Franks*: Can you recollect what they actually said to you?——I can remember quite a number saying: "I hear the credit squeeze is over", or: "I understand the credit squeeze is finished".

12936. *Professor Sayers*: Did this reaction come mainly as a result of the particular way in which it was treated in the Press, or do you think that it was associated very directly with the drop in Bank Rate itself, and that whatever the Press comments had been there would have been this reaction?——*Mr. Speed*: It is difficult to say. Had there been no Press comment at all apart from the bare announcement that the Bank Rate had fallen, I think that it would have had very little effect. It depends on the type of businessman of whom one is thinking. The small man would not have bothered very much, but the popular Press was quoted to me on quite a few occasions; people had read the headlines.—*Mr. Suttle*: My experience was somewhat different. There were just odd cases where people made the inquiry, or volunteered a statement that things were easier and credit restrictions relaxed, but generally speaking the view of the businessman in the wool textile trade was that this was not satisfactory evidence of an improvement. Coincident with the reduction in the Bank Rate there was a fall in wool prices, and the general consensus of opinion among my customers was that it was a little too early yet to decide whether the fall was going to be beneficial to trade.—*Mr. Millhouse*: In my area the reduction had little or no effect at all. I do not think that any of my customers took the view that things were going up; they look a long way ahead, and most of them took the view that inflation was probably still on the way and that this reduction in the Bank Rate was of little or no importance at all from the bank borrowing angle.

12937. Are we to understand that they were little affected because they had had little sense of any squeeze before?——I do not know what the reason was, quite honestly; I do not think that it was anything to do with the squeeze. Men acquire after many years of hard work in industry an intuitive sense whether things are going right or wrong; I think that this was one of those occasions when they said, despite the apparent optimism which might arise from this cut in the Bank Rate: "We do not believe it".

12938. *Chairman*: From your experience, do they attach importance, from the point of view of their general business prospects, to the movements of the Bank Rate? Does Bank Rate up mean: "Go slow", and Bank Rate down: "Go ahead"?——Bank Rate up does not mean: "Go slow". It does not make any difference at all generally speaking, to an industrialist, especially when it is coupled with a high rate of taxation, because the incidence of the high interest rate is offset by the allowance for tax purposes, and a manufacturer can in many cases pass on any increased charge to the consumer. It could apply, and in fact the very high Bank Rate of 7 per cent. did apply slightly, in those cases where margins were very thin. A concrete example here in a small way is a manufacturer who manufactures exclusively for one store where prices are cut to the minimum; there is no margin for any increase in his overdraft charges because he cannot recoup that from his one customer. But that is a very exceptional case.

12939. I was rather wondering whether it was ever taken as a general trade sign?——I think that the high Bank Rate has been taken as a general trade sign, particularly the 7 per cent.

12940 *Professor Sayers*: On this drop in February 1957, when the morning papers came out with the headline "Bank Rate reduced by a half per cent." or "Bank Rate down to 5 per cent." what sort of thing did customers say when they came into your office that morning?——They were rather humorous about it. They do not take a great deal of notice of the popular Press. They laugh and joke about it. They are very quick to turn it to the disadvantage of the bank manager if they have a chance to do so, but it is all done in very good spirit and they usually get back as good as they give. But Press comment, or what they term uninformed Press comment, is little regarded by the industrialist.

12941. *Chairman*: That brings us to Question 5. How would you answer that, Mr. Millhouse?——The answer from my experience is yes. There was a cumulative effect of the publicity and downward pressure, giving the feeling that facilities were not easily obtainable. I am sure that the reductions were not a direct result of the higher rate charged on overdrafts; but there was a very strong feeling indeed that this 2 per cent. rise in the Bank Rate, which was a very large increase, comparatively speaking, was evidence to the world, and to my customers in Leicester, that the Government realised the danger to the country's economy and were determined to take very positive and strong steps to do what they could to preserve the economy and currency. Broadly speaking, I think that is the way in which people's minds worked.

12942. Realising, as you say, that that meant firm and determined Government action, how did that influence their own decisions about whether they would go ahead on the same level of activity or less or more?——They were more cautious in their approach to business, and they were going to keep themselves in as liquid a state as possible, because they all know that liquidity is the answer to difficult business periods.

12943. *Professor Cairncross*: Does what you say about the higher rate apply equally to the personal and professional customers?——No.

12944. Did they try to pay off their overdrafts rather more rapidly?——They had been under a considerable amount of quiet but firm pressure for a good long period. Very few private individuals wanted to pay 8 per cent. unless they had to borrow; and if they had to borrow it was difficult for them to repay because they were paying 8 per cent.

12945. *Professor Sayers*: You mentioned just now how the businessman sees the answer in increased liquidity. He can get increased liquidity in various ways; by not buying machines, by reducing stocks and by turning off labour, and so on. In which of these various ways did you see customers making deliberate efforts to increase their liquidity?——The cutting down of the wages bill was never undertaken except as a last resort. If there was work to be done the workpeople were employed. Indeed I think that there is a good deal of concealed unemployment in industry in our part of the world; there is a good deal of very old family tradition. People have worked for the same firm for three generations, and employers are very loath indeed to turn away their people; they will find some job for them to do. When trade is bad, if there is no work for them to do, they have to be sacked; but very few employers, as far as I know, preserve their liquid position by cutting down on their wages bill while they have work for their people to do. The main method by which they preserve their liquidity is by not undertaking new purchases of machinery and extensions to their factory premises, or anything which involves medium to long-term borrowing or investment of their capital resources.

12946. On the face of it a good deal of such activity would show itself rather slowly, in that it involves a good deal of planning and preparatory work. Did you see quick effects of this kind?——I would like to take you up on your statement that the purchase of new machinery and the building of new factory space takes a long time to plan ahead; it does not really in many industries. It is a thing which can be put into mind, plan and operation within the space of three months. It depends very much on the swing of trade.

12947. You are talking of your own customers?——Yes.

12948. So that there could be effect within a matter of a few months?——Yes.

12949. Did you see these effects?——Yes.

12950. The effects of September 1957 would show themselves by the end of 1957 or early in 1958?——Yes; in the spring of 1958, I would say.

12951. *Chairman*: Then, taking questions 5 and 6 together; your general impression was that banking pressure was not needed after September 1957, and that the reduction was mainly spontaneous on the part of the customers of the bank?—*Professor Sayers*: Your suggestion was that they bad taken fright?——Yes, I think that it would be right to say it was spontaneous to that extent.

12952. *Chairman*: And the motivation was that they sought to remain as liquid as they could, and the whole stress lay on the side of not indulging in any extensions or additions of plant?——*Mr. Millhouse*: Yes.—*Mr. Suttle*: From my experience the answer to Question 5 is that such decline in advances as took place was automatic; it was on the part of the customer himself rather than the bank. It arose out of the climate that had been created by the previous factors and influences and emphasised by the steep rise in the Bank Rate, which brought home even to the waverer the firm conviction that things were difficult and that he had to play his part in it. From their own personal point of view some had to delay this reduction in advances because they had certain commitments, for seasonal stocks, for instance; but when they could they got rid of them. All those who were able to reduce borrowing did so for the reasons I have stated; first, the climate that had been created before; second, the fuller recognition of the serious state of affairs and, thirdly, the cost of the borrowing at that stage.

12953. Can you distinguish at all the kind of customer to whom the cost of borrowing as it had become might be relevant?——No. I think that one must apply that generally. They all thought that money was dear and borrowing expensive, and if they could reduce that overbead cost they would do so.

12954. *Professor Sayers*: Was this feeling that borrowing was expensive new after September 1957?——Yes. The real impact was then. Before that it had not affected them at all.

12955. *Professor Cairncross*: It did affect them, however, in conditions in which the outlook of the wool trade was not as rosy as it had been?——*Mr. Suttle*: Yes. It was obvious to the wool merchant that to maintain a stock was going to be quite expensive in the light of the increased cost of borrowing money and the coincident decline in prices.—*Mr. Speed*: I am wondering about the word "spontaneous" as suggesting a conscious, direct effort on the part of borrowers to reduce the amount of their borrowings at that particular time. I do not think that that interpretation is quite correct. I would say that it was more in the natural order of things and the way trade was going at the time. Old arrangements had worked themselves out, and the overdrafts previously arranged had been paid off or reduced. The main thing was that new ones were not being granted, and not as many people were asking for new ones; one that had been paid off would not ask for a renewal, or if it had been reduced would not ask for a further increase. The 7 per cent. Bank Rate and the publicity that went with it had quite an impact on the businessman, and did prevent or discourage him from making these approaches. But I would not say from my experience that there was a conscious effort on the part of borrowers to get overdrafts down because of the Bank Rate.

12956. *Chairman*: Do you think that the fact that bank advances did reduce themselves after September 1957 was due to a desire on the part of customers to be liquid, which is a positive thing, or that trade circumstances were making them liquid anyway?——A little of both. In so far as they had planned and borrowed prior to September 1957 for a specific purpose, they aimed at managing without borrowing after that purpose had been fulfilled. The general realisation of the situation discouraged some from asking for further advances and, for the same reason, there was not the same volume of new applications for overdraft facilities after September 1957. Whether the reduction was in fact partly due to the high cost of borrowing rather than a realisation of the seriousness of the situation (and the difficulty in obtaining bank finance) depended, in my experience, on the margin of profit of different businesses. A few on a small profit margin were deterred by the high rates. Those with a larger margin of profit (and in my area, in spite of the falling off some months earlier in freight rates, 1957 was a good year and fears of a contraction of business and profits had as yet only a limited effect), the 7 per cent. Bank Rate did not stop them from trying to borrow. The reduction of advances largely resulted from the refusal of new loans and the natural repayment or reduction of previous advances by virtue of trade conditions; it was the situation of the particular concern that brought about the reduction rather than a conscious effort.

12957. *Professor Sayers*: Your answer is that, as far as new applications for loans were concerned, there was some positive pressure from the side of the banks?——I would say so. There again, I am rather affected by the fact that my area largely depends on shipbuilding and coal. For a long time shipbuilding had very favoured treatment from C.I.C.; and a number of ancillary small and medium-sized businesses, because of their direct association with shipbuilding etc., had a similar measure of priority.

12958. *Chairman*: Question 7 is directed to any difference you may have observed in the way these things affect the small and medium businesses as compared with the larger concerns. Would you like to say anything?——*Mr. Millhouse*: As far as the principle in operation at the time is concerned, the medium and small business was treated in exactly the same way as the larger business. It cannot be denied, however, that with the larger business and their very much more powerful swing in turnover

figures and so on, a request for overdraft facilities can be disguised more easily. I feel that the industrialist took advantage of the situation; he knows what be wants and how to go about getting it. He knew very well that if he came in and asked for £10,000 to put an extension on his factory he would not get it; but an additional borrowing of £10,000 to finance a seasonal swing in trade for export (and there is a tremendous amount of export business emanating from Leicester) would be different. They are all wise to that. The smaller man was obviously at some disadvantage in that he could not, by the very nature of his business, to the same extent disguise what he was doing with the money. It is impossible for a bank manager to follow out in many cases the use to which the money which is borrowed is put.

12959. Is it not impossible for anyone, let alone a bank manager?——There are cases when it can be done; one can see a new factory going up, or new machinery being built. We visit our people and walk round the factories and talk to them about it.

12960. Your general point is that the larger concern is so placed that it can nearly always find an approved purpose for which it can say it wants money?——Yes. I think also that the larger business going outside for finance for which it was no use asking the bank got preferential treatment because the people who were in a position to provide that money were not bound by the same restrictive directives as the banks were, and could obviously pick and choose the people to whom they could lend their money and the terms on which it was lent.

12961. That is derived from your own observation?——*Mr. Millhouse*: Yes.—*Mr. Suttle*: My experience is pretty well on all fours with Mr. Millhouse's. So far as the restrictions on bank advances were concerned, we endeavoured to treat all alike. So far as the increase in the rates of interest were concerned, I do not think the smaller man was worse off, except with regard to the fact that any rise in the cost of living possibly affects the smaller man more than the man with greater resources. So far as the ability to find and make use of other sources of credit is concerned I would say that the advantage lay with the bigger businesses.—*Mr. Speed*: As regards the restriction of bank advances I would say that they were not at a disadvantage. All of them at that time, if they wanted over £10,000, had to go to C.I.C. unless it was unsecured or seasonal borrowing. I do not think that they were at any disadvantage as regards being considered. It depended on the type of business that they were running. As regards increases in the rates of interest, I do not think that it matters much whether they are small, medium or large. It depends whether it is long or short-term borrowing. With the small ones, in my experience, it depended on their margin of profit. I still had some who were prepared to pay the bigger rates. As to the ability to find and make use of other sources of finance, the north-east was still relatively prosperous in 1957 despite the slackening shipping market and freight rates. Some small and medium concerns were very conscious of the situation and thought it was not worth trying. They thought that they would be refused if they came to the bank, or they went to the bank, were refused and did not bother to go elsewhere. But others were determined to get the money, and in my experience they got it. There were plenty of other sources open to them. The large man has the market which is denied the small man, but he has to be vetted by C.I.C. before he can make that approach.

12962. The only way these various restrictions differentiated between small and medium concerns and large concerns is that there were a number of small and medium concerns who did not know where to turn?——Or did not trouble. It was not as urgent to them as to others. If there were people who were determined to have it and whom I had refused, they got it elsewhere.

12963. How did they find the way to get it elsewhere? Did they ask you?——Yes, I was asked. A number of the more obvious sources that had been available in 1955 and 1956 had closed. The insurance companies and building societies were no longer in the commercial market. A few of the finance houses were still operating, in so far as they could. We had kept their advances down when we made the first quantitative reduction, but they appealed to the public for deposits and were in funds in 1957.

12964. How does the small man know where to turn to?——Purely from business associates. After being refused at the bank they try the normal sources: finance houses, building societies, etc.

12965. How does he find his way about if he wants to keep on looking?——*Mr. Suttle*: The finance houses advertise. A number of customers asked me if I could suggest alternative methods, and I mentioned the insurance companies, building societies and the like.—*Mr. Millhouse*: I think it is a snowballing effect. A small man tries, say, a building society and someone in the building society says: "We cannot do it, try so-and-so", and he goes from so-and-so to so-and-so. It is surprising how many avenues open up with this constant inquiry.

12966. *Professor Cairncross*: You mentioned, Mr. Speed, that resort had been made on occasion in your area to private financiers for sums up to £20,000. Presumably that was by the small and medium-sized business. Do you know what sort of rates would be charged on those occasions?——*Mr. Speed*: I have heard of 10 and 12 per cent. being paid. I have heard of higher being asked for but not taken up. In one case I heard about they were asking 20 per cent., but the customer did not take advantage of the offer.

12967. Do you know if this is a normal part of the method of seeking finance by small and medium businessmen in your area, or is it something that came to the front after the credit squeeze became more intense?——It was something that came as a result of the credit squeeze. The general reaction since has been to come back to the banks.

12968. *Professor Sayers*: Did the supply of funds through this channel tend to dry up after September 1957 or not?——There again, as Mr. Millhouse said, new avenues are always opening up, and though the initial approach is possibly local these people would get introductions to various other centres; they would borrow from anywhere to get the money. There must have been a limit to the amount, but I was not aware of any noticeable drying up of resources. I still do not know of any small or medium businessman who was determined to get the money and failed to do so, provided that the price he was asked to pay was compatible with his margin of profit.

12969. Since September 1957 have you known many cases of people getting money from these private sources?——Quite a few. For small sums of a few thousands one source was private mortgages from private firms.

12970. These are long-term loans?——In that case, yes, if by long-term you mean five years and upwards.

12971. *Chairman*: What about Question 8?——Whether they regarded it as a temporary phenomenon or not would depend on whether their planning was long-term or short-term. If it was a long-term plan it would affect them because they would be fixing loans at high rates for a long-term period.

12972. *Professor Cairncross*: You mean that they would be reluctant to enter into long-term borrowing?——At those rates, yes.

12973. *Professor Sayers*: Would they in such circumstances borrow short with the idea of refinancing when rates came down?——*Mr. Speed*: I cannot recall any cases of that.—*Mr. Suttle*: I had no personal experience or evidence of that.—*Mr. Millhouse*: Nor I.

12974. *Chairman*: Question 9?——*Mr. Speed*: My answer is yes, quite definitely. *Vice versa*, not so definitely.—*Mr. Suttle*: I agree.—*Mr. Millhouse*: I have had the same experience.

12975. *Professor Sayers*: Even the 3 per cent. fall in rates during 1958 has not brought an appreciable swing back?——*Mr. Speed*: They tend to leave it on deposit unless they require it for a specific purpose.

12976. *Professor Cairncross*: Do you find that when the rates come down again they begin to move the money out of deposit account to some other financial institution? Do they become more interest conscious?——Yes, I have had some experience of that. As the Bank Rate has come down they have become more interest conscious and there has been a tendency to move some of it out for a higher rate of interest.

12977. Question 10 relates to a slightly different issue, as to whether any of your customers have shown any disposition to move, for instance, into Treasury Bills when rates were higher?——Treasury Bills and other

things, in particular municipal short-term loans for seven days, or for three months and thereafter on seven days' notice.

12978. Would you regard this as a general trend or is it something which disappears eventually?——It has slowed down. I am merely guessing now, but I would think that it would disappear, although there has been only slight evidence of a reverse tendency.

12979. In the case of movement into Treasury Bills that must be on a considerable scale because of the minimum that would have to be subscribed. Is it the industrial customers you notice making this move?——Yes.

12980. Do you act for them?——*Mr. Speed*: Yes.—*Mr. Suttle*: That is my experience also. I noticed a wider use of tax reserve certificates. The reverse tendency is not so marked.—*Mr. Millhouse*: My experience is the same.

12981. *Chairman*: Are these customers businesses of some size with surplus funds?——*Mr. Suttle*: Yes. I have even had experience of the personal and private customer taking Treasury Bills.

Chairman: I think that completes our questions. We are very much obliged to you, gentlemen, for coming today; you have helped us very much.

(*The witnesses withdrew.*)

The following witnesses called and examined:

F. W. BARRACLOUGH, ESQ., Manager, Midland Bank Ltd., Bristol.
C. J. CLIPSHAM, ESQ., Manager, Midland Bank Ltd., Coventry.
J. P. FURMSTON, ESQ., Manager, National Provincial Bank Ltd., Portsmouth.

12982. *Chairman*: We are much obliged to you, gentlemen, for coming to help us with answers to these ten questions of which we have given you a list. What we want to draw upon is your own actual experiences as you saw things operating. Perhaps you will each say in turn what your experiences are. Mr. Furmston, taking the first two questions together, what would you say?——*Mr. Furmston*: I would say that the restriction of advances in 1955-56 did prevent some customers from proceeding with their investment programme, but not a very big proportion, because by and large they got the money from somewhere.

12983. Was there a difference between 1955-56 and earlier years?——Yes. We had to say no to quite a lot of worthy people; but the first step they took by and large was to stretch their credit as far as it would go. The farmer used the corn merchant, the builder used the builders' merchant or the timber merchant. If his accommodation was £10,000 and was cut down to £9,000, by stretching his credit he probably found that extra £1,000.

12984. By going for trade credit in his own circles?——Yes. Sooner or later, of course, the builders' merchant and the corn merchant themselves came up against it. I think that business then tended to go to the more powerful battalions who had got funds they could finance these people with. Then another thing that happened was that a builder who wanted some new equipment, or a farmer who wanted a new tractor, tended to go to the hire purchase people rather than to us. For more extended investment programmes at that time the insurance companies were finding quite a lot of money for them. They offered more in 1955 than later on in 1957. At that stage people by and large got the money. Possibly the smaller man found it more difficult to get it, but we tended to be very considerate to the small man who had not other avenues.

12985. Mr. Barraclough, how far do your experiences run on the same lines as Mr. Furmston?——*Mr. Barraclough*: I would not differ from anything that Mr. Furmston has said. The bulk of the customers in 1955 and 1956 obtained their requirements from some source, but there were exceptions. Very often plans were modified or postponed, and ultimately in many cases assistance came from insurance companies for capital investment, and from hire purchase concerns for plant and machinery.

12986. You did find after the restrictions in bank advances in 1955 and 1956 that you had more disappointed creditworthy customers than you had before?——Definitely. They were refused bank accommodation; but the bulk of them in those days did obtain credit elsewhere.

12987. *Professor Cairncross*: You are speaking now of industrial customers?——Yes.

12988. The private and professional customers must have been disappointed too?——Yes, and they found more difficulty in obtaining alternative sources of finance.

12989. *Sir Oliver Franks*: Are these cases where the banks refused customers in 1955 and 1956 and finance was found after negotiation from alternative sources cases that actually fell within your experience?——Definitely. It is my intention to speak throughout from my personal experience

12990. *Professor Sayers*: Were any of your customers who had been disappointed and were not able to satisfy their wants entirely elsewhere checked in their plans for spending on extensions, new machinery, and so on?——In 1955 and 1956 to a minor extent; and they would be the smaller customers who had not such ready access or were not sufficiently well advised about the alternative sources.

12991. *Chairman*: Mr. Clipsham?——*Mr. Clipsham*: I agree entirely. Something was definitely happening in 1955 and 1956. I think that the smaller man suffered in comparison with his larger neighbour, but the whole thing was sufficiently elastic for other things, like hire purchase, the merchant banking houses, insurance companies and the like to fill the bill. Throughout the private and professional customers found it harder than anyone else. Their cases perhaps were not as good. The banks were extremely tolerant to the small man. Our representations to our head office were on the lines that we had to live with the community after all these things had passed, and we therefore looked ahead to be as equitable in our own judgment and as alleviating as the powers that be would let us. I agree with my colleagues; what they have said is my own experience.

12992. Mr. Barraclough, how would you answer question 3?——*Mr. Barraclough*: I would say that in 1955 and 1956 the increase in the rate of interest made not the slightest difference to any one at all.—*Mr. Clipsham*: From my own experience I do not believe that the rate has much to do with it, not in a manufacturing area of the country. Obviously taxation will absorb a lot of it, and prices and all things that can be done in a manufacturing area can adjust the end product. In 1955 and 1956 the increase in rate had in my judgment nothing to do with it whatever.—*Mr. Furmston*: I would say in 1955 no effect at all. The Bank Rate went up to 4½ per cent. We were already working on a minimum of 5 per cent., so that the effective increase was only one half of one per cent., to 5½ per cent. In 1956 it did have an effect to a certain limited extent, particularly with wholesalers; for wholesale tobacconists or wholesale timber people, for instance, working to a small margin of profit, carrying stocks began to look expensive. We saw that very much more in 1957.

12993. *Professor Sayers*: You mean by an effect not just grumbling to you?——No, they showed a sign of getting their stocks down; but nothing like as much as later. To the manufacturer who could pass it on it did not make much difference, but to a man who could not pass it on, a man dealing in an article with fixed prices, he began to try and get his stocks down.

12994. *Professor Cairncross*: It was nothing to do with the change in the trade outlook?——I would say not.

12995. *Chairman*: You have to get into his mind that the rate of interest he is being asked to pay is a very high one; it is not just the change in the rate?——The two go together. An additional 1 per cent. on £10,000 is £100; that extra money was cutting into his profit, and they work on very fine margins.

12996. There might be changes in the rate which did not put in people's minds the idea that it was a high rate of interest?——There might, but I do not think that that applies with the keen businessman.

12997. *Professor Cairncross*: Do you never go below 5 per cent.?——" Never " would be rather an exaggeration; The " blue chip " borrowers can get it at rather less than that.

12998. *Chairman*: May we go on to question 4? Have you anything in mind about customers' views on the reduction of Bank Rate in February 1957?——*Mr. Furmston*: Yes. There was a feeling about; people came into my office and said: " The Bank Rate is down; we have turned the corner. I suppose we can have this limit restored that you cut down? " It made life a bit embarrassing because there was no relaxation of the credit restrictions following the fall in the Bank Rate. There was a feeling about that the green light had come on and things were easier.—*Mr. Barraclough*: I would agree with that, with a certain qualification. I think that the smaller business people who had previously found it difficult to borrow on account of the credit restrictions saw this as the green light, and came along to us and said: " Obviously things are somewhat easier now. What are the chances of getting the accommodation which I require? " I am speaking now entirely of the smaller people. The larger businesses, who are perhaps the more far-seeing people, were not at all happy that things were as they should be. They did not see a green light in that adjustment of the Bank Rate to the extent that the smaller, and perhaps from a credit restriction point of view less desirable, borrowers did.

12999. *Professor Sayers*: Did people react in this way because they saw references in the press using the phrase " a green light ", or is this a reaction which is attached necessarily to a fall in Bank Rate?——*Mr. Barraclough*: I do not think that it was from the press comment. I think that it was the normal reaction to a fall in the rate after a previous increase; a general idea that things must be a little better, otherwise the rate would not have been reduced.—*Mr. Clipsham*: I should put a slightly different interpretation upon that. We had had this unpleasant job of restricting or refusing overdrafts to our customers, and in the cities in which we live there was much talk among the business community of the effect of the banks' attitude. When there was this reduction from 5½ to 5 per cent. the financial papers and the remarks of the financial editors did bring into news form a change in the rate which otherwise, I think, would scarcely have been noticed. I do not think that a fall in the Rate by itself does anything, but this was rather more spotlighted so that the ordinary man talked more about the fall in rate. He held this to be an indication that the authorities were saying: " Things are a little better than they were. Perhaps we are getting somewhere ", and all that my colleagues have said followed; we were asked if we could not make things a little easier. But I think that the major concerns, the more thinking section of the business community, said: " We just do not believe it yet ", and pressure for additional accommodation, with me at any rate, was not actually great.

13000. *Mr. Jones*: To what extent could you have given additional accommodation in circumstances where a customer had gone to the maximum of the amount authorised? The fact that the Bank Rate had been reduced from 5½ to 5 per cent., as I understand it, did not affect that position. Would borrowers in circumstances like that seek to secure an undertaking from you to increase their borrowings probably because they were borrowing from merchant bank sources or from finance houses to which they were paying a higher rate of interest, and wanted to save the extra burden that they were then carrying?——We had approaches for that very reason; people did talk in that way, but we were not in a position at that time to respond. We did not increase our advances for that purpose at that stage, with this fall in the Bank Rate.

13001. Could you have any barometer in your dealings with your own customers of the effect of a fall from 5½ to 5 per cent., except in such cases where customers had the right for a higher drawing and were not drawing to the limit?——*Mr. Clipsham*: That is a little difficult to answer. In practical banking we see all our customers who borrow, whether they are borrowing up to a limit or by an arrangement, once in twelve months or once in six months. All the people to whom we lend money during a period come in for discussion, so we should bear these things anyhow; but I do not think that just at the time of which you are speaking all these things happened at once.—*Mr. Furmston*: I think that in certain cases the people who had not been using their limits to the full did tend to go up, and rather regretted it later in the year.—*Mr. Clipsham*: Such increases were not necessarily by arrangement.—*Mr. Furmston*: No, but the limit was there and they had not been using it. When the Bank Rate dropped, they tended to increase their stocks, not asking for a higher limit but using the limit which was already available to them; later in the year, when they had stocked up, the Bank Rate shot up to 7 per cent.

13002. In spite of the fact that 8s. 6d. in the pound was carried by the Exchequer?——As I say, it depends on the nature of the business. If a man is working on a fine margin there may be no profit left for carrying bigger stocks at a higher expense.

13003. *Chairman*: Now may we go on to questions 5 and 6? Mr. Clipsham?——*Mr. Clipsham*: I think that the fall was due rather to lack of fresh applications and to fresh sanctions for borrowings than to a deliberate policy on the part of customers to reduce their borrowings. The high rate did make an impact; at this stage it had got to a point where people started to talk about it. Nevertheless, having in mind that most of our overdrafts are on an arranged reducing basis, this process of slow repayment was taking place anyhow, and with an absence of fresh applications and fresh sanctions a lower level of advances came to be shown. But it would be most unfair to say that there were not numbers who thought that it was a bit steep, and decided to see what they could do. I am not convinced that it was a question of the high cost; I think it was an indication to the country that things perhaps were still not so good, and that there might be a downturn in business. Profits were beginning to be looked at with a closer eye in respect of increased overheads. I think that from that point of view any action which was taken was against this diminution of profit. I do not know about commodity prices, but certainly decisions to defer things that were about to be undertaken in 1955 and 1956 were having effect, because nothing was done about them at that stage at all.

13004. Mr. Barraclough?——*Mr. Barraclough*: It is a question of the interpretation of the word " spontaneous ". I am inclined to agree with Mr. Clipsham that there was a reduction which customers could not help, and that was not spontaneous in the sense that they were themselves taking steps. We had then had two-and-a-quarter years of credit restriction. There is an increasing cumulative effect. At the beginning of a period of credit restriction there are certain commitments into which the banks have previously entered and into which customers have previously entered, and these go on. After two years those have largely been completed, and there is no large new and permanent borrowing taking its place. My own view is therefore that irrespective of the increase in Bank Rate in September, 1957, there would at that time have been quite a fall in bank borrowing. Subsequent to that, undoubtedly in the four or five months from September, 1957, onwards the rate, which had not been felt in 1955 and 1956, was increasingly felt, and particularly by the smaller people. There was a psychological effect of the increase in Bank Rate in 1957, which conveyed a lack of confidence, and there were fears of a downturn in business, which would naturally help any reduction in overdrafts; but my own view is that the main reason at that time was the cumulative effect of a long period of credit restriction.

13005. *Professor Sayers*: In question 6 you attach weight to item (*d*) particularly?——*Mr. Barraclough*: I would personally.—*Mr. Furmston*: I share that view. I do not think that there was anything " spontaneous " about it. Capital outlay was restricted in 1955; that takes one or two years to go through the pipeline, so that by 1957 our overdrafts would naturally be coming down. In the ordinary way we would have put new ones in their place; we were virtually putting no new ones in their place, and it was almost inevitable that they would gradually drop. There were other factors in it too. Restrictions on local authority building programmes, which had quite a marked effect on the builders. Probably the industry that was feeling it the most at that stage was the building industry. We saw signs of operatives being

put off, and builders started cutting each others throats for contracts, because there was less work to do, and they were cutting their prices to get it.

13006. This is after September 1957?——Yes, from then onwards.

13007. On the basis of what has just been said one might venture a guess that there would have been considerable developments of this kind anyway, even if there bad been no further measures taken in September 1957?——Yes. As regards the level of bank borrowing, I do not think that the rate was of prime importance; but if we could not lend money, automatically our overdrafts would go down.

13008. And this was as a result of the measures of 1955 and 1956?——Yes.

13009. *Chairman*: Is that consistent with the suggestion that people who wanted money to do things in 1955 could get it elsewhere if refused by the banks?——By then it was getting more difficult to get it elsewhere. Insurance company money had dried up to some extent.

13010. *Professor Cairncross*: Is it not just that people did not want to renew things?——There is always a wastage in overdrafts if we are not putting new ones in. If we lend a man money to buy a car he pays the loan off in two years, and that is the end of it, if the loan is not renewed.

13011. Why do you think people were not coming forward asking for new overdrafts?——It was not that they did not want them. There was so much publicity about this that they just did not think they would get them if they asked for them.

13012. You do not think that the events of 1957 made them want to feel a good deal more liquid, for instance?——Not altogether. I think that if the banks had had a free hand to lend money the overdrafts would have gone up.

13013. *Chairman*: You were all stressing that the experience of 1955 and 1956 was that when people wanted money, even if they could not get it from the banks, they could get it elsewhere. What were they deferring which produced this gradual rundown by 1957?——Extensions to factories, say.

13014. But what bad led them to defer it if they had got the money from somebody in the earlier years?——*Mr. Furmston*: I said to one of my customers who wanted to build a factory: "How does the higher rate of interest affect you?", and he said: "If I could borrow it from the bank the high rate of interest would not stop me because it is a passing phenomenon, and in six months time it will be down. But if I have to pay 7 or 8 per cent. to an insurance company for ten years or so I am not borrowing it".—*Mr. Barraclough*: In 1957 on the change of the Bank Rate certain customers were still going ahead with capital schemes and were obtaining their requirements elsewhere from insurance companies and so on, as they were in 1955 and 1956; but that did not affect bank overdrafts any more in 1957 than it did in 1955 and 1956. The effect on bank overdrafts, if they were getting their finance from elsewhere, was just the same as if they were not proceeding with their schemes at all. In 1955 to 1956 that was masked by existing commitments, whereas in 1957 it was accentuated by the cumulative effect of a long period of credit restrictions where there had been no material new lendings, and during the whole of that period old lendings had gradually been repaid, as they are automatically over a period of some years.

13015. *Sir Oliver Franks*: Given that advances fell noticeably between September 1957 and June 1958, one could say one of three things: (1) that it was due to the fact that the banks exercised an increasing pressure on their customers in that period; or (2) that as bank advances made for a period, either explicitly or on a general understanding, ran off, customers did not come to the bank to ask for more money because they knew they would be refused (in which case the banks are not doing anything different but the customer is reacting differently); or (3) that the customer was feeling that his market was deteriorating, that there was an element of trade recession in the country, that he was less confident about his own prospects, and that therefore he would be more cautious, not going in for new capital commitments, etc., and would use less money (in which case he still would not go to the bank for more money, but he would not go because he did not want to go). In what proportion do you think that the decline of advances was due to these three different factors I have enumerated.——Increasing pressure from the banks was not necessary; it was not as a result of increasing pressure. I agree entirely that customers did not come to renew arrangements which had run off, because they felt it was no good coming. I would even go further than that, and say that in many cases customers whose needs might have been met within the directive still did not come because they felt it was no good going to the banks. In regard to your third point I am in entire agreement; there was a general lack of confidence, and the manufacturer was certainly not manufacturing for stock; he was allowing his surplus stocks to run down and manufacturing only against specific orders.

13016. *Professor Sayers*: Would you venture a guess at the proportions as between (2) and (3)?——That is an exceptionally difficult question. I would not care to make any assumption.

13017. *Sir Oliver Franks*: Mr. Clipsham: you come from Coventry; and you come from Portsmouth, Mr. Furmston. Coventry is mainly manufacturing; and Portsmouth would be mainly commercial. Could we put the same question to you both?——*Mr. Clipsham*: I have to point out to you the nature of the main business of my city, that is the motor industry, which in good times and bad times has such a special place that it goes on anyhow, because it is of export value. Perhaps this does not really compare with any other industrial centre in any other part of the country. Having said that, I do not feel able to put a proportion on these two things, but I think there was more of the feeling that profit margins were not good, business outlook was less good, and cautious and well-informed businessmen were trying to keep their houses in order against an outside market which they thought was rather coming unstuck. There was more of that about it than anything else. The great virtue in this business was the publicity; the daily press constantly talked about the difficulty, and the community was informed that it was necessary for the banks to decline advances. That prevented many people coming who had a very good case to put had they come. I am sure publicity had a lot to do with it; but I think that the larger proportion was the outlook for future business.—*Mr. Furmston*: I would place publicity first. We have experienced since the credit restrictions were lifted an absolute avalanche of applications for money for quite substantial amounts, and trade has not changed all that much in the meantime. About September 1957 people did stop manufacturing for stock to an excessive extent, but since restrictions were lifted it has been the general experience of banks all over the country that there has been a flood of applications for money. As to the proportions between your second and third reasons, it must be guesswork to some extent, because every cross-section of every branch varies, but I would put it in the ratio of two of the second to one of the third.

13018. *Professor Cairncross*: Mr. Clipsham, given the circumstances in your area you would not have been under the same compulsion to reduce customers before September 1957 as the other areas?——*Mr. Clipsham*: That is so.

13019. So you would not expect Sir Oliver Franks's (2) to be as important in your area as in some other areas?——No; but it is still an industry which is very easily affected by the cold winds that blow. I had constant discussions with managing directors and the like of the motor companies, and they were apprehensive.

13020. That is Sir Oliver Franks's (3)?——Yes.

13021. Did you have a substantial run down in advances in the first nine months of 1957?——I would not have said so.

13022. *Chairman*: May we pass on to Question 7?——I have something to say here which I think is of paramount importance, and I think every practising bank manager in the land would wish it to be said. One of the earliest effects of restriction was to cause the larger units and companies in this country to seek extension of credit for money which they owed to trade creditors. In its simplest terms whereas they paid on a monthly basis they now sought to extend that period to seven or eight weeks. Inevitably, coming through the system, the small trader and the small manufacturer felt it more hardly because with less money to run his job he had to

wait longer to get payment. He had to come to the bank. The hank was as tolerant and easy as it could possibly be, but even so he suffered more than the larger business. The banks went out of their way to try to make it as reasonably easy for that man as they could possibly do; but nevertheless to your direct question the answer is yes, the medium and small businesses were at a disadvantage. They were not at a disadvantage in respect of rates of interest; but they were certainly at a disadvantage in their ability to find and make use of other sources of finance, because as time went on the supply was less and they were in a less good bargaining position, I would think.

13023. *Professor Sayers*: This is all a matter of what happened among your own customers?——Yes. I am not speaking of any other things except my many customers and the things I have bad to handle; I have not only seen them hut been in the awkward position of baving to make some justice out of them.

13024. The question was whether the bank could tide the small man through?——*Mr. Clipsham*: Yes. In the terms of the restrictions there was no reason why they should, but we did try to exercise that measure of understanding. The manager knew the reason for this, and knowing the reason he tried to get his head office to agree to a course to which perhaps they would not otherwise have agreed.—*Mr. Barraclough*: With regard to treatment by the banks under the terms of the directive there was no differentiation; in that way the small businesses did not suffer. As regards rates of interest, obviously the small man on his small turnover feels it just a little more than does the large business, but not materially. In the ability to find and make use of other sources of finance the small man definitely suffers. But I cannot too strongly stress the point made hy Mr. Clipsham, which had he not mentioned I should have done. It was a feature of the whole period of credit restriction that people attempted to remain as liquid as they possibly could; it was a natural tendency. The larger businesses could, not hy arrangement hut merely by delaying payment, take more credit, and they did. That was automatically passed on, and ultimately it was the small man who felt the consequence in that way. I had many approaches from small people who would say that some big concern was late in paying. They would say: "They are as good as the Bank of England. I do not want to say or do anything about it because I do not want to offend them, but it does put me in a difficulty." That was the main cause of the difficulty of the small businessman.

13025. Could you put a rough date on the time in which you first began to feel this about the small man being squeezed to the wall creditwise?——*Mr. Clipsham*: It was quite an early development. I can quote a case, without names, of a very well known concern, the chairman of which met his principal executives some time in 1955 or early 1956, early in the period of restriction, and said: "We bave seen this development happen before. This time we are going to be prepared. We are going to maintain liquidity. We are going to do this, that and the other, and we shall take a longer period in paying our normal trade debts." I could quote many other cases where the same process was brought into effect about the same time.—*Mr. Barraclough*: It was when there was a realisation that the period of credit restriction was not going to be very short, but was likely to go on.

13026. *Professor Cairncross*: You have given us the impression that almost any type of small firm might be subjected to this. Such figures as we have show that public companies were on the whole giving rather than receiving trade credit over this period. Would it be your impression that it would be merely the small retailer or the small manufacturer, or would it be small enterprises in each sector who might be placed in this position?——I would say that it applied universally, but obviously it would be felt a little more keenly by the small manufacturer.

13027. *Chairman*: Although he would be in many cases a suhcontractor.—*Professor Cairncross*: The small manufacturer would not be a public company?——*Mr. Barraclough*: No, not a public company.—*Mr. Clipsham*: Coventry depends on a dozen or so large concerns, but their product is dependent upon the many hundreds of smaller and yet smaller concerns who produce for them. It may well be that one of these small concerns of twenty or twenty-five men in a very small workshop is making a tiny bit of brass of a peculiar shape, without which neither the Jaguar nor the Thor rocket can operate, though it is something which the big concern cannot or does not undertake itself. These people are subcontractors, but vital subcontractors; they were the people who felt this pressure, with whom I was dealing. There are more of this type of person in Coventry than retailers and commercial people. You may say: "If that is so, and if the product was something essential to the major thing and that had the blessing of the country, then why did you not find everything that was needed?" I must remind you of what I said earlier on; as a businessman I have to live with my community afterwards, and I dare not show preferential treatment; my customers large and small, my business friends, must remain so. Whether in the case of what is desirable or not desirable they had to be treated on the same basis.

13028. *Mr. Jones*: Were these advances sought more in terms of working capital requirements or fixed asset requirements or both?——I would not pay much attention to the fixed asset at this time. It was working capital to carry them on that was required, to meet an existing position in raw material, wages, overheads, and the like. We were not aware at that time how long this was going on for; it was not a case where a customer could say that it was for a certain period, and all would be well at the end of that time.

13029. *Chairman*: Where do you stand on this, Mr. Furmston?——*Mr. Furmston*: I rather differ from my colleagues, because I think the small man was stretching his credit as much as he could. I did not get a lot of experience of the big giants not paying up. If you wish to fix a date, I would say that it was in early 1956 that this tendency started of saying: "We have had a month's credit; we will now take two". I agree that we helped the small man as much as ever we could. Bank managers are given certain discretions and within those discretions we belped the small man all we could. I am not sure that the one that did not feel it the most was the medium-sized firm. He bad neither the access to other money which larger firms had, nor this very sympathetic understanding which was extended to the small man.

13030. *Professor Cairncross*: In the case of the subcontractors that Mr. Clipsham mentioned to us they were presumably not prevented in the end from carrying on with their business. How did they get the necessary finance?——*Mr. Clipsham*: The answer to that really ought to be: "Heaven knows." They did not go to a specific place for a specific amount of money. As I say, they had our sympathy; we sometimes did things that perhaps we should hardly have done in the light of our directions. We did all the things which are open to us in our job and by our personal contact with different people to try to ease them over the stile. I think that that is really how it was done.—*Mr. Barraclough*: Many of these small people were assisted on a purely temporary basis without any agreed arrangement at all. They would merely come along and ask for temporary assistance until they received a certain specific payment which they were expecting.—*Mr. Furmston*: That is what I meant when I was talking about our discretion.

13031. *Chairman*: Is there anything you would like to say on question 8?——I think we have covered it. It was not and never has been disregarded in competent planning, but it did not have the importance that one would bave expected it to have.

13032. And question 9?——*Mr. Furmston*: There was certainly a noticeable tendency to move from current to deposit account; not so much back in the other direction.—*Mr. Barraclough*: Not only did they tend to stay there, but they are still there.

13033. *Professor Sayers*: In spite of the 3 per cent. fall in the rate?——*Mr. Furmston*: Definitely.

13034. They have become more interest conscious, I suppose?——*Mr. Furmston*: Yes.—*Mr. Barraclough*: The high rate drew the attention of the public to the existence of deposit accounts and monies were transferred, the bulk of which have not yet come back. I do not suppose they ever will.—*Mr. Furmston*: We have had the worst of both worlds, because they moved it to get the 5 per cent., but they have not moved it back now to the current account. On the other hand, during the brief period when the bankers' deposit rate was 5 per cent. we probably retained deposits which would in the ordinary

way have gone to building societies; they are now going to building societies because our rate is back to 2 per cent.—*Mr. Clipsham*: As a trading community we are very subject to habit. I am sure that a lot of the money which was put on deposit will be left there because it has become a habit to have something there; people will not think that now that the rate has fallen it is hardly worth having it there.

13035. It is not just a matter of transferring back; people who happen to be accumulating rather a lot on current account are transferring it to deposit account?——*Mr. Furmston*: Yes.—*Mr. Barraclough*: They have become deposit account conscious.

13036. *Chairman*: Then Question 10?——*Mr. Furmston*: There was a very noticeable tendency, particularly in respect of Treasury Bills, with the larger concerns.

13037. You would say the larger concerns?——*Mr. Furmston*: Yes, the medium concerns did not bother with Treasury Bills. It has to be a lot of money, with the minimum of £5,000.—*Mr. Barraclough*: I would say that that was more evident during 1955-56, when there was a greater margin there between the Treasury Bill rate and the deposit rate, than later. It is amazing how quickly the public in a position to invest notices these marginal rates. Since then that has eased off and it would not be true to say that monies invested in 1955-1956 in Treasury Bills have been re-invested and are still in Treasury Bills.

13038. You think that they have formed a habit of comparing rates and moving accordingly?——*Mr. Barraclough*: Yes.—*Mr. Clipsham*: In respect of Treasury Bills.

13039. You think that they are now alive to the advantage of doing it if the occasion arises?——*Mr. Clipsham*: Indeed I do.—*Mr. Furmston*: They are not doing to the same extent. 1955 was the time when it became evident; money was almost by-passing us.

13040. *Professor Sayers*: Do they do it all through you?——They tend to.

13041. You have not noticed any making of connections with the London discount houses?——No.

13042. *Professor Cairncross*: Did you find any other form of short-term investment than the Treasury Bill coming into favour at the time, competing with the banks?——*Mr. Furmston*: There was a tendency for people to go to some of these hire purchase people who were advertising 7 per cent. on deposits.—*Mr. Clipsham*: They still are. There is a lot of money going into the hire purchase companies.

13043. Local authorities?——A bit, but not so much as one might imagine.

13044. Did you notice any movement by private customers into Treasury Bills?——*Mr. Clipsham*: I did not.—*Mr. Barraclough*: I did, from the private persons who were in a position to take advantage.

Chairman: I think that completes our questions. Thank you very much, gentlemen; we have had a very interesting time.

(*Adjourned until Friday, 23rd January, 1959, at 10.45 a.m.*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-EIGHTH DAY

Friday, 23rd January, 1959

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.

THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.

W. E. JONES, ESQ., O.B.E.

PROFESSOR R. S. SAYERS, F.B.A.

SIR REGINALD VERDON SMITH (Questions 13207 to 13268 only)

GEORGE WOODCOCK, ESQ., C.B.E.

SIR JOHN WOODS, G.C.B., M.V.O.

MR. R. T. ARMSTRONG, *Secretary*

MR. G. PENRICE, *Statistical Adviser*

The following list of points for discussion was sent to the witnesses before the sitting:

1. Techniques of control of bank lending, in the light of the introduction of the special deposit scheme.
2. The banks' connection with hire purchase, in the light of the acquisition by many of the banks of interests in finance houses.
3. "Personal loans" schemes, and their consequences for the banks.
4. The possible extension of simplified current banking arrangements, in the light of the Midland Bank's introduction of a "personal cheques" scheme and of continental experience with postal "giro" systems, and the consequences for the banks.
5. The views of the banks on the requirements of short, medium and long-term credit for agriculture and the banks' capacity to meet those requirements.
6. How far could the banks avow a policy of making term loans to industrial concerns (and indeed to farmers)?
7. The banks' present and future policy with regard to I.C.F.C.; in particular—
   (i) Will further finance for I.C.F.C. (if and when required) come from the shareholders or is it now suitable that it should be raised outside?
   (ii) Is the banks' loan finance to be treated by the I.C.F.C. as short term or long term money?
   (iii) Are the present restrictions as to the maximum and minimum scale of operations due for adjustment?
8. Questions relating to statistics:
   (i) Whether it would be possible to publish in future a quarterly analysis of gross deposits (or at least to publish regularly such figures as would shew deposits of companies).
   (ii) Whether it would be possible to publish in future quarterly figures of net cash transactions in gilt-edged securities and holdings of gilt-edged securities (shewing under-five-year and over-five-year bonds separately).
   (iii) Whether it would be possible to publish in future quarterly (or monthly) figures relating to overseas business, in particular—
   deposits of non-residents,
   gilt-edged securities held for overseas banks,
   sterling bills held on non-resident account,
   advances to non-residents.
   (iv) Whether the banks would see any objection in principle to the Inland Revenue or the Central Statistical Office publishing aggregate figures of profits earned by banks as a group, on the basis of figures extracted from Inland Revenue records. At present such figures are published for the banking, insurance and finance sector as a whole.
   (v) Whether it would be feasible for the clearing banks' monthly statement to give figures for banking offices within the U.K. rather than for banks as a whole.

D. J. ROBARTS, ESQ., Chairman, A. W. TUKE, ESQ., and A. D. CHESTERFIELD, ESQ., representing the Committee of London Clearing Bankers, called and examined

13045. *Chairman*: Mr. Robarts, I have been able to give you a list of the various heads under which we would like further help from you. I think it would be simplest if we took them in the order in which they appear on that list. May we start with point 1?—*Professor Sayers*: In our discussion a year ago* you disclosed the disadvantages of the system of control which was then in operation very clearly. We have now this provisional new system of special deposits which was established after, I understand, quite substantial discussion with yourselves, so that you will have considered yourselves how this compares with the old system. Am I right in thinking that it has the advantage, as compared with the old system, that it does not to the same degree blunt competition between the banks?——*Mr. Robarts*: It has never been worked yet, and so we have no practical experience of what would happen; but I would say that in general that would be correct, that its advantage is that within the restrictions which this would impose on our liquidity we can manage our affairs.—*Mr. Tuke*: We dislike it less because it is general and not particular; it operates on the credit base as a whole, rather than telling us that we shall not lend money to this class of customer or that.

* See Minutes of Evidence Qns. 3523 to 4000.

13046. From your own point of view do you see any other advantages in it as compared with the other system?——*Mr. Robarts*: Of course we dislike any of these things, and the situations which cause them to be used, which in our view are avoidable. Within that I think that what we have said probably covers the main advantage.

13047. *Chairman*: When you say you dislike all these things I am not sure how far that goes. You are not saying that the authorities should not have power through operations to influence action taken by the banks in the use of their own resources?——No, I am not saying that.

13048. It is on the particular method of doing it that your criticism would be concentrated?——Yes.

13049. *Professor Sayers*: Your attitude is summed up in Mr. Tuke's phrase that this is a system you dislike least?——Yes.

13050. *Mr. Woodcock*: Did not Mr. Tuke say in his annual statement that to operate this fairly between one bank and another might prove difficult if not impossible?——*Mr. Tuke*: I am perhaps drawing on my imagination a little, but also remembering certain things the Governor said when he told us about this. Let us suppose that the authorities take the view that there is too much

liquidity in the system, and that therefore we might be tempted to lend money too freely; if the liquidity ratio of the banks as a whole was 34 per cent. and they thought it ought to be 32 per cent. they would make a call of 2 per cent. of special deposits. That might be right for the banks as a whole. One bank might be at 35 per cent., and could find it easily; another might be at 33 per cent, and could find it less easily; another might he at 31 per cent., and not know where to find it.

13051. It would he a general provision?——*Mr. Robarts*: I understood that from my conversations with the Governor of the Bank at the time.

13052. Would that make it impossible? On Mr. Tuke's assumptions that might he said to be unfair as between one hank and another, and he said that to operate it fairly as between one bank and another might prove difficult, if not impossible?——*Mr. Tuke*: On the hypothesis that the authorities are going to insist on dealing with the banks as a whole, I do not see how it is possible for it to be equally fair to the hank with 35 per cent. in liquid assets and the hank with 33 per cent.

13053. One of the great problems in the next few years is the maturing of Government debt. That is always likely to create a difficult liquidity situation. This would he one way for the Government to deal with it. Another would be cutting Government expenditure. Are you suggesting that the Government should have no option, that they should have one way of dealing with the matter and not another?——*Mr. Robarts*: I was not making any such suggestion.

13054. *Professor Sayers*: In your discussions with the authorities did you consider seriously any other of the alternative techniques of control? For instance, did you consider in those discussions the possibility of control of the ratio of advances to deposits?——*Mr. Tuke*: These were not discussions in the sense that you mean. We did not debate the various alternatives and eventually agree on this one. We were told that this was what was proposed, and allowed to express our views, but it all happened in twenty minutes. We did not discuss alternatives.

13055. If the choice were open to you, what would be your reaction in terms of least dislike to the alternative technique of restricting the ratio of advances to deposits?——*Mr. Robarts*: We would prefer the special deposit scheme.

13056. Why?——*Mr. Robarts*: For the reason which I indicated as the main advantage over the credit squeeze which this method commands: that we can then manage our own business within the restriction which this imposes. We could take our choice as to how to meet a call for special deposits. If we had a fixed ratio it would he a much more rigid affair.—*Mr. Tuke*: Again, we would prefer the general to the particular.

13057. That leads me to another question, in which I look at it from the point of view of the authorities seeking to attain certain ends. In the imposition of a plan of this kind the authorities might he seeking to influence your behaviour in a particular direction and it might therefore be important to know what you mean by retaining this freedom of action. What would you do if at the present time there was a call for some hundreds of millions in special deposits?——*Mr. Robarts*: The first thing we would do would be to adopt a much more restrictive lending policy. We should have to make loans less freely. If that did not enable us to build up our liquidity sufficiently to make this deposit then we would have in the first place not to renew maturing Government securities, and beyond that possibly to sell some Government securities

13058. You are putting it that the first impact would be on your lending. Last year we were given the impression that the first reaction would be to strengthen your position by reducing your holding of the shortest Government securities?——*Mr. Chesterfield*: That had not anything to do with the special deposit scheme at that time.

13059. This was a reaction to any measure of this kind, not to specific measures?——*Mr. Tuke*: We should be bound to be more restrictive in our lending, but if we had a Government security falling due in the next month or the month after, that would help us out.

13060. This is the important point: the immediate reaction would be to take a more restrictive attitude to any lending to customers?——*Mr. Robarts*: To fresh lending; we should not call in loans except as a last resort.

13061. If this is the first reaction, what would be your objection to the alternative system of imposing a ratio of advances of deposits, which would obviously have a very direct impact on your attitude to lending?——*Mr. Robarts*: It would he a more rigid system, and I think you would find that in practice it would put the hanking system into a very difficult situation. Certain advances have to be made for the good of the economy; if we were right up to the prescribed ratio, short of getting more deposits (which we cannot just get when we want them) we could not make the advances.—*Mr. Tuke*: Again, I dislike getting orders from however high and wise a source as to precisely how I am to do my business. I would much rather have a certain amount of money, and, if my resources are diminished, be allowed to decide myself what I do about it.

13062. You would have that liberty anyway if the ratio of advances of deposits were fixed. You would know just as you know now that there are some advances which must be made to keep the business of the country going and you would allow for that. You would be more particular, more cautious in making any other loans because of the necessity of keeping those loans going. Surely that would be equally true under that system and under the system of special deposits?——Does not your proposal seem to depend on the unreal hypothesis that we make all our advances afresh every morning?

13063. I do not think so. May I put my question another way. The special deposit system gives you the option of fortifying yourselves hy selling your very short Government paper. I thought from last year's discussions that is how in fact you would react; but now you say that you would react the other way?——*Mr. Robarts*: It is very difficult to be pinned down exactly to that, because clearly if one had a Government security maturing just at that time one would use those proceeds as a matter of normal business to make one's special deposit.

13064. So the composition of your portfolio would affect the degree of restriction that you impose on the making of new advances?——Yes, I think it would.

13065. *Chairman*: Why would you turn particularly to restricting future advances rather than turning to the short-term hond market or indeed for that matter, if the market was sustainable, the medium-term hond market?——If we were restricted we should have to impose a restrictive attitude. There are certain advances which one would hesitate considerably before making in those conditions. One's attitude would, I admit, be influenced by the structure of one's portfolio and the state of the gilt edged market. The things all go together; it is difficult to put them in an order.

13066. *Professor Cairncross*: You gave us the impression a year ago that the proportion of your assets which took the form of advances was abnormally low?——At that time it was.

13067. And presumably still is in the sense that the disparity between the old pre-war proportion and current proportion is very wide?——Yes.

13068. The impression left with us was that if you were free you would make a steady and progressive increase in that ratio. I accept the point that, if your portfolio was so constructed that it was difficult to cash some of your bonds, you might have to adopt a restrictive attitude towards advances. But you also left the impression that you had short-dated honds which could be sold without involving a substantial loss. Would it in those conditions still be true that you would need to adopt a restrictive attitude to advances?——*Mr. Robarts*: It would very much depend on the conditions then ruling.—*Mr. Tuke*: There is a distinction to be made between allowing Government securities to mature and selling then. If it comes to selling them, there is really only one buyer, and that is the Government hroker. The very short honds can be sold to the discount market, but if one has to go on to three, four and five year bonds and the Government hroker is not prepared to take them, one will not sell them.

13069. Would it be your policy to fortify yourselves against the possibility of special deposits being called for by holding a larger proportion of short-dated bonds than you would otherwise wish to do?——*Mr. Robarts*: I do not think that this influences the policy of the National Provincial Bank at all. We have always believed in holding a short-dated portfolio with a short average date, and we still do.—*Mr. Chesterfield*: The introduction of this scheme has made me wish to keep even shorter than I was previously.

13070. Does it mean that you would resist more strongly a move to return to something nearer the pre-war maturity distribution of Government investments?——*Mr. Robarts*: The National Provincial Bank's portfolio of gilt-edged securities was not much longer before the war than it is now; I could not speak for other banks.—*Mr. Tuke*: I would not like to answer that without notice.—*Mr. Robarts*: I should say that in general the policy is the same.

13071. *Professor Sayers*: I thought, and you very much confirmed this in what you said here last year, that you considered that your first duty and your first commercial interest were to lend to your customers to meet their requirements, and that your portfolio of short Government bonds was there under present circumstances to give you freedom, in the absence of Government restriction, to lend to your customers, and that you hoped that you would have opportunities to lend more. Indeed, reading the annual statements of the Chairman, I detected a note of rejoicing that there seemed to be a demand for more advances. Yet you say that if you were put in this position of particular tightness your first reaction would be not to make new advances?——*Mr. Chesterfield*: We are supposing that this new scheme for controlling lending has been brought into operation. In those circumstances our advances ratio would presumably be very much higher than it is even today, because the deposit scheme would not come into operation unless that were so or unless there was a likelihood of its becoming so.—*Mr. Tuke*: If this special deposit scheme is used rightly, there is a presumption that there is an inflationary situation which ought to be checked. That is the time when we ought to be checking the making of new advances, especially for certain not very important purposes.

13072. If you take the line that the circumstances would in any case call for a restriction of advances, then what is your objection to restriction of the ratio of advances to deposits?——Fairness between bank and bank. One bank at the moment might have 35 per cent., another 30 per cent. If the authorities fixed 33 per cent. as the maximum, one bank would be in great difficulty while the other would not.

13073. Do not questions of fairness between banks arise under any of these systems, in one form or another?——But there is much more commonly a wide range of variation between the banks on their advances ratio.

13074. Is there not also variation between the banks in their liquidity ratio?——*Mr. Chesterfield*: Yes, but it would probably generally be all very much the same at any given make-up date.—*Mr. Robarts*: The special deposit scheme includes a provision that if any given bank, having met its special deposit account, then has an urgent and necessary demand for money, it can get a release.

13075. *Chairman*: At discretion?——At the discretion of the Bank of England.

13076. *Professor Sayers*: The same discretion could presumably be used to modify any other system?—Yes.

13077. *Chairman*: I think that deals with point 1, unless there is anything you yourselves would like to add?——*Mr. Robarts*: Only to draw the distinction which I may have failed to make between a restrictive attitude and a hard and fast refusal of any new advances; a system which necessitates a restrictive attitude is much to be preferred to one which enforces a hard and fast refusal of any new advances.—*Mr. Tuke*: Yes, a restrictive attitude to new advances of a particular type.

13078. But at the end of the question, when you have considered it, you do not feel that you could put an order of priority in your reactions which could be taken as a general proposition?——*Mr. Robarts*: It is quite impossible; one has to consider one's whole position.—*Mr. Chesterfield*: Perhaps our attitude recently has been coloured by the fiction that it is always possible to sell short-dated gilt edged securities.

13079. *Professor Sayers*: By the fiction?——Perhaps I should say by the assumption.

13080. In the first half of 1955 the banks unloaded some £200 million of their bonds, and those sales were not matched by Government purchases. I found that episode very surprising, because bankers had always told me that they knew quite well that in fact they could not unload huge blocks of Government securities unless the Government would buy, and yet in 1955 it happened?——Over the last two or three months it has been quite impossible to sell large blocks of short-dated securities.

13081. Except when the Government was supporting it?——Which they have not been.

13082. Do you remember this episode in 1955?——Frankly I do not. So much happens every day that I should mislead you if I said that I remember it.

13083. What is the advantage of holding very short bonds?——*Mr. Chesterfield*: The likelihood of being able to sell them is greater than it is with long ones.—*Mr. Tuke*: In the ordinary course of business the Government broker is normally a willing buyer of the next maturity so that it can organise the conversion. So a bank which holds some of the next maturity, so long as it has any left, can always get that amount of money. When that has gone, then it is at the pleasure of the Government broker whether one can sell or not.

13084. *Professor Cairncross*: Mr. Chesterfield, your discovery of the fiction has not prevented you from still holding short bonds, and indeed wanting to get shorter for fear of special deposits?——*Mr. Chesterfield*: No, I certainly do.

13085. *Chairman*: May we come to point 2?—*Professor Sayers*: In connection with the banks' interest in hire purchase companies I notice that Mr. Tuke in his annual statement made some reference to the policy of the hire purchase companies in bidding for deposits longer than seven days and offering higher rates than the banks' deposit rates. I wondered how that policy is to be reconciled, if it is to be reconciled, with what Mr. Tuke told us last year about the banks not wanting to have varied deposit rates for varied terms. It seems to me that in effect they are now going to bid for longer term deposits. Does this mean that the view you took a year ago when you were talking to us has been changed?——*Mr. Tuke*: Barclays have not got a hire purchase subsidiary; we have merely got an investment. I do not think that it suits the business of a bank, which is different from that of a hire purchase company, to pay different prices for deposits of varying date, because they all go into a common pot and are treated equally. It would be paying extra money for nothing. A hire purchase company obviously has to pay a higher rate than the bank pays, because otherwise the money would go to the bank.

13086. You are thinking of situations in which the hire purchase companies were independent companies. Hire purchase companies are now owned to quite a substantial degree by the banks. People look on these as being as safe deposits for their money as the banks. Is it not in effect another door to the bank for the depositor?——I do not think so. Depositors have no legal right to come on the bank if the hire purchase company does not pay them. It might suit us to bail them out, it might not.

13087. Do you think the public is likely to take that attitude? If this is to be the policy, does it not mean serious competition with the banks?——*Mr. Tuke*: In principle I would rather see hire purchase companies, whether subsidiaries or affiliates of banks or independent, finding their own money and coming back on their banker for temporary finance rather than have what amounts to permanent loans from their banks.—*Mr. Robarts*: That is our policy in the National Provincial Bank; and we are the only bank that has a 100 per cent. owned subsidiary.

13088. Do you not anticipate that, now that these hire purchase companies are very publicly linked with the banks, people are going to regard them as safe depositories in a way they did not a couple of years ago?——*Mr. Tuke*: It will improve their credit, of course, but it is not quite the same thing as the bank.

13089. Is it not a serious modification of their policy in not bidding up for deposits?——*Mr. Tuke*: I do not think so.—*Mr. Robarts*: My bank regards its hire purchase subsidiary as an entirely separate business.

13090. Is the depositing public going to consider it so?——So far we have not noticed any change.

13091. So far it has been very new, but a great deal of attention has been drawn to the fact that the banks have these subsidiaries.—*Mr. Woodcock*: I thought Mr. Tuke made that point in his speech. Did he not say that, even when the link does not involve the moral obligation of a parent towards its subsidiary, its existence will help the hire purchase company to raise money from the public at more favourable rates, and thus to offer better terms for its lending business?——*Mr. Tuke*: It will help them to get credit. Professor Sayers is concentrating on the period of the credit. That is not relevant to me.

13092. *Professor Sayers*: The fact is that you are using these channels to bid for deposits in a way you said last year that you did not think that the banks were interested in bidding for deposits?——The banks are not bidding for deposits. If anything they are losing them.

13093. This is all on the assumption that all that has been said fails to convince the public that the hire purchase companies are now very definitely linked with the banks. Is not that a very big assumption?——It is true that some of the hire purchase companies are now linked with the banks, and the public knows that; but that does not mean that the banks are looking about for a back door to get money on long term and to pay extra for it. The hire purchase companies taking deposits directly from the public, whether on higher rates or whether on long term or not, in fact take a deposit which might otherwise come to us. How do we like that? On the ground that we want at all costs to get as many deposits as we can, I do not think that we would like it, but I do not think that is the ultimate criterion from our point of view. I think that the hire purchase companies should finance themselves.

13094. It only alters the use made of the deposit?——It comes back into the system certainly; but, if a hire purchase company takes a deposit of £100,000, that may come out of Barclays Bank. We have to find the cash.

13095. This is a process to which you gave a blessing in your statement?——Personally, I think that on balance it is better that the hire purchase companies should finance themselves to a large extent by these means.

13096. How is that reconciled with what you told us last year?——I do not think that a bank which runs a banking business, which is similar to but not identical with the hire purchase companies, requires money at longer term than seven days.

13097. Is not that because you find it possible to split your personality in a way that perhaps the public will not?——*Mr. Tuke*: I do not think that the ordinary member of the public would take this rather academic point that you are taking. I really do not think that there is anything in this at all.—*Mr. Robarts*: In the National Provincial Bank our attitude has been, ever since we bought our subsidiary, that it should manage its own business and go on exactly as it had in the past, with the knowledge that we would make loans to it in the event that it wants them. This was made quite clear from the outset, and it does so. I think that it is very important to keep the two businesses of hire purchase and banking completely separately, as I said last year, and that is what we are doing.—*Mr. Chesterfield*: The position of my bank is almost exactly the same as Barclays.

13098. But whatever you have said about keeping the businesses separate you have not kept the businesses separate in the public mind?——*Mr. Chesterfield*: I would dispute that question.—*Mr. Robarts*: I would also dispute it.

13099. *Mr. Jones*: Why is it essential to keep the two operations separate? There has grown up within recent years a system of repaying bank loans on the basis of gradual repayments over a number of years. The banks lend a substantial amount of money for hire purchase to individual customers. Is there any reason why they should not undertake to do the same sort of thing in wider terms? If I want £1,000 to buy a car and am a credit-worthy customer I can go to any one of the banks, and I take it that I can repay that money on terms that I fix with the bank manager making the arrangement. Is there any reason why something similar to that should not operate in respect of hire purchase business?——*Mr. Robarts*: There are a great many loans made very much on the lines you have described. But hire purchase business is different from a bank loan, in that it involves a charge over the goods which are being bought on hire purchase. It is a different type of business; it requires different skills and different experience. I think that it is better to have it run as a separate organisation which has made a study of this particular type of lending, rather than to put it into a bank whose normal type of lending is different.

13100. For the banks this business is a type of investment. The British clearing banks have never been prepared to find money for investment in industrial and commercial enterprises by the purchase of equities. In that they are unlike certain banks abroad. Is there any difference between investment in equities and an investment in hire purchase companies?——That is a question of size. Our investments in the shares of hire purchase companies are only a relatively small proportion of our total investments, whereas if your are thinking of banks investing in equities, as I believe is done in certain Continental countries, you are talking of a much bigger proportion.

13101. *Sir Oliver Franks*: Is it also relevant that the business of a hire purchase company is related to that of a bank in the sense that both of them are dealing with money and financing their customers. In that way might not one say that there is a closer natural link between hire purchase finance and bank lending than there would be if a bank was investing in an ordinary industrial concern which is not concerned with finance but production?——*Mr. Robarts*: That is a point well worth making.—*Mr. Tuke*: Our investments in other banks or kindred businesses such as a hire purchase company are an exception from our normal rule; we do it, as Sir Oliver says, because it is kindred business, and we do it only to a small extent. It is recognised as a trade investment in our balance sheets; it is treated differently for income tax purposes. There are all sorts of things about it.

13102. *Mr. Jones*: You think that it is wrong to participate by investment in industry but it is perfectly legitimate and reasonable to participate in hire purchase business investment?——*Mr. Tuke*: That is not really the distinction, I think. It is a question of whether we are investing our customers' money or our shareholders' money. In these relatively small investments we make in kindred business we invest shareholders' money. If we are investing in industry it is customers' money which is repayable on demand or on seven days' notice, and it would not be a proper thing to do.—*Mr. Robarts*: To have any impact on the economy with a policy of investing in industry we should get into big blocks of shares which would form a substantial proportion of our investments. That, I would say, is entirely wrong. These are only a very small proportion of our investments and are covered by our capital and reserves. They are the shareholders' money and not depositors'.

13103. *Chairman*: May we turn to point 3?——*Professor Sayers*: I understand that the advertisements of these schemes have been followed by a very considerable use of them by the public. I wondered whether you have any interpretation to place on the degree of use of them. During the credit squeeze the personal and professional advances helped to take a good deal of the brunt, so that one would expect that as soon as it was removed there would be a resurgence of the more personal type of advance. Has the growth during the last few months been simply a resurgence of the old business after the period of squeeze, or is there genuinely an extension of business beyond the kind that the banks have previously done?——One must first of all distinguish between banks which have "personal loans" schemes as such, and banks which make personal loans and always have on the ordinary banking basis.

13104. I have assumed that even the latter will have been drawing attention to the fact that they do advances business of this type, if not in this form?——*Mr. Robarts*: Yes, that is right enough. My impression is that a lot of the increase in personal loans is simply a replacement of what was taken out in the credit squeeze.—*Mr. Tuke*: It is obviously a bit of both; how big a bit of each I could not say. There is this point that banks in the last few months positively advertised their willingness to lend

money. I do not know if it is true to say that they have never done that before, but it is fair to say that that has brought in people who would not have ventured to come to us otherwise. So I think that we have extended our loan business more than the natural reaction from the ending of the credit squeeze, but it is very early days to say yet.

13105. *Professor Sayers*: On point 4 we have all had an opportunity of reading Mr. Chesterfield's very interesting letter in *The Banker* for January, 1959.

Following is the text of the letter:

Sir,

Sir Oscar Hobson's article "Towards a Banking Democracy", in the November issue of *The Banker* was doubtless intended to provoke discussion, especially his comments on the need in this country for a giro system to supplement or replace our existing cheque system. He was perfectly right in his guess that bankers here have been thinking about this question; indeed, for a long time past that has been the case. They have examined the workings of most of the continental arrangements for transferring money and their relevance to British needs. This examination is continuing and no firm conclusion has, so far as I am aware, been reached by the banks; but what has been learned so far would not lead them to regard a proposal for the introduction of a giro system into this country as imperative. They realize, however, that a final decision may not necessarily rest with them.

Giro systems as they operate in most of the countries of Western Europe and in Japan are efficient and they provide a quick, cheap and convenient service to the users. Almost without exception giro systems are post-office operated; and thus they offer the user a spread of offices that no bank or group of bankers could hope to rival, and by using pillar boxes and postmen for the receipt and delivery of payments they provide a service with which banks cannot compete. Some of the giros are reported to make handsome profits for their governments; but their integration with the postal services makes a true costing of their operations virtually impossible and leaves the observer with more than a suspicion of hidden subsidies.

Part of the profits arise from the fact that, in the countries which operate them, giros tend to be very largely "closed circuits" in the sense that a high proportion of the funds handled never leave the system at all, either in the form of cash or by transfer to the banking system. A giro so situated can usually work on very different standards of liquidity from those that commercial banks must observe. But for any giro that had to operate alongside and presumably in harness with an already well-established cheque system comparable to our own or to that of the United States, liquidity considerations would probably prove to be as important as they now are to the commercial banks.

Investigation of the various giro systems shows that when they were established none of the countries concerned had machinery for the clearing of cheques as highly developed and efficient as that operating in this country, nor was the banking habit nearly so widespread. Had it been otherwise most of the present giros might never have seen the light of day. The use of cheques has continued to grow in this country and the case for establishing a giro here is correspondingly diminished. In the U.S. and Canada, where cheques are used even more extensively than in Britain, the need for a giro system has never been felt. How many people experience the slightest difficulty in making a purchase and paying for it by cheque?

It is indeed primarily because the financial structure, tradition and needs in this country are so different from those in countries that employ a giro system that some of the banks here may believe it would be a mistake to introduce one simply because it is in existence elsewhere. Traditionally, current account holders in this country have access to the manifold financial and other services provided by the banks. Moreover, the service they are accustomed to is still largely as personal as that given by the old private bankers whose places the present joint stock banks have inherited. There is little evidence so far that the bankers' customers would have it otherwise.

It is true that one bank is experimenting with a utility service, and others may follow; but neither that bank nor any other can yet say how great the demand for accounts of this kind will be, nor how often people, who thought that that was all they wanted, will find that, for example, the availability of an occasional small overdraft is, after all, a convenience worth paying for.

All the banks are keen to extend the banking habit to new sections of the public and particularly to the rising class of highly-paid artisans. But it will not be a quick or easy business to attract large numbers of these people into the banks. In the meantime, for those who still prefer to make the bulk of their payments in cash, and have only an occasional sum to remit by other means, the G.P.O., by postal orders, money orders or through the P.O.S.B., provides an adequate service. Those who have a few more remittances to make but who feel no need of a current account may make use of the Trustee Savings Banks.

The commercial banks already operate a kind of credit clearing which has many of the features of a giro system. Indeed, from the point of view of customers making regular payments there is little to choose between the two. It is through this credit-clearing system that many dividend and interest payments, as well as standing order payments—subscriptions to clubs, insurance premiums, school fees, etc.—are made. This credit clearing is also used by many firms for the payment of salaries. Indeed, it is a simple matter for anyone who has a number of payments to make, provided he knows the bank and branch at which the relative payees keep their accounts, to give his banker a list of them, with a single cheque to cover the total amount. These "traders credits" as they are called—are already widely used, though as yet their volume is small in relation to the enormous number of payments made by cheque. There is no reason why this means of payment should not be expanded if the demand for it increases.

This short note does not, and is not intended to, answer all Sir Oscar's points. A giro system could be operated in this country either by the banks alone or by the banks in co-operation with the G.P.O., and it would be useful to those people who want nothing more than an easy way of transferring money. Whether it would bring in sufficient interest-free deposits to make it a profitable undertaking is open to question. The cheque system, supplemented where necessary by the credit clearing, appears to suit British conditions best. Bankers therefore may well feel that ways of improving and extending the use of the cheque and traders credits systems are their most appropriate lines of investigation, and that their customers will be best served thereby.

Yours faithfully,

A. D. CHESTERFIELD.

Westminster Bank Ltd.,
41, Lothbury, E.C.2.
16th December, 1958.

Professor Sayers: May we take that letter as representing the views of the banks on this question?——*Mr. Tuke*: Of us three anyhow.—*Mr. Robarts*: It represents what I think about it.—*Mr. Chesterfield*: I think that it represents the views of the banks, from what my colleagues told me at our normal monthly meeting yesterday, though I did not consult any of them before I wrote it.

13106. Is there anything you want to add?——I do not think so.

13107. I had the main impression from it that this was something to be looked at further, but that your provisional view was that, if there is a job to be done, it is a job to be done by the Post Office rather than the banks? Is that fair?——*Mr. Chesterfield*: No, I do not think that is a fair reflection of my letter at all. It may be that it can be more readily undertaken at this present time by the Post Office than the banks because of their greater coverage, but I do not think that what you have said was the conclusion I reached in my letter.—*Mr. Tuke*: A giro system is peculiarly appropriate to certain countries on the Continent for two reasons: (1) the banking system is not so highly developed as it is here, and (2) people get their money paid to them in cash. These are perhaps two ways

of saying the same thing. We have a highly developed banking system, and that is a higher grade of society. It would be a retrograde thing for England to go in for a giro.

13108. It depends upon whose point of view one is taking. From the point of view of the small man it may not be a retrograde step. Could one not put the difference between continental countries and England rather in this way, that in England the banking system has had the opportunity to push further down the income structure than on the Continent because the General Post Office has been so backward in not providing us with a system of this kind, whereas continental governments have provided it?——That is another way of looking at it. I would be very much more impressed with the idea of a giro if it was in operation in America; but it is not, and there the banking system is in some ways ahead of ours.

13109. Surely for purposes of payments and getting about the American system is vastly inferior either to the English system or to the continental system?——In some ways; but more people use a cheque in America than here.

13110. But with much greater inconvenience than here and with infinitely more inconvenience than they use the giro on the Continent?——Yes. But I think that the difference between England and the Continent is that in England the salaried man (I am not talking about the wage earner for the moment) gets his money credited to an account, draws out what he requires to spend and leaves behind the rest on which he draws cheques to make payments. On the Continent I would imagine that he gets his money in cash, keeps in his pocket what he wants to spend and pays into the giro what he does not want to spend. It is the other way round. I think that there is a good deal of significance in that distinction.

13111. *Chairman*: Is there any limit to the banks' readiness to accept standing orders for payment out of an account?——*Mr. Robarts*: No limit at all.

13112. Any bank is ready to take any amount of standing orders?——*Mr. Tuke*: Or one particular order for one particular transaction.

13113. To what destinations can they go? Must they go into another banking account?——*Mr. Robarts*: In practice they do. One can give a standing order to pay cash; it is not very common, but there is no reason why it cannot be done.

13114. Banks will accept a written order to despatch cash by post?——*Mr. Robarts*: Certainly.—*Mr. Tuke*: Or to pay it to someone who comes and collects it; a pension, or something like that.

13115. *Professor Sayers*: The Midland Bank's personal cheque scheme is an attempt to provide the small man with some of the facilities that he would get with the giro. Have the other banks any plans for following suit? Or is this a question you would rather not answer?——*Mr. Robarts*: I cannot answer it, because I do not know what the plans of all the other banks are.

13116. To your knowledge we are not on the eve of a great development of this?——Certainly not to my knowledge; but my knowledge is limited to one bank.

13117. Lord Monckton described it in his statement as a long overdue reform. Is that your view of it?——No, it is not my view.

13118. Is it your view of it, Mr. Tuke?——*Mr. Tuke*: You have quoted my speech at me several times, so perhaps I may say that I made a back-handed allusion to this in my speech when I said that we did not want to draw distinctions between the requirements of one class of customers and another. I do not think that they are separable into two pens like that.

13119. If a giro system were established by the Post Office what do you think the consequences for the banks would be?——*Mr. Chesterfield*: It would take years to establish. A man requires a lot of persuading that it would be easier to make a payment through a giro system which necessitates his filling in a form three times, or four times in some Continental countries, instead of giving a cheque. The rate of growth of the number of depositors might decline. There is an enormous growth of numbers or accounts every year in the clearing banks. People do not seem to think that the banking service is too bad. I can only speak for my own bank, but I would judge that the annual rate of increase in the number of current accounts in the clearing banks is between two and three hundred thousand per annum, at least.

13120. You must have given a good deal of consideration to this spread of the business. Have you considered the question of hours of opening in relation to this?——Yes.

13121. And the hours remain?——So far.

13122. Are they going to remain?——I do not know the answer to that.

13123. *Professor Cairncross*: About what proportion of the adult population has banking accounts in this country?——I do not know; I should think at least 50 per cent.

13124. *Professor Sayers*: Have the banks done any market research into questions such as this?——*Mr. Robarts*: Collectively, no; individually, yes, in the sense that we keep a very careful check on the number of customers of the bank, on the number of accounts that we have gained from other banks and the number of accounts that we have lost to other banks. I would imagine that all banks do that for themselves to see how they are getting on.

13125. Are there any big differences between the degree to which the banking habit has spread in different regions of the country?——*Mr. Chesterfield*: I happened to see a few of our managers this week and I was questioning them on this very matter. I think that it is right to say that in the North of England the banking habit has grown more than it has in the South.

13126. It has gone further, or it has been growing faster in recent years?——The improvement in the North is most noticeable within the last six months.

13127. That does not mean that the banking habit has gone further?——I think it has.

13128. As well as growing faster lately?——Yes.

13129. *Mr. Woodcock*: I have the impression that for people who are paid by cheque with no option, particularly young people who do not keep large balances, running a current account in those conditions is very expensive?——*Mr. Robarts*: In these circumstances the bank would probably make a charge, because after all the balance kept on the account is the main way in which a bank earns the money to run its business.

13130. Would not those people possibly be attracted by one or other of these schemes?——I do not see that unless it was Government subsidised it would be a great deal cheaper.

13131. Is not the Midland Bank's scheme cheaper?——*Mr. Chesterfield*: It may be a good deal dearer than charges made by other banks for small accounts. I think it true to say that some customers of that bank who may elect to open an account under this scheme, or to change to the scheme and thus pay a specific charge in advance, may find the cost greater than it would have been had they enjoyed normal current account services.—*Mr. Tuke*: It takes no account of the balance on the account. We have an enormous amount of small private accounts where we charge nothing at all because there is a sufficient balance on them.

13132. I am thinking of cases where there is little or no balance?——*Mr. Chesterfield*: Where there is no balance at all the customer has to pay for a service.

13133. And would not the Midland Bank scheme be cheaper in cases of that kind?——I would not think so.

13134. *Professor Sayers*: Mr. Tuke, you said that you bad a very large number of small accounts on which you make no charge. Would you like to put that as a proportion?——*Mr. Tuke*: It is certainly a very large number; I would say it is a large proportion of our private accounts, and the majority of our accounts are private accounts. A large proportion is more than half; would you say more than half, Mr. Chesterfield?—*Mr. Chesterfield*: My guess would be almost half, certainly.

13135. All my complainants are in the other half!——One does hear more of the complainants than the satisfied people; even so we get very few complaints indeed. Our managers tell me that a complaint is the rarity on the question of charge.

13136. There is a certain fatality in such matters!——I think it is a realisation of the service they get.

13137. *Chairman*: Now we come to point 5. We did not have an opportunity of asking you questions about your reactions to the financing of agriculture when we

saw you before, and we should like to get your position on that now. Although in theory all banking advances are repayable at call, one has a working knowledge that not all in fact are expected to be called at any one moment, and therefore there is obviously some margin for play. What is your position with regard to the financing of the farmer by the bank, assuming that for the moment you keep all your advances to him ostensibly repayable on call. How far do you and can you in fact depart from that in dealing with that rather special problem of the needs of the farmer?——*Mr. Robarts*: The farming industry is one of our largest borrowers; I am not sure that it is not the largest.—*Mr. Chesterfield*: I think it is the second largest.—*Mr. Tuke*: Agriculture accounts for 11 per cent. of the total of advances.—*Mr. Robarts*: The theory of the thing is that we lend from seed time to harvest, though in practice a great deal of money is lent to farmers which is outstanding for a long time.

13138. Lending from seed time to harvest meets one particular need of the farming operation; but we know that, especially nowadays, there are other needs?——Yes indeed. We lend a great deal of money which remains outstanding for a long period. That is done on the knowledge of the farmer acquired by the branch managers, and a close watch is kept on the individual farmers. We certainly expect to see substantial fluctuations in the borrowing of any individual farmer. But they are a class where our experience has been very good over the years, and we treat them very liberally.

13139. There must be many farmers who to the knowledge of their bank managers are receiving bank advances that are not intended to be used only for seasonal needs and which they do not in fact expect to be asked to repay at short notice; is that not the case?——That is certainly the case. By and large, I suppose, we should relate our lending to farmers to the value of the crops and cattle on their farms, as distinct from the value of the land and buildings. In other words, it is working capital, not permanent capital.

13140. *Sir John Woods*: Is it a principle not to lend a farmer capital for building a barn or buying tractors?——We do a great deal, but if it is for real capital purposes it should be a bridging operation, and he should get his capital from, for example, the Agricultural Mortgage Corporation. I am not going to say he always does.

13141. *Mr. Jones*: In the case of an advance for a fixed capital project, for what period would your branch manager be inclined to fix the loan? Would he be prepared to give fairly long-term or medium-term credit to the farmer, if he was a credit-worthy customer, if his assets appeared to indicate that he was worthy of an advance?——*Mr. Tuke*: Our normal advances are for twelve months, subject to reconsideration.

13142. Would there be a maximum of twelve months?——We should always look at it every twelve months.

13143. You would have the right to call it in after twelve months?——We have the legal right to call it in any day, but at the end of twelve months there would be a new arrangement.

13144. *Chairman*: But there is no distinction in that between loans to private persons, loans to farmers and loans to industry?——No; twelve months is the normal thing. There are sometimes shorter periods, when the requirement is known to be short-term; and the tanker credits, of which you know, were for longer periods.

13145. *Professor Sayers*: This twelve months is essentially a period of routine review, and you maintain the legal fiction that every loan is repayable on demand?——Yes.

13146. How important is it to you to maintain this legal fiction? Some borrowers may be deterred by the fact that there is this legal fiction, coupled with a warning from the bank manager that the whole thing is going to be subject to review in twelve months. If you undertook to lend for a fixed term on a reducing basis, and that was not only the understanding or the intention of the bank manager but the actual form of the loan would that not meet a need which is not met at present? Have you really any objection to doing it?——There is a practical point; if a customer is making away with his assets, fraudulently or otherwise, we have to be able to pull him up. For exceptional reasons of that kind it is necessary to maintain the legal right.

13147. *Chairman*: Would not a debenture with appropriate terms meet that?——That is the classical case, I think, if a company's assets are being frittered away and given to creditors at the expense of the debenture holders.

13148. You could probably specify the conditions which would make you entitled to do it; but perhaps a debenture would not apply to the farmer anyway?——No, it does not really apply.

13149. Suppose that I was one of your branch managers in an agricultural district; how would I know what policy to follow with the approval of my superiors in dealing with farmers who came in for accommodation, or whose business I wanted to get?——You would know what it had always been, and unless you were told anything to the contrary it would go on being that.

13150. How would I know what it had been?——You would know by experience.

13151. And what would I learn from experience?——A great benevolence.

13152. That is what I wanted to know. They are regarded as rather a special concern of the bank by tradition?——That is undoubtedly so.

13153. *Professor Sayers*: This is true of all the banks?——*Mr. Chesterfield*: Yes; and of course the farmers know that, although these credits are made and renewed yearly, provided that all is going well the loan will not be recalled. I have to be careful not to give the impression that there is a contract in this; but obviously if we have a good farming customer we are not going to say to him: "You have had this loan for twelve months; now we would like it all back", although we have the right to do so.

13154. *Chairman*: So although the form you have maintained is that it can be recalled at any moment or when a review is done, it is not a deterrent to the farmers?——*Mr. Tuke*: I have never found it to be so.—*Mr. Chesterfield*: Nor have I. I have seen hundreds of cases where accommodation of this nature has been arranged, and the bank has quite openly said at the beginning: "Of course, in the normal course of events this accommodation will fall due for review in twelve months' time, but in the absence of unforeseen circumstances we do not anticipate the least difficulty in renewing it, either at a lower figure or at the figure it happens to be at the moment". That goes both for the farmer and the local bank manager who have, over very many years, taken this as a normal feature. Neither of them has been incommoded by it in the slightest degree, in my experience.—*Mr. Tuke*: Mr. Jones mentioned a loan for a capital purpose. Assuming the bank made a loan of £2,000, it would come up for review after twelve months. If it had been reduced out of profits by £500 (that is probably a little optimistic but it could happen), then we would normally renew it at £1,500 for the next twelve months.

13155. *Mr. Jones*: And in certain circumstances, I suppose, you would continue the whole overdraft?——We might.

13156. But you never lend on the basis of fixed repayments of capital and interest over a longer period than twelve months?——We never make a formal arrangement for an annual reduction. To take an extreme case, we would not make your £2,000 repayable over 20 years.

13157. If he wanted a 20-year advance he would have to go to some institution other than the bank?——Yes.

13158. *Mr. Woodcock*: To take Mr. Jones' example, could you give us any idea of the length of time the bank would have in mind for the clearing of the debt as a whole?——If he repaid £500 a year, it would take four years; that would be pretty good. I am talking now about a special capital advance, not the normal "in and out" advance, which can be the same figure every year for twenty years. That is a perfectly good banking account.

13159. *Mr. Jones*: You are saying in effect that it would be possible to get £2,000 and that whilst the outstanding debt would be subject to review every twelve months, provided that there was the capacity, on the basis of experience, to make repayments, there would be the tendency for that to go on for an indefinite period, particularly in respect of someone you knew from experience to be a credit-worthy customer?——That is an absolutely right definition, except for "indefinite period", because if the repayments are made it will come to an

end fairly soon.—*Mr. Chesterfield*: Perhaps Mr. Jones means "not defined" rather than "indefinite".—*Mr. Robarts*: That would certainly be right.

13160. *Chairman*: Is it your impression from your managers' reports that you have been able to accommodate farmers who wanted finance in recent years, or that there are credit-worthy farmers who have not had the resources that you could have obliged them with?——*Mr. Chesterfield*: The latter is certainly not my impression at all. The farmers were treated as a very special case under the credit squeeze, and were not in fact squeezed.

13161. That was your experience?——*Mr. Chesterfield*: Yes.—*Mr. Robarts*: I agree.—Mr. *Tuke*: They were never squeezed; they might think they were but they were not.—*Mr. Robarts*: The qualification is that they were credit-worthy, of course.

13162. Yes. What is your attitude towards the Agricultural Mortgage Corporation? Do your managers act as agents for it?——No; but they freely recommend farming customers who want long-term finance to go to it.

13163. Are you familiar with its workings and the results that are produced by application to it?——*Mr. Chesterfield*: I have not heard any great cry from anybody that it does not meet the demands made upon it.—*Mr. Tuke*: I have had a good deal of personal experience of it in the past, but my experience is too stale to be of real value. Their primary object is to make long-term mortgage loans, but they are also able to make improvement loans for shorter periods. That is something that they have not been very active about until lately, but they are now activating themselves a bit. I think that that can meet a need for the farmers, and should be encouraged.—*Mr. Robarts*: The change has been that farmers can now get a 33⅓ per cent. improvement grant; there may well be scope for the Agricultural Mortgage Corporation lending the other two-thirds.

13164. Have they branch offices?——I do not know. The cases I have seen have always gone to the London office.

13165. Then may we go on to point 6?—*Professor Cairncross*: By way of introduction to that, can you give us any idea of the rate at which you turn over your advances? What is the monthly inflow of repayments in relation to what is outstanding?——I have never seen any figures for that. I should think it is an unobtainable figure because it is nearly all on fluctuating overdrafts.

13166. It has been put to us that at times you have had a run down in advances occasioned by not making new advances, and I wondered at what rate of advances you would run down, if that situation arose?——I have no idea, because it must depend so enormously on the conditions of the country at the time.

13167. You have told us in effect that you do not make term loans at all?——*Mr. Robarts*: We must qualify that. Export credits and certain tanker financing schemes are the main exceptions. The Finance Corporation for Industry and the I.C.F.C., which we are going to talk about shortly, have in practice had loans outstanding for many years, in fact ever since they were formed.—*Mr. Tuke*: Does "term loan" imply a definite annual reduction, or does it mean that the whole loan is outstanding for, say, five years and then has to be repaid in full.

13168. *Professor Sayers*: It can be either; in fact most term loans in the United States are reduced at regular intervals in the fixed period.—*Professor Cairncross*: Do you not find any commercial demand for accommodation on that kind of basis, not for the whole of an overdraft, but perhaps for a part of it?——*Mr. Chesterfield*: Yes.

13169. But you do not think it desirable to accede to that type of request?——*Mr. Chesterfield*: We do very little of it.—*Mr. Tuke*: The customer is never precluded from reducing if he wants to, and his overdraft goes up and down with his ordinary payments and receipts, so that he is not paying interest on the full amount all the time. So he does not demand a fixed loan.

13170. Is it not two-sided? He has the certainty that he can rely on a given period for the use of the money if you give him a term loan, whereas at present nominally the money is on call, and this may be a material factor?——*Mr. Robarts*: This is comparable with what we said about farming advances. Obviously if we have a good, secure loan to a good industrial customer, we are not just going to require him to pay it back at the end of twelve months.

13171. There must be many occasions when an industrial borrower hesitates to go for money to the bank. Would you be willing to give him money for five years, if that is what he wants and if he is willing to pay you on that footing?——*Mr. Robarts*: If he is a good customer it would be quite reasonable for him to go to the bank and put that proposition. We would not do it under what I understand to be the American term loan system. We would do it in the normal way, and it would be understood that the purpose for which it was required would enable repayment to be made within five years. If he wanted money for substantially longer than that, then we might say: "We will lend it to you while you raise some permanent capital from the market."—*Mr. Tuke*: Professor Cairncross referred to the apprehension that might arise from its being repayable on demand. Apprehension, if it does arise, arises from the annual review, which is a practical reality; the repayment on demand is what Mr. Chesterfield called, in another context, an assumption.

13172. *Professor Sayers*: It is that annual review that is absent from the American term loan?——Yes. So far as customers demur about this, it is not the repayment on demand but the annual review that they object to. But of course they have their balance sheet once a year, and we require them to produce it once a year, so the annual review does work in with that.

13173. How vital is this annual review?——*Mr Robarts*: It is very important from the bank's point of view.—*Mr. Tuke*: It is a discipline for us to look at our loans at least once a year. It ought to be done more often, of course.

13174. *Professor Cairncross*: But the small borrower might be asked for a review at the very time when it is least opportune This is the risk be has to run. Perhaps his balance sheet looks bad, and that is the very time you ask him to make a repayment?——*Mr. Robarts*: We would only ask him to make that repayment if, having regard to his circumstances, the debt was too high and therefore unsafe.

13175. *Chairman*: Would it not be possible to express what you have in mind in the form of two or three conditions, so that you would say: "You may have the money for whatever period of time seems appropriate, provided either that you repay so much, or that you do not deal with your assets in this way or that, but show this or that satisfactorily in your balance sheet each year"? Then he knows where he is, whereas he does not if you say: "We will look at this in the course of the annual review and then we will tell you what we are going to do"?——*Mr. Robarts*: I would think the first part of the statement is what in fact happens.—*Mr. Chesterfield*: I think that what happens is what I said in regard to the farmer's loan [see answer to Question 13154].

13176. He knows the conditions?——Yes.

13177. When you take security on a debenture, are you not forced to take it on a period loan, subject to your power to move in on certain conditions?——*Mr. Robarts*: Yes, but even when we are lending on a debenture, the debt itself is repayable on demand still.

13178. *Sir John Woods*: The debenture is collateral security?——Yes. There is a difference between lending on a debenture and investing in a debenture.

13179. *Professor Cairncross*: Have you really abandoned any idea of entering the field of industrial banks, either directly or through subsidiaries?——The I.C.F.C., which is our joint subsidiary, does this sort of thing.

13180. Does not the I.C.F.C. lend deliberately for a long period and for purposes different from those which you normally set out to cover?——I would not say that the I.C.F.C. lends for purposes different from the things we would in the main cover. It does it by different means, and probably for much longer; they are of a more capital nature, of course.

13181. Is not the contract different? It represents a willingness to stay with the risks, even though they may look bad at the time. Perhaps that is an equity, which you do not reckon a bank should take and, as the banks are operating at present, would not take?——Yes, I agree.

13182. Had you thought of setting up any subsidiaries which might take an interest in industrial banking in the I.C.F.C. way and compete with the I.C.F.C., if necessary?——*Mr. Tuke:* The I.C.F.C. is our joint subsidiary, so at present we are doing that.—*Mr. Robarts:* There are a good many concerns that do this business; not only the I.C.F.C. but merchant banks, issuing houses and so forth. They naturally do it much more by way of public flotation than just by lending money.

13183. *Professor Sayers:* A year ago the banks were not in the hire purchase business, and you could say that there were a good many other people doing this business and the banks were not in it; but now you have gone into it. Professor Cairncross is asking you whether you have any thoughts of going into industrial banking in the same sort of way as you have gone, in the last year, into hire purchase?——*Mr. Tuke:* The hire purchase companies do what you call industrial banking (at least ours does); so it is being done.

13184. So your answer is that you have already done it, and Mr. Robarts's answer is that you would not think of doing it?——*Mr. Robarts:* There is a very great difference between banks and hire purchase companies. The hire purchase companies have that as part of their business. What I want to emphasise is that the banks should not, in my view, invest depositors' money in industrial shares.

13185. *Professor Cairncross:* But you have no objection to this principle; I.C.F.C., as you say, is the child of the banks. I was asking whether some of the banks might have their own affiliates to make loans of this kind or take equities in this way?——*Mr. Chesterfield:* When our own capital and reserves reach such a pitch as to permit us to do so with safety, in other words when we are not lending our customers' money which we are liable to repay on demand, then, in my view, in the long-term, we shall do it.

13186. You make a distinction between what you do with your capital and what you do with your customers' money; but the money you are lent from your customers stays with you almost as long, in practice, as the money you get from the shareholders?——*Mr. Tuke:* But it is all repayable.

13187. *Professor Sayers:* You know that you have your current accounts, and that they go on from year to year. You know that the business of the country cannot run unless people keep their money with you. Nothing is so fixed, surely, in total as your current accounts?——*Mr. Chesterfield:* That is what enables us, in some degree, to make these advances to industry, agriculture and private persons on rather longer term than on demand. Investing in equities is a very different proposition. I would think that, if we invest in equities at all, we should invest only our own money. That is where a great many banks came unstuck on the Continent in years gone by, in so investing their customers' money.

13188. Is not that what the continental banks do now?——*Mr. Chesterfield:* I do not know.—*Mr. Robarts:* I think that they have learned their lesson.

13189. *Sir John Woods:* Would there be a great deal of difference in the money if you created, with a very small proportion of your deposits, an industrial banking subsidiary?——Of course it is all a question of proportion. To do anything worth while, to make a real impact on the economy, requires a great deal of money; that would involve investing depositors' money in a way which could not be justified.

13190. That would seem to imply that there is a very large unsatisfied demand for small and medium-sized concerns which is not satisfied by the institutions already available. I had the impression from what you said that you thought that there was not such a demand?——*Mr. Robarts:* I did not mean to give that impression at all. To do anything which would be a large factor in the system would require more money than we would feel justified in putting in, because it would draw upon our depositors' money, but I do not imply by that that there is a large unsatisfied demand.—*Mr. Chesterfield:* Perhaps I am rather commercially minded, but I would not be averse, if our own funds were available, to entering business of this nature to satisfy a real demand, whether or not it had traditionally been somebody else's business. There is the element of competition in our business, as I said twelve months ago. In regard to personal loans, we have entered a very competitive field and I think that in the years to come we shall tend to go more into industrial banking with our own money.—*Mr. Tuke:* Surely there is no point in this series of questions unless it is assumed that there is a large or fairly large unsatisfied demand.

13191. *Professor Cairncross:* I do not think that I would make that assumption. I believe that a small number of inventions in the last fifty years have transformed human life, and that some of these have been made under the auspices of smaller firms and not big ones; so that quite a little, done at the right time, might mean that we got well away with an industry which might otherwise be built up in another country. This might be of no relevance, but I do not think that one can assume that because it is a small amount of capital the consequences to society are not very considerable if somebody important is not getting the money. What we should like to know from you is whether there are individuals who would merit more support with long-term capital up and down the country, and who may have difficulty in getting it?——*Mr. Chesterfield:* I was discussing with some of my colleagues in other banks yesterday the development of electronics in particular in relation to our own industry. There was a suggestion put forward that the banks should finance a development of a particular process or perhaps more than one particular process. We have that very definitely in mind, but it would not come within the normal field of bank credit.

13192. That is exactly what I had in mind: some invention of a major type.—*Sir John Woods:* Was that a development of immediate practical importance to the banks themselves?——It might have practical importance for the banks themselves in due course, but it was not just the development of a machine to do something for one or other or all of our particular banks. It is a proposal to give a development contract where we can see a line of promising discovery, although we know we may be throwing some money away.

13193. But it was in relation to some electronic development which could lead to the installation of some system into the working mechanism of the bank?——*Mr. Chesterfield:* Something in which we were particularly interested, yes.—*Mr. Tuke:* And which would be available for other people as well as ourselves.—*Mr. Robarts:* Regarding Professor Cairncross's questions, it is fair to say that there are in this country any number of firms who owe their start to a bank advance. Many people will tell you that that is how they started.

13194. *Chairman:* They were more than started; they were supported?——Yes; but they could not have started unless they had managed to get a loan.

13195. Now we come to point 7, on the I.C.F.C. We have seen the statement of policy and the *aide-memoire* that the bankers issued at the time the project of the I.C.F.C. was announced to the public. The banks made a special point at the time this project was being launched that the I.C.F.C. should derive its funds from the banks which were concerned in starting it, and not from the public. That is some time ago and circumstances may have changed. Is that policy still regarded as being essential today, and, if so, what are the reasons for it?——I have Lord Piercy's permission to disclose to you exactly what our plans are. We feel that in the future it is desirable for the I.C.F.C. to make public issues of senior capital. We would wish to continue to hold the ordinary shares but I have agreed, on behalf of the banks, with Lord Piercy and with the shareholders that when the markets are suitable he will make a flotation, probably of a debenture issue. This is only in very broad outline at the moment, but he is putting his company into such a form, with new articles and so on, that he will be able to do that. The proceeds of the issue will, in our plan, be used to make a reduction in the borrowing from the banks, which has been outstanding for a very long time and is continually growing, and further to finance his future requirements. I have suggested to him that the terms of such an issue of stock shall be drawn up so that he can make future issues also. At the same time the shareholders will pay up the unissued capital, bringing the paid up share capital to £15 mn. That will cause a reduction of the loan capital; it is merely converting loan capital into share capital. It would be our hope that in the future (it will take some time to accomplish) his finance will be run on the same sort of lines as that of the Agricultural Mortgage Corporation, to

whom we lend money in anticipation of the receipts which come from issues; and we have all agreed that this is a desirable object.

13196. The first proposed issue, I understand, is meant to make a net addition to the resources of the I.C.F.C., and not merely to put the public who take the securities in the place of the banks?——It will do both, according to the plan. It will make some reduction in the bank borrowing, and it will provide the I.C.F.C. with further resources to expand its business.

13197. And your future attitude towards its resources would be that you envisage the banks providing finance with a view to its being taken over by public issue, when a suitable time arrives?——That is the eventual aim. It will take some time to achieve, because I.C.F.C.'s borrowing is very substantial.

13198. When you started the I.C.F.C. with the banks as its sponsors, you did intend that it should borrow substantially from the banks?——That was always foreseen, and indeed it has done so; but that is a long time ago and we feel that it is time for another look at this policy.

13199. *Sir John Woods*: Does the total plan therefore involve reducing the loans from the banks to nil?——Maybe at some point, but it will be always a very fluctuating affair. The plan involves very substantial reduction in what might be called the permanent loans. These loans have gradually risen, because the company has been doing more business—and good business—but its only source of fresh money has been the banks.

13200. *Mr. Jones*: I understand that the banks were rather reluctant to subscribe for this scheme at the beginning. I think that perhaps there has been some change in that attitude with the passing of the years. Is there any degree of reluctance now, not only to find the amount of capital unsubscribed but to provide a greater amount of capital when the issue is made?——I am not sure about the reluctance. We have had, in times of credit squeeze, to ask the I.C.F.C. to play its part in the restriction of credit. We could not exempt them from the credit squeeze.

13201. I am talking about before the credit squeeze, right at the beginning and through the intervening years. At the beginning were you not rather less than willing co-operators in the scheme?——*Mr. Tuke*: I was in at the beginning; in fact I was a joint author of the memorandum. Once it was decided that a corporation of this sort was to be set up the banks decided how much money to put in, and eventually it was to be £45 millions. That was quite a lot for an experimental thing. We felt that it ought to go slowly, and we did perhaps hold the reins a bit tight at the start; we were not sure how it would go. We thought that we might lose money. I daresay that the people in it thought that we might have let them go before we did, but it was right that we should have been cautious.—*Mr. Chesterfield*: I, like Mr. Tuke, was in at the beginning. The proposal was for the corporation to be wound up within a reasonable period; but it was found quite impracticable, in fact undesirable, to incorporate such a provision in the memorandum and articles of association.

13202. But is this not a distinguished son, in whose development and distinction the banks ought to have taken pride?——We indeed have, and from my recollection of the past there was not that reluctance to which you refer.

13203. Will the banks make a substantial contribution to the new issue?——*Mr. Robarts*: That is not envisaged. It would be a public issue, to which the public would subscribe.

13204. Is there any reason, having seen the distinction that this offspring has achieved, why the banks should not give it practical, financial and moral support?——*Mr. Chesterfield*: We shall be giving it much more than moral support, because we shall be putting in all the capital on which the company itself is formed.—*Mr. Tuke*: There would be no point in taking money out of one pocket to put it in another.

13205. You are saying in effect that you will find the authorised capital not yet subscribed, which is equivalent to £7½ mn.?——*Mr. Chesterfield*: That is so.

13206. Having regard to what is required in this particular field, is there not an opportunity for the banks to make a very remarkable contribution to the economy in this field?——*Mr. Chesterfield*: We think that there is, and that we are putting it on the best possible footing we can, by owning the share capital, which is the basic interest in it.—*Mr. Tuke*: We have superannuation and pension funds, and I can envisage that these funds might help with this debenture issue, but not the banks themselves.

(*Adjourned until* 2.15 *p.m.*)

MR. D. J. ROBARTS, MR. A. W. TUKE and MR. A. D. CHESTERFIELD further examined

13207. *Chairman*: The next question about the I.C.F.C. is whether the loan finance which at the moment is held by the I.C.F.C. is treated from the point of view of the banks as short term or long term money. You have told us that the ultimate intention is that it should be recouped by the banks by public issue so far as that can be achieved; what about the meantime?——*Mr. Robarts*: Each bank may look at this thing differently, because we all have loans to I.C.F.C. In the National Provincial Bank's calculations of what we agree to lend on medium-term finance, which is in the main for export credit facilities, we do not include the I.C.F.C., but that could very easily vary from bank to bank.—*Mr. Tuke*: I do not draw this absolute distinction between short-term and long-term. We have not got in our minds a definite figure beyond which we will not go for money which is long or short. I would not admit that we have any long-term loans except the export credits. When we went into the I.C.F.C. we expected it to be a long-term affair, and it has so proved; we are now trying to make it something different. We do not want them to look at it as going on being long-term.

13208. Within the years that it has been operating no money has, in fact, been withdrawn from the I.C.F.C.?——*Mr. Tuke*: No; we are under a moral obligation to one another to put in our due proportions. As between ourselves we would not feel it right to call them.—*Mr. Chesterfield*: In my day-to-day reckoning, which I keep as a record either to depress myself or cheer myself up in regard to medium-term commitments, I include I.C.F.C. and F.C.I. as medium-term.

13209. *Mr. Woodcock*: Do you vary the rate of interest on it?——We vary the rate of interest of part of it.

13210. What part is that?——*Mr. Tuke*: The distinction is not between long and short, but between new and old. We lend a certain amount at 3 per cent.; if they want more they must pay a higher rate for it.—*Mr. Robarts*: We fixed the old money at 3 per cent., and the new money is borrowed at half per cent. over Bank Rate with a minimum of 4 per cent. We drew a line at a certain date.

13211. The old money remains at that price throughout?——*Mr. Robarts*: Yes.—*Mr. Tuke*: That was a concession. They lend at a rate of 5 per cent., and they would get into difficulty if we did not do this. We do it, but it is not business.

13212. *Chairman*: As the launching of it was done as a general arrangement between the banks, is there not a general responsibility with regard to the banks' policy to I.C.F.C.?——*Mr. Robarts*: Yes, indeed; it comes up to the Committee of London Clearing Bankers when they want to borrow more money, as did the arrangement I outlined this morning.

13213. It would not be the right picture that each bank is left separately to consider what it will do about its loan and how it will treat it?——*Mr. Robarts*: No; it is general policy.—*Mr. Chesterfield*: Some of the banks have representatives on the Board of I.C.F.C. too.

13214. You have told us about the ultimate intention to get the bank financing, except what is shifted into permanent capital, taken over by the public in due course, but it may take a period of years. I presume that your policy would not lead you in the meantime to recall any of the loan capital which is outstanding between you and I.C.F.C., unless a public issue could take it over?——*Mr.*

Robarts: That is the position. Even in the credit squeeze we never recalled any. We were merely rather reluctant to increase beyond the minimum amount to keep them going.

13215. Then we come to sub-heading (iii). I suppose that you fixed these restrictions about the maximum and minimum scale of operations as a rather rough generalisation to indicate the scale of operations when they started. Were they regarded as rigid to them, or is play allowed with regard to the operation undertaken by I.C.F.C.?——There is some elasticity. Originally it was £5,000 to £200,000; that has gone up to £250,000. One cannot confine these transactions too exactly, but, by and large, their business lies between those figures, the thought behind it being that anything substantially over that can probably be dealt with by a public flotation.

13216. The value of money has changed quite materially since this began?——*Mr. Robarts*: That is very true.—*Mr. Tuke*: It may still be true that for anything over £200,000 it is possible to go to the Stock Exchange.

13217. Would you accept that today as a measure of what could be economically or satisfactorily issued?——As regards the issue or placing of capital for not much more than £200,000, I am not quite sure.

13218. It would be a placing rather than an issue.——*Mr. Tuke*: It might be, but it goes through the Stock Exchange. This was the Macmillan gap; they thought that there was a field where it was not practical to go to the Stock Exchange because it was too expensive *pro rata* and that at the lower end the banks would take care up to £5,000. That £5,000 might be £10,000 now, indeed it might in individual cases be a great deal more; but I think that £200,000 still more or less stands.—*Mr. Chesterfield*: It was agreed some time ago that in exceptional cases flexibility could extend to £250,000 but there has been no subsequent request for further upward revision.—*Mr. Tuke*: In the times when we have been trying to keep this from going too fast we did not want individual cases to be too big.

13219. *Professor Cairncross*: Does this sum of £250,000 extend to the whole amount or only to the amount which would be advanced directly by I.C.F.C. and retained by them?——*Mr. Tuke*: There has been a bit of misunderstanding about that, because I.C.F.C. have once or twice taken a participation of £200,000 in a bigger thing. I personally have thought that that was wrong, because if the total was £1 mn. it could go to the Stock Exchange, and there was no need for I.C.F.C. to be in it at all. But in the strict letter of the law I think that they were entitled to take £200,000 of it.—*Mr. Robarts*: I think that the original intention was that the top limit should apply to what they do on their own. I do not think that anybody envisaged them taking participations in bigger undertakings, as they have occasionally done.

13220. *Chairman*: But the size of the finance is not the only thing which might debar an issue from the Stock Exchange. A record of profits which might be promising for the future might not justify an issue in any one year?——*Mr. Tuke*: That consideration specifically comes into the purposes of F.C.I. rather than I.C.F.C.; F.C.I. is to deal with big things which are not yet ripe for the Stock Exchange.

13221. *Professor Cairncross*: Is it your view that the efficiency of the Stock Exchange is so improved that it can now handle issues of £200,000 only, when that sum must be equivalent in value to only one-third of what the Macmillan committee had in mind?——I do not think it is a question of efficiency. There are certain inescapable costs which when spread as a percentage over the whole come out too high if the whole is not above £200,000.

13222. I accept it as a matter of cost rather than efficiency; but do you not think that perhaps today the sum might be a little higher than £200,000?——I should quite understand if it did so prove; but I think there are issues or placings being made for sums not much in excess of £200,000.

13223. It was put to us by Lord Piercy that he would like a little more latitude here. He may not have approached the clearing banks but he appeared to envisage making loans on I.C.F.C.'s own account of the order of £300,000, say, and possibly taking proportions of that participation up to perhaps £400,000. I dare say that if he were pressed he would be willing to accept £500,000 as an upper limit. Would you see any objection to some latitude in that direction?——*Mr. Chesterfield*: I do not like the participation aspect; I would not object so much to the other.—*Mr. Robarts*: Participation has always seemed to me rather illogical; a condition of that must be that the whole thing being done is considerably more than £200,000, in which case it can be done in the normal way through the Stock Exchange and issue market.

13224. It is a normal feature of industrial banking that one seeks participation?——Certainly; but I.C.F.C. was formed for the special purpose of providing finance which could not normally be done on the Stock Exchange.

13225. It is still rather on the borderline of what the Stock Exchange would normally handle on the upper limit. I accept that some placings are made for smaller sums than that, but even if it lay between £250,000 and £500,000 costs might be rather high?——Anything from £300,000 to £500,000 could, I should have thought, be done through the Stock Exchange.

13226. At reasonable costs?——*Mr. Tuke*: It is a question of whether one is prepared to pay the price. There is a price at which one can do £200,000 or £250,000.

13227. Does it not become prohibitive the lower one goes? May it not be quite high at £400,000 or £500,000? If the banks were approached on this, would you hesitate to accept a higher limit than £300,000 for I.C.F.C.?——The main purpose of this company is to fill the Macmillan gap, and it is not intended to spread beyond that. I quite understand that Lord Piercy would like to have more money to be allowed to do more things which he cannot do without having more money at his disposal; and he sees at this moment a chance of getting his hands on more money.

13228. *Professor Sayers*: The "Macmillan gap" was based on the view that for issues below £200,000 the costs of issue through the Stock Exchange channel were so high as to squeeze out various projects that it would be in the national interest to carry through. If you adjust that figure for the rise in costs, would it be surprising if the figure comparable to the figure of £200,000 in the Macmillan Report was now something like £500,000?——*Mr. Robarts*: I could not say without research whether the costs of an issue expressed as a percentage of that issue have in fact risen. The main cost of an issue, of course, is the initial stamp duty. It depends whether it has to be advertised. If it had to be advertised admittedly it would go up, but probably an issue of the size we are thinking about would be a placing which would not be advertised.—*Mr. Tuke*: The stamp duty and underwriting charge are a percentage of the amount. By and large they have not altered, but there are certain other expenses which no doubt have gone up quite a lot.

13229. When one has allowed for all those things, the figure parallel to the Macmillan committee's £200,000 must be way above that?——*Mr. Chesterfield*: That makes it all the more remarkable that we have not had a further application from I.C.F.C.

13230. *Chairman*: But you would agree that your policy remains to provide this organisation with sufficient money for it to be able to provide money for those deserving companies which cannot manage a Stock Exchange issue owing to the question of cost. It is a practical question of what the level is today, below which the cost is uneconomic?——*Mr. Robarts*: Yes.

13231. *Professor Cairncross*: There was a second issue, that you dislike participation. Does this dislike extend to loans or interests taken in companies, when the sums involved are well below £200,000?——No; I think that that would be logical. What seems illogical is to have a company designed for the special purpose of doing transactions under £200,000 engaging in a participation in transactions considerably over that figure which can be done on the market.

13232. Is it not desirable to leave a little room for experiment here? There are alternative means which put money at the disposal of small companies. If one is too dictatorial may one not prevent the development of the most efficient method of providing industrial capital?——

We have not been hard and fast about this thing; they have done transactions of rather more than this. One must have some elasticity in these matters.

13233. *Chairman*: Then we come to the questions of statistics on which we would like to get your views; that is point 8.—*Professor Cairncross*: The suggestion in sub-heading (i) is that it would be of interest if you published quarterly some analysis of your deposits, and specifically that it might be possible to show the deposits of public companies. It would be possible to do this either on a very limited footing or on a more elaborate footing. If it were a limited footing one might have perhaps 2,500 odd quoted companies which would presumably not be a tremendous undertaking; if one went beyond that this might be a fairly elaborate job?——Yes. These statistics involve an enormous amount of work, however you look at it and I am anxious as a matter of policy, and I hope this Committee will agree, not to throw any unnecessary statistical work on us. We have been very anxious not to stand in the way of the supply of statistics for this Committee, and I hope we have given you what you want; but for future routine statistics I think we ought to try and keep as low as is consistent with providing proper efficiency.

13234. I have great sympathy with that, and I do not want anything I say to be at all in conflict with that general principle.—*Mr. Tuke*: May I amplify what Mr. Robarts has just said? There are various statistics, large in number, that we accumulate for our own purposes. It is no trouble to us to pass them on, subject always to our being prepared to disclose the information. There are other statistics which we do not want, the cost of which is entirely a burden to us. They fall into two classes, and it seems to me that we ought to take a different view of one from the other. There are statistics wanted by, or already provided to, the Bank of England for the purposes of helping in the management of the country's finances; we are willing to go a very long way at our own expense to help with that. There is another class. Professor Cairncross used the word "interest"; if I may say so without disrespect, if it is merely a question of interesting academic economists I am not very anxious to spend a great deal of money on that.

13235. Do you not think that academic economists have contributed to an understanding of monetary policy?——They all quarrel amongst themselves, so that one does not know what to believe.

13236. *Chairman*: Do we have to think of all the banks concerned having a permanent staff which is devoted to the collection of some volume of statistics over and above those which are available to the public or those which are supplied under existing arrangements to the Bank of England?——*Mr. Robarts*: What happens is that Head Office asks for returns from the branches; the people who are affected in those branches are engaged in the normal work of the branch, and they just produce those figures as part of their day's work. Head Office, of course, collates them all, which is no mean task, and then eventually they are sent to the Clearing House, where Mr. Barkshire, the Secretary of the Committee of London Clearing Bankers, puts them together for all the banks.

13237. *Professor Cairncross*: In this case the interest lies in knowing something about the movements in the liquidity of the companies in the country; and it would be material to forming a judgment of that to see what was taking place in the movement of their holdings of cash. I am picking particularly on companies because we have other information about the movement of company profits and investments which can be matched with this. If one were thinking of making it a minimum undertaking I had thought that perhaps public companies might reduce it to manageable proportions?——That is a vast reduction as compared with the whole field. If you could see your way to including only deposits of, say, £10,000 or more that again would cut things down a hit; and, of course, the less frequently you want them the better from our point of view: perhaps yearly instead of quarterly, if you agree.

13238. The value of this would lie in greater frequency, even if that meant the loss of completeness. It is important here to have up to date information, and if one waits for company balance sheets that may be too late. You may be in possession of much better figures than ours. It appeared to me that this was a very much smaller undertaking than the kind of analysis you do on, say, personal deposits, which is an immense undertaking?——Yes, I see the force of that. I wonder whether we could do something like this. Could you raise the lower limits very substantially?

13239. If it related to quoted companies, for instance, the lower limit could clearly be quite substantial. I do not suppose that there are any quoted companies whose deposits with the banks would not be likely to be of the order of £10,000 or more?——*Mr. Chesterfield*: Are you talking about net deposits or gross deposits in this context? Are you talking of net deposits of public limited companies?

13240. I think this was intended to refer to gross deposits?——I should be quite prepared to support Mr. Robarts if he likes to make a recommendation that we should provide the total of the credit balances over £10,000 of public limited companies twice a year.

13241. It is not in the Committee's mind to discuss in detail what is the appropriate proposition; we are merely trying to explore with you what along these lines might be a possibility without putting too great a burden on you?—*Chairman*: Can you give us any idea of what magnitude of work this would impose on you?——To confine it to public companies only makes a big difference to this question. I do not know how many there are in existence.

13242. *Professor Cairncross*: Quoted companies number under 3,000.—*Mr. Chesterfield*: That number would not be difficult at all.—*Mr. Robarts*: If you want quoted companies I feel sure we can do that twice a year.

13243. *Professor Sayers*: Would quoted companies four times a year be much more awkward?——*Mr. Chesterfield*: When we are talking of numbers of the magnitude which Professor Cairncross has indicated, I do not think that it is a matter of importance whether we do it quarterly or half yearly.

13244. *Professor Cairncross*: May we turn to sub-heading (ii)? We understand that a figure for net transactions in gilt-edged securities is communicated to the Bank of England. Would you feel any difficulty about making that figure available for publication?——We have said that we are prepared to make the figures available to this Committee. I do not think that we want to publish them regularly on our monthly statement, where they could be got hold of by one or two of the less well-informed commentators in the Press. We should like to continue to give the information to the Bank of England under the arrangement which we entered into with the then Governor in 1943, when we agreed to make available quarterly figures of investments in Government Securities on the lines indicated, and the Governor wrote on 8th October, 1943:

"They [sc. the Treasury] readily accept the understanding that no request shall be made to the banks at a later date for the use of the figures of the banks as distinct from those of other institutions in any publicity either written or oral and that similar figures should be required from all the non-clearing banks."

13245. *Chairman*: The attitude was that, if they were married to the figures of other institutions, then there would be no objection to their publication?——That is so.

13246. *Professor Cairncross*: This would imply that if we could prevail on other institutions to take the same view as you do, there then might ensue the publication of figures for a wide group of institutions, including banks?——Yes.

13247. Subheading (iii) also relates to the division of your figures of holdings of gilt-edged securities between under five year bonds and over five year bonds. Would you see objection to disclosure of that to the public at some interval?——*Mr. Robarts*: I would see the very greatest objection.

13248. You observed this morning that I was in some doubt whether any substantial change had taken place since before the war in this distribution. I imagine that, if we are in doubt, the general public would be still

more in doubt whether the banks' holdings of gilt-edged were now on average shorter than before the war?——*Mr. Chesterfield*: The general public would not think anything about it.

13249. I was referring to the informed public. There have been discussions of this in the financial Press?——Not altogether well informed, if I may say so.

13250. Would it not be better if they were well informed?——We can see the point of view that this would be very valuable to the Treasury, and we have supplied these figures to the Bank of England and to your Committee; but we are not at all keen on the idea of publishing them to all and sundry.

13251. What is the reason for this?——Everything can be picked up by certain financial journalists who will fasten on anything which could in any way be used to the detriment of the banks' wellbeing.

13252. *Professor Sayers*: Do you not immensely increase the risk of misuse of what is published if you do not put informed people in the position of making intelligent comment? I myself am continually feeling inhibited in making any public comment on uninformed comments by other people because I do not know the facts. You are encouraging me in this silence; you are giving more rope to the people who make uninformed comments. Is that what you really want?——*Mr. Tuke*: We do not want the public to discuss our affairs. We would much rather they did not. The more information we give them the more they will discuss our affairs, and that is what we do not want.

13253. *Professor Cairncross*: Until a few years ago it was not possible to know what your holdings of Treasury Bills were or to make any subdivision in the category of bills. It would seem to me that there is as much importance attached to knowing the difference between the holdings of short or long dated bonds as there is to knowing the difference between the different types of bills. They are not the same, though they are grouped under one heading. If this is a subject that is of interest to the monetary authorities, ought it not also to be of interest to people who are trying to form an idea of Government policy?——*Mr. Robarts*: My objection to it is that, if we divide the holdings of the banks into under five years and over five years, and for some reason, let us say due to a Government funding operation, the figures show a substantial decrease in under five year bonds and an increase in over five year bonds, it is open for someone to say that these banks are going for more income at the risk of depreciation of their investments. That is a remark that could be made, though it would probably be nothing to do with the reason for which the increase in the over five years took place.

13254. I accept that any information is liable to misinterpretation, and this is particularly true of statistics; but if it is true, as we have been led to believe, that the liquidity of the commercial banks is a matter of very great importance and if that liquidity is itself conditioned by the structure of their bond holdings, is it really right to leave the public in ignorance of what the distribution of maturity of Government securities happens to be?——I do not think that the detailed analysis of the security holdings of the banks is important to the general public.

13255. *Chairman*: Your point of view applies just as much if the figures are given as being as aggregates of the banks as a whole?——I was assuming that they would be.

13256. And if the aggregates of the banks were merged in the aggregate for financial institutions as a whole, would you then feel there was any large danger?——*Mr. Robarts*: We have conceded that. If they are in an aggregate of the financial institutions as a whole that removes, to my mind, an enormous objection. Financial institutions as a whole are a vast field. In fact, I suppose it includes most of the short-term Government debt.——*Mr. Tuke*: A great many financial institutions within that definition would hold nothing but shorts; bringing in the discount market would make an addition of one half. I do not think that you would be very much edified.

13257. *Professor Cairncross*: May we pass to subheading (iii)? The question relates to the distribution of liabilities and assets in your balance sheet between residents and non-residents. Some of this information must already be known to you and to the Bank of England. Where the figures are already available, do you see any objection to making public totals for residents as distinct from non-residents?——*Mr. Chesterfield*: Would you include the holdings of the Bank of England with the figures of the clearing banks?

13258. I would have thought that there was no objection to their being included in the total?——*Mr. Chesterfield*: This is a question which is very important to the Bank of England and to the Treasury. I would have thought that the dangers of ill-informed comment on publication were very great.—*Mr. Robarts*: I think that these figures should be, if they require them, supplied to the Bank of England; I can quite understand that they may well want them. But it would be a very dangerous thing to publish them, because in the event of the exchange being under any suspicion, which does unfortunately happen from time to time, if at that time one could see very big movements of foreign balances either in cash or investments in London it could be quite damaging.—*Mr. Chesterfield*: We would see no objection to permitting the Bank of England to make our figures available to the Treasury.—*Mr. Robarts*: That is quite a different thing; I am talking of publication.

13259. You think that it is more dangerous than publishing figures for the gold reserves?——*Mr. Chesterfield*: Gold reserves are an accomplished fact. Publication could give rise to more speculation and ill-informed comment. It might be, for instance, that some big overseas depositor might decide to buy Government securities; that amount would come out of our figures of non-resident deposits, and might give somebody the idea that money was being withdrawn from London.

13260. Subheading (iv) relates to the disclosure of the profits of the banks as a group on the basis of the information already available to the Inland Revenue. They do, as you know, publish figures for banking, insurance and finance, but they are not in a position to break that down to show us figures of banking separately. Do you see objection to their publishing these figures?——*Mr. Robarts*: I am sorry to be continually refusing, but I see the very greatest objection to this. First of all, the figures indicated to the Inland Revenue must be absolutely confidential and always have been. They publish this wide group, but it is so wide that one cannot separate it out. Second, the banks' profits are vastly affected by their transactions in gilt-edged securities, because they are taxed as traders in securities. If they make a profit or loss on those tradings, the profit is an increase on and a loss is a reduction in the normal trading profits of the bank operating on the gilt-edged market, so that the profits as taxed by the Revenue can vary enormously. Third, it was accepted by the Cohen Committee, on which the Companies Act, 1948, was founded, that it was not in the public interest to show big swings in bank profits. If there is a thoroughly bad year in the gilt-edged market that could give a very misleading impression to the public, and perhaps a disquieting one which would not be at all warranted.

13261. Your figures at present are in a rather special category in that they are not published while for other industries figures are published on exactly the same definition. What you are suggesting to us is that the definition is perhaps inappropriate to show the true outcome of the operations of the banks, but I have heard similar arguments used in the last ten or fifteen years by other industries. When they have inflation or depression in mind there always must be circumstances in which any definition of profits is liable to mislead a person looking at figures?——An industrial company is in an entirely different situation from a bank. It does not to anything like the same extent depend on public confidence as banks do. The banks depend, and the whole country relies, on the absolute confidence of the world in the banking system here. That was well recognised by Lord Cohen's Committee, when they found that it was inexpedient for the banking system to show its total profits or its transfers to and from internal reserves or the amount of those reserves. That conclusion was come to in the public interest, because it was felt to be necessary that public confidence, at home and abroad, in the banking system should not be imperilled by bad experience in any one year. The same considerations seem to apply to the figures now asked for, and the banks would deplore any departure from the findings of the Cohen Committee in relation to them.

13262. *Chairman*: It seems to me that your answer centres upon the law as established by the most recent Companies Act which was based upon the recommendations in the Cohen Committee Report, which did, you say, give a special position to banks and some other institutions?——Yes, and on the reasons that lay behind the Coben Committee recommendations.

13263. If it were not for that position, there would be no reason to distinguish a statement of the aggregate profits made by banks in the year as published by the Inland Revenue from the statement of the aggregate profits made for any other section of industry or commerce?——*Mr. Robarts*: I think that the reasons which led to the Cohen Committee putting the banks into a special category were and remain valid.—*Mr. Tuke*: It is impossible to divorce disclosure of profits and disclosure of reserves. One cannot be disclosed without a certain disclosure of the other.

13264. *Professor Cairncross*: I did not think that that was a point here, if one took the Inland Revenue definition of profits and not your definition for the purposes of determining dividends, allocations to reserve and so on?——*Mr. Tuke*: The Inland Revenue returns, though no doubt accurate, are very misleading for that very reason in regard to our trading profits in any one year; but even if they were not misleading I do not think that they ought to be disclosed.—*Mr. Chesterfield*: I remember the evidence to the Cohen Committee very well indeed. One of the things that was said was that the banks' reputation for stability was a national asset of first importance and that it would not be in the public interest to endanger confidence at home or abroad in that stability.

One of the arguments used in giving evidence to the Cohen Committee was that an adverse happening might affect one bank more than another and might therefore mean that business was transferred from one bank to another. An added reason has come about since 1943 for the non-publication of these profits, namely the tremendous increase in the value of trade which is financed through London. The evidence given in 1943 was at a time when the foreign business with banks in London was probably at its smallest volume within the last thirty years; an enormous increase in international transactions has taken place since then. This means that it is very much more likely now than it was when the evidence before the Cohen Committee was given in 1943 that all or many British banks might suffer as a result, for example, of some serious international disturbance.

My own experience in the twelve years that I have been a General Manager of the Westminster Bank is that at certain periods it would have been disastrous to the banks and to the British economy generally if the Inland Revenue figures which you are now suggesting should be published had been published. If the banks' capital and reserves were three times the amount that they are to-day, then I might have different views but in the present circumstances it might prove detrimental to publish these figures, which are, after all, largely the result of transactions completed during a certain accounting period. They take little or no cognisance of contingent liabilities and how far these contingent liabilities are likely to become real ones.

We have heard about the profit and loss accounts being affected very much by profits on the sale of gilt-edged securities; we have not heard anything about the very substantial losses that may have accrued through enforced realisation of Government securities. Indeed it might be that in certain circumstances, if the suggested figures were published, they might show not variations of profits so much as evidence of actual losses. That was a state of affairs which the Cohen Committee had in mind, I think, when they recommended the exemptions given to the banks.

I think also that if these profit figures were published and if they were in excess of those published by the banks, their publication might provoke a lot of useless, tedious and, in some cases, deliberately mischievous comment. The banks, by the very nature of their business, are not in a position to indicate precisely the reasons why they think it necessary to place certain, possibly substantial, amounts to contingencies and reserves. They cannot discuss a series of companies or even a country in public. This state of affairs might go further; it might have the effect of "drying up" the very large facilities which we place at the disposal of countries all over the world, on both sides of the iron curtain, because we might be afraid to grant such large facilities if we knew that we could be taken to task for having made a loss in one particular year. As I have said before, that loss might not affect only one bank. The size of international transactions is so large that a catastrophe anywhere would almost certainly affect two or three or more banks. It would be an exceptional time if in the Foreign Exchange Department of the Westminster Bank we had not a turnover equivalent to some hundreds of millions of pounds per annum. A large proportion of that relates to trade which never comes to this country at all. The income arising from these transactions is substantial.

It has taken generations to build up the present world wide faith in British banking, and our ability to carry out those transactions which do not directly affect this country but which are world wide. It would require the publication of only one really bad figure to impair that confidence, and upon that lamentable event taking place the financing of world trade might go to those great foreign banking corporations, the growth of whose published capital and reserves has not been hindered, and indeed severely curtailed, by such pressures as we have had in this country where, by and large, we financed two wars and where we have had very severe restrictions and taxation.

I am not sure for what purpose it is suggested that this risk should be taken. I should feel very unhappy at leaving you without saying that I think that none of the reasons for publication could be valid against this risk.

13265. *Chairman*: There is publication of aggregate figures for the banking, insurance and finance sector as a whole; would you suggest that there are any ill effects from publishing those figures to the kind of confidence you are speaking of?——No, because they are aggregated in a sufficiently widespread field of differing industries.

13266. Could the insurance companies, in the years when these composite figures have been published, have contributed more to the swings involved in the complete figure than the banks?——I would have thought that could not be so. I have in my mind particularly the early 1950s when the banks had a rough passage.

13267. You think the banks would be a more unstable element in the variation of the figures than they have been?——*Mr. Chesterfield*: In general, yes; it may be in a particular year that experience in America would have affected the insurance world more than us, but it is the virtue of the amalgamated figures to conceal that.—*Mr. Tuke*: In the 1957 figures, if I remember rightly, six years' profits are shown of that composite financial group, and they vary from £11 million to £90 million. That is a terrific variation, and it just cannot be what you might call normally accurate.—*Mr. Robarts*: As I said before, it is swung enormously by the profit and loss on purchases and sales of gilt-edged securities.

13268. *Professor Cairncross*: May we turn to sub-head (v)? When figures were supplied to the Macmillan Committee they excluded in respect of the National Bank business done south of the Irish border. Would it be possible to present the clearing banks' figures in such a way that they related to banking offices within the United Kingdom?——I am afraid that I only received very short notice of this question, and we have not been able to give it adequate consideration. I do not think that the exclusion of direct business outside the United Kingdom would have much effect on the totals; I think it only concerns the National Bank's business in the Republic of Ireland and Lloyds Bank's Indian business. May we have a further look at this and if you so desire let you know?*

Chairman: Then that brings us to the end of these questions on which we wanted your help. We are very much obliged to you for coming here today.

* See Appendix to Minutes of Evidence

(*Adjourned*)

MINUTES OF EVIDENCE TAKEN BEFORE

THE COMMITTEE ON THE WORKING OF THE MONETARY SYSTEM

FIFTY-NINTH DAY

Thursday, 30th April, 1959

PRESENT:

THE RT. HON. THE LORD RADCLIFFE, G.B.E., *Chairman*

PROFESSOR A. K. CAIRNCROSS, C.M.G.
THE RT. HON. SIR OLIVER FRANKS, G.C.M.G., K.C.B., C.B.E.
THE VISCOUNT HARCOURT, K.C.M.G., O.B.E.
PROFESSOR R. S. SAYERS, F.B.A.
SIR REGINALD VERDON SMITH
SIR JOHN WOODS, G.C.B., M.V.O.
MR. R. T. ARMSTRONG, *Secretary*
MR. G. PENRICE, *Statistical Adviser*

The representatives of the Treasury examined at this session were given advance notice of the following points for discussion. Written notes were submitted on points 1, 3, 8 and 9 ; these notes are incorporated in the record at the appropriate points.

1. Short-term finance of local authorities and nationalised industries:
   (a) use of bank advances ;
   (b) possibility of the issue of bills.
2. Developments in 1958 in local authority financing.
3. The technical feasibility of regular bi-annual reviews, and if necessary revisions, of taxation (including investment allowances); the possibility of regular Autumn Budgets.
4. Domestic monetary policies and events, and in particular short-term interest rate policy, in 1958-59.
5. Short-term international movements in 1958-59 ; have uncovered movements been appreciable. Has this episode any implications for the international structure of short-term interest rates?
6. Now that E.P.U. has been wound up, is the Treasury content to look solely to international rather than to regional arrangements for reinforcing liquidity? How much importance is to be attached to E.M.A. in this regard?
7. Would it be possible or desirable for Her Majesty's Government to float a loan in the United States or elsewhere to reinforce the gold and dollar reserves on some appropriate occasion?
8. There appears to have been a tendency in 1958 for other sterling area countries to obtain a greater amount of capital outside London. Have the Treasury any information on, or comments about, this trend?
9. In previous evidence Treasury witnesses mentioned £300 to £350m. as the sort of surplus on the current balance of payments which it was desirable to achieve. Has there been any revision of this figure?
10. Is the use of the United Kingdom's new quota in the I.B.R.D. subject to the same restrictions as that of the original quota?
11. The Committee understands that drawings from the I.M.F. have to be repaid in gold or convertible currency. What is the definition of "convertible" here? Is sterling now a "convertible" currency for this purpose?
12. Would the Treasury accept an estimate of £90 to £100m. for the swing of "leads and lags" and trade displacements in the 1957 crisis? Does the Treasury believe that the maximum possible swing due to "leads and lags" is much in excess of this figure? If so, would it be possible to make a reliable estimate of the swing?
13. Can the Treasury estimate the size of the "pool" of dollar securities held by residents of the United Kingdom? Has the size of this pool varied? If so, can the Treasury estimate by how much? Is it known by what channels increases or decreases take place? What restrictions or conditions are imposed as to the types of dollar securities which may be acquired by residents of the United Kingdom?

The following witnesses from H.M. Treasury called and examined:

SIR ROGER MAKINS, G.C.M.G., K.C.B., Joint Permanent Secretary
SIR ROBERT HALL, K.C.M.G., C.B., Economic Adviser to H.M. Government and Director, Economic Section
SIR DENIS RICKETT, K.C.M.G., C.B., a Third Secretary
W. ARMSTRONG, ESQ., C.B., M.V.O., a Third Secretary

13269. *Chairman*: Our purpose in inviting you this morning, Sir Roger, is to clear up certain points of which we have given you notice; you have been good enough to reply to some of the questions with documentary evidence, which will go into the record. May we start with question 1, on the short-term finance of local authorities and nationalised industries?

The following notes were submitted in response to question 1:

1. Short-term financing of local authorities.
2. Local authorities' mortgage rates 1955 to 1959.
3. Short-term financing of the nationalised industries.
4. Use of Bills by local authorities and nationalised industries.

1. SHORT-TERM FINANCING OF LOCAL AUTHORITIES

Bank borrowing

The quarterly returns published by the British Bankers' Association show that despite the changes in credit policy since 1954 the level of bank borrowing by local authorities has been fairly even. The figures (in £ million) are:—

	1955	*1956*	*1957*	*1958*
February ...	102·8	86·4	81·3	74·5
May	83·7	74·4	91·2	80·8
August ...	94·1	82·1	84·7	83·0
November ...	83·0	79·8	74·7	79·0

Short-term mortgages

There are no complete figures showing the volume of borrowing by local authorities by short-term mortgages, but it is possible to show the sources of borrowing by local authorities on capital account in the financial years up to 1957-58. The figures are set out in Table A attached. They show the sharp and substantial transition from borrowing from the Public Works Loan Board to borrowing in the market which took place as the result of the change in the P.W.L.B. lending policy in October, 1955.

It is also possible to show the composition of local authority debt at 31st March, 1955, and 31st March, 1958

(15th May for Scotland in each year) from a survey of local authority loan debt made by the Treasury last year. The figures are set out in Tables B1 and B2 attached. They show that whereas the total loan debt (excluding borrowing by one authority from another) had increased during the three years between the two dates surveyed by 30 per cent., borrowing from the P.W.L.B. and by certain other methods had increased as follows:—

	Per cent.
P.W.L.B. mortgages increased by	13
Other mortgages	63
Temporary borrowing	200

(Table C attached gives the composition of the figures of temporary borrowing in Tables A and B and shows that a high proportion of the borrowing was in very short-term loans, especially in 1958.)

There are no figures for borrowing by all authorities on short-term mortgages but we have weekly estimates made since 30th September, 1956, of short-term mortgages (i.e. 1 to 10 years) made by local authorities in the London market. These are no more than estimates and exclude any mortgages made locally or in provincial markets: they show (in £ million):—

	1956	1957	1958
January to March ...		35·0	17·5
April to June		28·75	23·75
July to September ...		17·0	28·5
October to December ...	27·25	22·0	37·0

For the first 12 weeks of 1959 (which correspond to the periods shown in the table for January to March) the figure is £45·75 million.

TABLE A

CAPITAL ACCOUNT OF LOCAL AUTHORITIES IN THE UNITED KINGDOM, 1955-1958

£ million

	Financial years to 31st March		
	1955–56	1956–57	1957–58
1. Net borrowing from Public Works Loan Board and Northern Ireland Government Loans Fund	306	58	39
2. New stock issues	16	61	39
3. Net borrowing from superannuation funds, etc.	25	40	25
4. Lending to persons (net) ...	− 55	− 47	− 30
5. Other borrowing (net)	133	317	305
6. Capital grants from the Central Government	17	20	24
7. Current surplus before providing for depreciation and stock appreciation	105	140	167
8. Gross fixed capital formation (equals total of items 1 to 7 above)	547	589	569

Notes

Item 2. New stock issues as shown in the Bank of England series on capital issues.

Item 3. Borrowing from funds "connected with" local authorities such as superannuation funds, sinking funds and other funds which are not part of the local authority sector.

Item 4. Lending for small dwellings acquisition (including advances under the Housing Acts).

Item 5. This is a residual item consisting mainly of net borrowing on mortgages and temporary borrowing, but also including unidentified changes in financial liabilities and assets and any residual errors.

TABLES B

TREASURY SURVEY OF LOCAL AUTHORITY LOAN DEBT

Great Britain, 1955

31 *March, England and Wales;* 15 *May, Scotland*

Table B1

£ million

Method of borrowing	Debt due for repayment				Total
	In 1 year or less	In from 1–5 years	In from 5–15 years	In more than 15 years	
1. Public Works Loan Board mortgages	1	15	293	2,420	2,728
2. Other mortgages	23	131	306	137	596
3. Bonds	6	17	41	4	67
4. Stock quoted on the London Stock Exchange	8	74	171	171	424
5. Other external borrowing, apart from temporary borrowing...	1	—	1	6	8
6. Internal advances:					
(*a*) From own Superannuation Funds	3	13	60	87	162
(*b*) From other funds	25	10	29	32	96
7. Temporary borrowing (¹)	170	Not applicable			170
8. Total loan debt	234	261	899	2,857	4,251
9. Inter-authority loans included above	3	7	25	30	64
10. Total loan debt excluding inter-authority borrowing (item 8 less 9)	231	254	874	2,827	4,187

(¹) Under S. 215 (1) (*b*) of the Local Government Act, 1933, S. 260 (1) (*b*) (*c*) of the Local Government (Scotland) Act, 1947, or other similar provisions. Borrowing in anticipation of the receipt of revenue is excluded.

Owing to rounding the totals may not equal the sums of the component parts.

TREASURY SURVEY OF LOCAL AUTHORITY LOAN DEBT

Great Britain, 1958

31 *March, England and Wales;* 15 *May, Scotland*

Table B2

£ million

Method of borrowing	Debt due for repayment				Total
	In 1 year or less	In from 1–5 years	In from 5–15 years	In more than 15 years	
1. Public Works Loan Board mortgages...	1	34	377	2,668	3,081
2. Other mortgages	62	426	290	195	973
3. Bonds	4	48	46	10	108
4. Stock quoted on the London Stock Exchange	28	75	197	176	477
5. Other external borrowing, apart from temporary borrowing...	1	1	1	5	8
6. Internal advances:					
(*a*) From own Superannuation Funds	4	28	82	109	224
(*b*) From other funds...	22	26	26	42	116
7. Temporary borrowing (¹)	512	Not applicable			512
8. Total loan debt	635	638	1,021	3,205	5,498
9. Inter-authority loans included above	5	9	19	23	55
10. Total loan debt excluding inter-anthority borrowing (item 8 *less* 9)	630	629	1,002	3,182	5,443

(¹) Under S. 215 (1) (*b*) of the Local Government Act, 1933, S. 260 (1) (*b*) (*c*) of the Local Government (Scotland) Act, 1947, or other similar provisions. Borrowing in anticipation of the receipt of revenue is excluded.

Owing to rounding the totals may not equal the sums of the component parts.

TABLE C

TREASURY SURVEY OF LOCAL AUTHORITY LOAN DEBT

Temporary borrowing(¹) outstanding 1955 and 1958

Great Britain

31 *March, England and Wales;* 15 *May, Scotland*

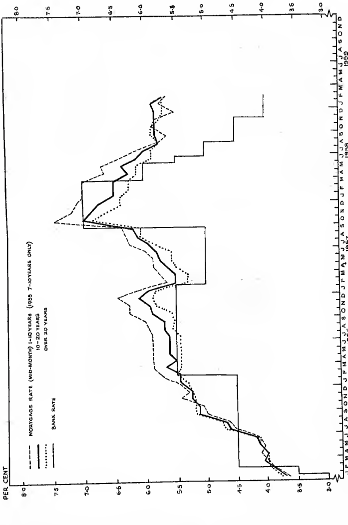
£ million

Period of loan	1955	1958
At call or 7 days	104	275
Up to 3 months	23	84
For 3–6 months	6	64
For 6–12 months	1	23
Revenue balances temporarily used for capital purpose	36	66
Total	170	512

(¹) Under S. 215 (1) (*b*) of the Local Government Act, 1933, S. 260 (1) (*b*) (*c*) of the Local Government (Scotland) Act, 1947, or other similar provisions. Borrowing in anticipation of the receipt of revenue is excluded.

Owing to rounding the total may not equal the sums of the component parts.

2. LOCAL AUTHORITY MORTGAGE RATES



Date (mid-month)	7–10 *Years**	10–20 *Years*	*Over* 20 *Years*	*Bank Rate (mid-month)*
	Per cent.	Per cent.	Per cent.	Per cent.
1955 January ...	$3\frac{5}{8}$	$3\frac{11}{16}$	$3\frac{3}{4}$	3
February ...	$3\frac{7}{8}$	$3\frac{7}{8}$	$3\frac{15}{16}$	$3\frac{1}{2}$
March ...	4	$4\frac{1}{16}$	4	$4\frac{1}{2}$
April... ...	$4\frac{1}{8}$	4	4	$4\frac{1}{2}$
May	$4\frac{1}{16}$	$4\frac{1}{8}$	$4\frac{1}{8}$	$4\frac{1}{2}$
June	$4\frac{1}{8}$	$4\frac{3}{16}$	$4\frac{1}{8}$	$4\frac{1}{2}$
July	$4\frac{1}{2}$	$4\frac{5}{8}$	$4\frac{11}{16}$	$4\frac{1}{2}$
August ...	$4\frac{3}{8}$	$4\frac{11}{16}$	$4\frac{3}{4}$	$4\frac{1}{2}$
September ...	5	$5\frac{1}{8}$	$5\frac{3}{16}$	$4\frac{1}{2}$
October ...	$5\frac{1}{16}$	$5\frac{1}{4}$	$5\frac{3}{16}$	$4\frac{1}{2}$
November ...	$5\frac{7}{16}$	$5\frac{1}{4}$	$5\frac{3}{16}$	$4\frac{1}{2}$
December ...	$5\frac{5}{16}$	$5\frac{1}{4}$	$5\frac{1}{8}$	$4\frac{1}{2}$
	1–10 *Years*			
1956 January ...	$5\frac{1}{2}$	$5\frac{7}{16}$	$5\frac{5}{16}$	$4\frac{1}{2}$
February ...	$5\frac{3}{4}$	$5\frac{7}{16}$	$5\frac{1}{4}$	$4\frac{1}{2}$
March ...	$5\frac{7}{8}$	$5\frac{11}{16}$	$5\frac{7}{16}$	$5\frac{1}{2}$
April... ...	$5\frac{7}{8}$	$5\frac{1}{2}$	$5\frac{1}{16}$	$5\frac{1}{2}$
May	$5\frac{7}{8}$	$5\frac{5}{8}$	$5\frac{7}{16}$	$5\frac{1}{2}$
June	$5\frac{7}{8}$	$5\frac{5}{8}$	$5\frac{7}{16}$	$5\frac{1}{2}$
July	$5\frac{7}{8}$	$5\frac{5}{8}$	$5\frac{7}{16}$	$5\frac{1}{2}$
August ...	$5\frac{15}{16}$	$5\frac{11}{16}$	$5\frac{7}{16}$	$5\frac{1}{2}$
September ...	6	$5\frac{11}{16}$	$5\frac{17}{32}$	$5\frac{1}{2}$
October ...	$6\frac{1}{4}$	$5\frac{1}{2}$	$5\frac{9}{16}$	$5\frac{1}{2}$
November ...	$6\frac{1}{8}$	$5\frac{15}{16}$	$5\frac{13}{16}$	$5\frac{1}{2}$
December ...	$6\frac{7}{16}$	$6\frac{1}{8}$	$5\frac{7}{8}$	$5\frac{1}{2}$
1957 January ...	$6\frac{1}{8}$	$5\frac{15}{16}$	$5\frac{13}{16}$	$5\frac{1}{2}$
February ...	$5\frac{5}{8}$	$5\frac{1}{2}$	$5\frac{7}{16}$	5
March ...	$5\frac{3}{4}$	$5\frac{1}{2}$	$5\frac{5}{16}$	5
April... ...	$5\frac{7}{8}$	$5\frac{5}{8}$	$5\frac{1}{2}$	5
May	$5\frac{7}{8}$	$5\frac{3}{4}$	$5\frac{9}{16}$	5
June	6	$5\frac{13}{16}$	$5\frac{9}{16}$	5
July	$6\frac{1}{4}$	$5\frac{15}{16}$	$5\frac{7}{8}$	5
August ...	$6\frac{5}{16}$	$6\frac{3}{8}$	$6\frac{1}{16}$	5
September ...	$6\frac{3}{8}$	$6\frac{7}{16}$	$6\frac{1}{16}$	5
October ...	$7\frac{1}{2}$	7	$6\frac{5}{8}$	7
November ...	$7\frac{3}{16}$	$6\frac{7}{8}$	$6\frac{5}{8}$	7
December ...	$7\frac{7}{8}$	$6\frac{3}{4}$	$6\frac{7}{8}$	7
1958 January ...	7	$6\frac{1}{2}$	$6\frac{5}{8}$	7
February ...	7	$6\frac{1}{2}$	$6\frac{1}{2}$	7
March ...	7	$6\frac{1}{2}$	$6\frac{1}{2}$	7
April... ...	$6\frac{1}{8}$	$6\frac{1}{4}$	$6\frac{1}{8}$	6
May	$6\frac{11}{16}$	$6\frac{3}{8}$	$6\frac{1}{8}$	6
June	$6\frac{3}{8}$	$6\frac{1}{8}$	$5\frac{7}{8}$	$5\frac{1}{2}$
July	$6\frac{1}{8}$	6	$5\frac{7}{8}$	5
August ...	$5\frac{1}{2}$	$5\frac{3}{4}$	$5\frac{3}{4}$	$4\frac{1}{2}$
September ...	$5\frac{1}{2}$	$5\frac{13}{16}$	$5\frac{7}{8}$	$4\frac{1}{2}$
October ...	$5\frac{7}{8}$	$5\frac{13}{16}$	$5\frac{7}{8}$	$4\frac{1}{2}$
November ...	$5\frac{13}{16}$	$5\frac{13}{16}$	$5\frac{3}{4}$	$4\frac{1}{2}$
December ...	$5\frac{1}{2}$	$5\frac{13}{16}$	$5\frac{11}{16}$	4
1959 January ...	$5\frac{3}{4}$	$5\frac{7}{8}$	$5\frac{11}{16}$	4
February ...	$5\frac{5}{8}$	$5\frac{11}{16}$	$5\frac{11}{16}$	4

* The ban on local authority mortgages of up to 7 years was lifted in January 1956.

3. SHORT-TERM FINANCING OF THE NATIONALISED INDUSTRIES

It has been the practice of the nationalised industries* to meet their short-term capital needs only by bank borrowings. Until the system of advances from the Exchequer was introduced in 1956 the industries relied on bank advances until it was convenient to fund the greater part of the outstanding debt by a stock issue. It was found that these issues, which were made under Government guarantee, had to an increasing extent to be supported by the Departments, sometimes at an inconvenient time, and accordingly the system of Exchequer financing was introduced.

The figures for the bank overdrafts of these industries (from both the Clearing Banks and Scottish Banks) since 1954 are set out in the following table. These show the increase in the overdrafts up to the end of June 1955, the sharp decline after the issue of £200 million stock by the British Electricity Authority in August 1955, and the fresh increase until June 1956, after which (in August 1956) Exchequer advances were made. It was part of the arrangement under which these advances were introduced that the bank overdrafts should be reduced over a period of eight months to a level which would accommodate only the current working needs for short-term money, and that thereafter any capital requirements should be met out of the Exchequer advances. The intention was to reduce the total of the overdrafts by £5 million a month from August until December 1956 and by £15 million a month from January to March 1957. (The figure of £118·7 million for 31st December is not inconsistent with this arrangement. It is higher than might be expected, partly because it is not a figure struck at the customary mid-month date, and partly because it immediately preceded special Exchequer advances of £21·4 million made at the beginning of January which represented a deferment of advances that would otherwise have been made in mid-December.)

* i.e., the seven nationalised industries that receive Exchequer advances under the Finance Act, 1956 (as extended), viz., the Electricity Council, the North of Scotland Hydro-Electric Board, the South of Scotland Electricity Board, the Gas Council, British Transport Commission, and the two Air Corporations. (The National Coal Board draws all its external finance from the Exchequer, for both long-term and short-term purposes.)

BANK OVERDRAFTS OF THE NATIONALISED INDUSTRIES

This table shews the total of the bank overdrafts of the seven nationalised industries from the Clearing Banks and the Scottish Banks at the dates specified:—

		£ million
1951	31 December	106·9
1952	31 December	119·3
1953	31 December	63·9
1954	31 December	133·4
1955	16 March	159·5
	30 June	214·3
	21 September	99·6
	31 December	37·7
1956	21 March	65·7
	30 June	100·8
	19 September	90·3
	31 December	118·7
1957	20 March	43·0
	30 June	59·6
	18 September	49·0
	31 December	82·5
1958	19 March	52·8
	30 June	73·2
	17 September	68·6
	31 December	84·8
1959	18 March	81·2

Source: Committee of London Clearing Bankers and Treasury, published from 30th June, 1956, in the Monthly Digest of Statistics.

4. THE USE OF BILLS BY LOCAL AUTHORITIES AND NATIONALISED INDUSTRIES AS A SOURCE OF SHORT-TERM FINANCE

It has been the policy of the Treasury to resist, for two fundamental but related reasons, the use of bills as a source of short-term finance. The first reason has been the desirability of preserving the nature of a bill as an essentially liquid and preferably self-liquidating instrument; the second, that because the bill is accepted as a liquid asset by the banking system, the creation of additional bills is liable to add to the banks' liquidity and, in sufficient quantity, may also affect the control of short-term interest rates.

Different considerations arise in the two cases under consideration:—

1. *Local Authorities*

Where local authorities are concerned it is not, strictly speaking, a question of issuing bills of exchange (covering for example, the movement or purchase of specific goods) but of issuing promissory notes somewhat akin to the Treasury Bill. In the opinion of the Treasury such instruments should not be used for the financing of capital expenditure because that would offend against the principle that a bill or promissory note should be a short-term instrument whose liquidity is absolutely assured and which therefore should be used only to finance such operations as the movement of goods to market. When, however, the borrowing is not for capital expenditure but to meet current expenditure in anticipation of revenues, it can be argued that the revenue from the rate levied by the borrowing authority gives assurance that, provided

their total amount is appropriately limited, the bills outstanding can be liquidated within a reasonable period. A number of authorities have powers to issue bills for this purpose, the Act of Parliament giving the power usually specifying that the total amount issued shall be limited to a given proportion of the rateable value of the borrowing authority. Where these powers exist and where certain additional rules laid down by the Bank of England are observed (the most important being that for an agreed period of 60 days the authority in question should have no bills outstanding), the bills are eligible for discount at the Bank of England and consequently command fine rates in the London market.

Only 29 local authorities (including water and harbour authorities) at present have statutory powers to issue bills and no new powers or extension of existing powers have been granted since 1935. Most of these authorities have not exercised their powers for more than 30 years, and in practice consent has been given in recent years only for the issue of bills by eight authorities who have continued to exercise their powers. The aggregate limit of the bills that may be so issued is only £7·4 million. If, however, any large number of local authorities were to acquire powers to borrow on bills, a very substantial addition to the supply of bills in the market would have to be expected; and this might be sufficient adversely to affect the readiness of the market to absorb the Treasury Bills offered for tender or at any rate to weaken and perhaps undermine the power of the authorities to control short-term interest rates and the liquidity of the banking system.

2. *Nationalised Industries*

Each of the nationalised industries has power to borrow temporarily, "by way of overdraft or otherwise", but none has yet issued bills. There are clearly instances where the use of bill finance by the nationalised industries would be unexceptionable. For example, the Coal Board might finance their foreign purchases of pit props while afloat by this means. To employ bills, however, to provide general finance or working capital for any of the nationalised industries would be a misuse of bill finance. Even to use bills as other industrial companies do (e.g. to finance stocks) would be open to objection. In the first place, control of the amount of bills so issued could hardly be operated in the normal way, by a refusal by the Bank to buy the Bills if they appeared in undue quantity, since the Bank could hardly refuse to take the paper of what is in effect a governmental agency. Secondly, even if control by other means could be secured, the issue of such bills in any quantity would be open to the same objections as apply to the issue of bills by local authorities.

13270. *Professor Sayers*: I wonder if you would tell us first something of the general circumstances that you think should regulate the use made of bank advances by local authorities and nationalised industries?——*Mr. W. Armstrong*: I do not know that we have any deep theory about that. We would regard the proper use of bank borrowing for those purposes as similar to that of any other borrower: that is, for temporary purposes.

13271. How can it be settled by the same considerations as apply to private borrowers when there is the whole credit of the State behind these bodies?——I can only say that that is the way it works in practice. So far as local authorities are concerned, our belief is that these bank borrowings are mainly in anticipation of revenue, that they use their overdraft facilities to even out the disparity between expenditure and revenue as the year goes on. So far as nationalised industries go, again it is used to even out the disparities between expenditure and revenue, and in particular to deal with the situation that arises immediately before they get a capital advance from the Exchequer. Under the present arrangements, when their borrowings for capital purposes are from the Exchequer, we make advances to them at regular intervals, and so far as they need money in the last few days of the fortnight before they get an advance from us, their bank borrowings go up.

13272. Do you limit either of these bodies in their use of bank advances to the circumstances you have just stated?——The local authorities are quite free; we place no limits on them either as to amount or purpose. Any limitation there may be on the amount will be a matter for arrangement between them and their bankers. The Control of Borrowing Order in form applies to them, but they have been given an exemption, which was intended to be roughly parallel to the exemption private borrowers have for borrowing in the ordinary course of their business, the effect of which is that pending receipt of revenue for non-capital purposes they may borrow without reference to the Treasury under the Control of Borrowing Order.

13273. If it were a matter of borrowing for capital purposes, what would be the position?——It would require consent; in practice they do it by using internal funds, short-term mortgages, short-term loans and so on, rather than by using their bank overdrafts.

13274. If they did choose to negotiate loans with the banks for other purposes, you would raise no objection?——We should not have any means of knowing that they had done so.

13275. *Chairman*: From the point of view of the economy, if you did know, would you mind?——We should get anxious if we thought that the volume of very short-term borrowing was getting to the point where, if there were a change in circumstances and they were no longer able to continue such short-term borrowing, they might find themselves in difficulties.

13276. Your concern is not whether the banks are the source of short-term borrowing but with the volume of short-term borrowing itself?——Yes.

13277. *Professor Sayers*: The present volume of £500 mn. or so does not give rise to any anxiety?——We thought it was high, and we thought the increase in it was rapid. Following the survey, we discussed it with the Standing Joint Committee of the local authorities' associations, and they took the view that this survey showed quite a normal situation; they were surprised that the volume was not greater. Their hunch would have been that as time had gone on the increase in temporary borrowing was much greater. They are considering with us the possibility of doing the survey on a regular basis, so that it can be watched.

13278. You are not alarmed by £500 mn.; would you be alarmed by £1,000 mn.?——It is not possible to put a figure on what would alarm one. It would depend on the attendant circumstances, and also on the speed by which it was rising.

13279. For what reasons would you be alarmed by its rise?——No more than what one might call the administrative or practical reasons: that the growth in the amount of short-term borrowing obviously presents the possibility (as I mentioned earlier) that if there is a change of circumstances, if the short-term loans are called in, if the possibility of re-financing them gets less, a number of local authorities would find themselves in difficulties, and they would be turned back to the Exchequer. I think that it would be rather from that point of view than from the point of view we looked at just now.

13280. What is there to choose between a situation in which they are financed by the Exchequer or by other methods, if either way they are coming on to the gilt-edged market?——I think there may in the end be very little to choose, but one wants to know which of the reins is going to take the strain.

13281. Have you any knowledge at all of the rates of interest which the local authorities have to pay to the banks, or is that a matter of independent bargaining?——So far as we know, it is; we do not know what the rates are.

13282. What would be your attitude to an increase in bank borrowing by nationalised industries?——We are much more closely concerned there, because all their borrowings have to have our approval and in practice have to have our guarantee.

13283. Is there a practical difference between the approval and the guarantee?——So far there has been no practical difference. If we have approved a borrowing, we have also guaranteed it.

13284. Does not that apply equally to the local authorities?——It is not so explicit and formal. In the case of the nationalised industries a piece of paper has to be produced and submitted to Parliament. In the case of the local authorities there may be an implicit situation as

between H.M.G. and local authorities which might amount to the same thing, but it is far from the same thing here and now in dealing with it.

13285. Is it not the same thing when it comes to operating in the market?——It may be the same thing in effect, but it is not the same thing from day to day, in that a nationalised industry has to come to us for approval of an increase in its overdraft arrangements, whereas a local authority does not.

13286. Are you willing to see the nationalised industries' overdrafts rise much above the present level, if they wish?——We have been, in present circumstances.

13287. Have you any information on the rates they have paid to the banks?——Yes, we have, because they are rates which reflect the fact that these borrowings are guaranteed, and since there is a guarantee attached to them, Government credit is attached to them, and we take an interest in what the rates are. The rate charged is Bank Rate or 4 per cent., whichever is higher; so the present rate is 4 per cent. That is the present formula; but if Bank Rate fell to a very low level the formula would probably be renegotiated with the banks.

13288. Are these overdrafts on the same general terms otherwise as they are to private persons, repayable on demand in law, and subject to revision every year in practice?——The terms in these cases are review every quarter; the guarantee is formally given for a period of three months, and then reviewed and in normal circumstances renewed. It may be increased, or it may be reduced. That is the formal position.

13289. *Professor Cairncross*: Is it likely that you will continue to collect these figures on local authority debt?——The Standing Joint Committee was quite hopeful that it would be able to persuade the local authorities that this return should be on a regular basis. The Committee has asked to be allowed to send the summary of returns to each local authority with the proposal that it should be instituted on a regular annual basis. Those returns are now practically ready, and will be going out to local authorities very soon.

13290. You would not therefore be able to confirm with figures the local authorities' impression that their present short-term obligations are normal in relation to their bank borrowing?——No; we have information of this kind for the first time.

13291. When an industry becomes nationalised, it is usually considered one of the advantages of nationalisation that it gets long-term capital on much more favourable terms; but it does not, from what you have told us, appear to get short-term loans on terms essentially very different from large borrowers other than Government borrowers?——That is true; it gets it more cheaply, but not so much more cheaply.

13292. If you take the local authorities, is not this discrepancy even more perceptible? In long-term credit the local authority can borrow on terms that are not very much worse than the gilt-edged rate, but on short-term many of them have been on terms very different?——Yes. This reflects what the market thinks of them. As you know, in 1955 it was decided that the rates to be charged by the Public Works Loans Board should follow those charged in the market, as reflected by the price of local authority stocks and the rates for these mortgages; and we have since then left it to the market to settle what the public authorities are charged. We have endeavoured to follow the market rather than to lead it.

13293. *Professor Sayers*: Have you in fact left it to local authorities to borrow on bills as much as they liked?——Not to borrow on bills; our note on that shows that a very small number of them borrow on bills.

13294. How can you say you leave them to the market, if they are kept out of that part of the market?——I meant the market as it is made up, given the ways in which local authorities in fact seek to borrow, and given that only eight of them borrow on bills at rates which are, again, by private arrangement.

13295. *Professor Cairncross*: Would it be your view, that if local authorities were free to go to the bill market, they would not take advantage of that?——One just does not know. The eight who do it are an interesting collection: there is London, Birkenhead and Blackpool in England; none in Wales; and five in Scotland: Glasgow, Edinburgh, Aberdeen, Lanarkshire, and Greenock, which has authority to borrow on bills up to £100,000 at any one time. That suggests to me that the interest in bills is very much a matter of the personal interest of a given City treasurer, or of local tradition rather than of anything else. I may be wrong about that, but from time to time other authorities show an interest in this, and it is usually because an individual who is in that authority has experience of the system and is keen on it. In general there has been no demand for this on the part of the local authorities, and the other twenty-one who actually have the statutory powers have shown no signs in recent times of wanting to exercise them.

13296. They are subject to a provision which does not apply to the central Government, that they must at some time in the year have no bills outstanding?——Yes.

13297. *Chairman*: Is it your impression that the local authorities have been paying very high rates for the money they have got on short term?——They have been paying high rates. I should guess that that reflects the pressure the local authorities have been exercising on the short-term market.

13298. But if they can get something closely related to the gilt-edged rate when they go for long-term funds, why is it they have to pay so high for short-term money?——Other than that there have been rather a large number of them, I do not know.

13299. You think there is competition for the funds?——Yes.

13300. *Professor Cairncross*: That would suggest that the present pressure to borrow on short term by local authorities is abnormal?——It would; there again, as I said earlier, we do not really know. It is our impression that, whether one calls it abnormal or normal, there has been an increase in the last year or two. There is a very clear increase in the two years we took in our survey, and we believe that that increase was going on through 1958.

13301. Can you tell us at what rate the eight authorities do borrow on bills when they go to the market?——No, I am afraid I cannot.

13302. *Professor Sayers*: Do the auditors from the Ministry of Housing and Local Government ever call the attention of the local authorities to the apparently high rates they are paying for their short-term borrowing?——I do not know.

13303. *Sir John Woods*: Would there be a comment from the auditors if a local authority proceeded to borrow from the bank for capital purposes?——Equally, I am afraid I would not know whether the auditors would comment on that. I do not know what the auditors' arrangements with the local authorities are, but I would be a bit surprised if they did comment on bank borrowings for capital purposes; it would appear to me in general to be rather outside their functions.

13304. *Professor Cairncross*: You have not made a special study of the institutions which advance the money, to see to what extent they are buyers of Treasury Bills?——No.

13305. So it is not very easy to say whether, if the local authorities sought to issue bills, they might find a market in the very institutions which at present advance the money on mortgage?——No, it is not; one just does not know.

13306. *Chairman*: Before we leave the question of bills may we take it that it is the settled policy of the Treasury that local authorities should not extend their access to the bill market?——Yes.

13307. Would you accept that the main reason is that you do not want the bill market disturbed by what might be considerable potential competition for money?——Yes. If particular local authorities in England decided that they would like to follow London and the others, I do not think we would stand out flatly against it. It is both interesting and curious that they have not. Of

course, as you know, Birmingham has got its own special arrangements; how Manchester and Liverpool are placed I have no idea. They very likely also have their own arrangements, and possibly it has never occurred to them to change, or perhaps they see no advantage in changing, in present circumstances. But we would not wish to see it become very widely extended.

13308. *Professor Sayers*: When you say that you do not want to see the bill market disturbed, do you mean that you fear that development of borrowing by local authorities in this country would make for more irregularities in market rates?——I think one has a feeling it would make for more irregularity generally, both in amounts and rates, and in the ability to foresee and influence what is happening.

13309. *Sir Oliver Franks*: You would be less certain that you could completely manage the short-term market?——Yes.

13310. *Professor Sayers*: It is your interest in maintaining a highly managed bill market that you wish to keep undisturbed?——Yes.

13311. *Chairman*: Then I think that covers questions 1 and 2. You have submitted a note on question 3, on the possibility of regular bi-annual reviews, and if necessary revisions, of taxation.

Following is the note submitted in response to question 3:

1. It is understood that the Committee are interested in this because a number of those who have given evidence before them have argued first that fiscal measures are among the most important means of regulating the economy, and secondly, that it is unfortunate that such measures can normally be introduced only once a year at the time of the Budget.

2. It is assumed that it is not suggested that the whole of the Government financial system should be changed over to a six-monthly basis, with estimates and accounts presented for six months only, but rather that the annual system of accounting should continue as at present, with the Budget on present lines, but that in addition it should become the normal practice for the level of taxation to be reviewed mid-way between Budgets. The object of this would be to enable changes in taxation to be made, when this was judged necessary for the purpose of regulating the economy, without giving rise to the belief that some extraordinary crisis had occurred.

3. As the Committee are aware, Autumn Budgets, though exceptional, are by no means unknown, and have been resorted to on two occasions since the war, in 1947 and 1955. In addition, there have been a number of occasions when particular tax changes have been made, other than at the normal time, as the following examples show:—

September, 1949—Tax on distributed profits increased from 25 per cent. to 30 per cent.

January, 1954—Purchase Tax changes by Treasury Order. Tax imposed on floor tiles, etc., and reduced on jewellery, electric heaters, etc. Net cost to Exchequer under £3 million.

February, 1956—The Chancellor announced the suspension of investment allowances to take effect from the following day. This was later embodied in the 1956 Finance Bill, which was introduced in April in the usual way.

December, 1956—Temporary increase of 1s. a gallon in hydro-carbon oil duties. Embodied in the Hydro-carbon Oil Duties (Temporary Increase) Bill.

4. The fact that Autumn Budgets or other mid-year changes in taxation have been relatively rare is not, in the Treasury's view, due to any reluctance to use fiscal measures for regulating the economy, but rather because, in normal circumstances, six months is too short a time to judge the effect of the measures taken in the normal Budget. Even when tax changes take immediate effect, some time is nevertheless needed for their effects, especially the indirect effects, to be seen in the economy. In many cases, including in particular the income tax, some weeks must necessarily elapse before Budget changes result in any changes in the incomes received by tax-payers. If therefore a regular Autumn Budget became the established practice, it is likely that in most years the Government would have no changes to propose. It is only when some drastic change in economic circumstances has occurred of a kind unforeseen at the time of the normal Budget, that an Autumn review is likely to result in any proposals for change.

5. Moreover, in considering the use of changes in taxation between Budgets the following practical considerations have to be borne in mind:—

(*a*) Frequent changes in taxation can be seriously disturbing to trade and industry. This is particularly true of the purchase tax. There have been vigorous complaints from traders at the annual uncertainty which the Budget creates. These complaints would be greatly intensified if a second period of uncertainty were added. The present period of uncertainty comes at a time when business is already slack after the Christmas rush, and accentuates that slackness. But a period of uncertainty in September and early October would have more serious effects. It would impede the flow of goods into retail shops for the Christmas trade which increases in importance every year.

(*b*) There is a particular difficulty about Income Tax. This would be most serious in the case of an upward change during the year. Since income tax is an annual tax, it would be impracticable, as well as inequitable between tax-payers, to have different standard rates of tax for different parts of the year. It is therefore necessary that any mid-year alteration in Income Tax should be made retrospective to the beginning of the financial year. This would mean that for the remainder of the financial year PAYE taxpayers would not only be paying tax on the higher rate on their current earnings, but would also be paying arrears at the higher rate on their earnings in the earlier part of the year. If such a change were introduced towards the end of the calendar year under an Autumn Budget, it would be likely to impose so serious a burden on individual pay packets as to be virtually ruled out except in circumstances which called for the most drastic action. Clearly the difficulties would not be quite so severe in the case of a decrease in income tax rates. But there would be great pressure to pass on the benefit of the change to all concerned as quickly as possible and the administrative difficulties would be just as great.

Further, any change in the standard rate of tax during the year means that all deductions from income, dividends, interest, etc., which have been made up to that point are wrong. They can be put right and there are precedents which could be followed dating from the exceptional past years when such changes were made. Broadly they involve that where tax has been deducted at the original rate from fixed income paid on securities an adjustment up or down is made in the deduction from the next subsequent payment. In the case of dividends on ordinary shares, the general rule would be to treat the net amount of dividend received under deduction of tax at the original rate as though it had been received under deduction of tax at the subsequent rate. These provisions can be somewhat arbitrary in their incidence, and although they have had to be adopted on one or two past occasions of crisis, they would be most irritating if they recurred frequently.

6. In general, the administrative difficulties of mid-year changes, particularly in income tax, can be very serious. Thus, for the several millions of direct assessments which are made on persons receiving income in full any revision of rates after the early Autumn may mean the sending out of a revised calculation involving a very heavy burden at a time when the staff are already heavily engaged on the annual cycle. It is true that changes in PAYE, if they were only in the rate of tax, could be dealt with by revised tables. But if the changes involved variations in the different personal allowances, there would be an enormous job of what is called "recoding" to be done. This burden would be so great that it would probably make such changes impracticable.

7. Both the practical and the administrative difficulties were referred to by the Chancellor of the Exchequer (Mr. Macmillan) in a statement in the House of Commons on 4th December, 1956, introducing the increase in

hydro-carbon oil duties. The text of this statement is reproduced as a footnote below.*

8. It is also the case that the preparation and passage of a Finance Bill can take up a great deal of the time of Parliament and Ministers.

9. Finally, it should be recalled that the Government has powers to take action for the purpose of regulating the economy at any time of the year in a number of other ways. Apart from monetary and credit measures themselves, and changes in the field of public investment, there are steps in the fiscal field that can be taken without a Budget:—

(*a*) Although major changes in the purchase tax are normally made in or at the time of the Budget, powers exist to make changes by Treasury Order at any time—and in case of real need and subject to the practical considerations referred to in paragraph 5(*a*), it would be possible and not unprecedented to use these powers on a given occasion to make major changes at another time of the year.

(*b*) If it is desired to stimulate consumption, it will in future be possible to accelerate the repayment of post-war credits without legislation. A Bill which empowers the Treasury to prescribe by regulation the arrangements for repaying the credits is at present before Parliament and in his Budget Speech on 7th April, the Chancellor of the Exchequer said:—

"I propose, however, to seek enabling powers to permit the repayment of credits by statutory order, so that if, later in the year, financial and economic circumstances were such as to justify going further, I should be able to make a proposal to this effect."

(*c*) It is technically possible, as Mr. Macmillan showed in February 1956, to make changes in initial or investment allowances at any time in the year, without immediate legislation.

10. On balance the view of the Treasury is that, while the device of an Autumn Budget is useful from time to time, the weight of argument is decisively against establishing it as a regular part of the system.

13312. *Professor Sayers*: Would it not be possible to split the income tax year quite formally, and say that there is a rate of income tax fixed for the half year rather than for the year? What would be the difficulties about that?——*Sir Roger Makins*: I think that it is clear from what we say about the way in which income tax is established that it would be a formidable task to revise and alter the whole system in order to get it on a bi-annual basis. I would not say it was impossible, but I would say that there was no advantage in it.

13313. The answer you have given us in writing assumes that the income tax year remains as at present, but deals with the question whether the rate for the whole year could be changed half way through the income tax year. I am asking a rather different question: how difficult would it be to split a year? After all, a year is an arbitrary length of time. The period of assessment is now twelve months; could the period of assessment be six months? How difficult would it be to switch to a six-monthly system?——*Sir Roger Makins*: We have not given it consideration, because the advantages of doing it are not apparent, but I would suppose that it would be a considerable additional burden on companies to have to go over their tax position bi-annually rather than annually.—*Mr. W. Armstrong*: If we went over to a six-monthly system, presumably companies would have to draw up all their accounts on a six-monthly basis, and they would have to declare dividends for six months, and so on, which they do not do now. Unless one was prepared to have that change made right across the board one would get extraordinary distortions in industry.

13314. The major difficulty about switching to a six-monthly system is that you would have to carry the accounting system of the whole country with it?——*Sir Roger Makins*: The full apparatus would have to go with it.

13315. *Chairman*: Do you agree, Sir Robert?——*Sir Robert Hall*: Yes. I have not addressed my mind in any great detail to this question, but my initial reaction is that it is a question of convenience, and it would in fact be inconvenient to all concerned to have to operate on a six-monthly basis, and that would be the primary answer to the question.—*Mr. W. Armstrong*: After all, a year may be an arbitrary period, but it has some relationship to the seasons, and some enterprises are seasonal.—*Sir Robert Hall*: Everybody has got so used to a year that it is hard to recast one's mind into the idea of splitting up time into different fractions. I should have thought in principle that we do not want them any shorter than is necessary in the facts of the case, because we do not want to duplicate the effort involved. It is convenient to go by the seasons provided; we have got used to it, and there is no doubt that a great deal of extra work would be entailed if we had to do all these operations twice a year instead of once.—*Sir Roger Makins*: I agree with Sir Robert Hall that there is no objection in principle to having bi-annual budgets, but that there are very strong arguments of a practical nature which seem to be very strong against it; and on the other side one has to consider what really is the objective which we are going to gain by making this a requirement?—*Sir Robert Hall*: From the point of view of the level of activity, we keep the whole economic pattern under continuous review, and it is convenient to have instruments which do not have to be used at the same time every year. We try to have a number of such instruments. It takes quite a while after we have made a change to be confident of what the effect is, with the whole system being rather rigid and statistics coming in rather slowly. I feel very strongly that when we have done anything we ought to have the courage of our convictions and give it a chance, to see whether it does what we thought it would do. Of course, as the paper shows, when things go badly wrong we can have a substantial change.

13316. *Professor Cairncross*: Is there any reason why taxation provisions should be announced at one time of the year? A hundred years ago they were not; they were scattered over a series of bills. Is there any reason why income tax should be settled in April along with the other taxes?——*Mr. W. Armstrong*: There are strong parliamentary and political reasons for taking the tax battle in one battle rather than as a series of conflicts. Experience has shown that we are more likely to be defeated in detail than if we take the whole thing in one go.

13317. *Professor Sayers*: Let us take the point that, having done something, you should then give it a chance and not switch too quickly: I see the force of that, but it applies to any instrument, to monetary or direct controls as well as to taxation? It is a reasonable argument against changing the Bank Rate every week, for instance?——*Sir Robert Hall*: Very much so. As has been pointed out on earlier occasions here it has been a great advantage of the Bank Rate that nobody is surprised if we do change it; but in general I would think that it was an astonishing state of affairs if we were changing the Bank Rate every week.

13318. I am a little surprised at your putting the period for which you want something to run at anything approaching a year. If it were not for the parliamentary objections to changing taxation too often, would there not be an advantage in rather more frequent change, in that when there has been a change of direction in economic policy people are content to let it run for a few weeks but after three or four months they begin to look and see in which way the economy is changing, and to discuss whether some other change of direction is not desirable? Is it not as frequently as that, rather than once in twelve

* *Following is text of Mr Macmillan's statement of 4th December 1956:*

"The traditional tax upon which the country relies in times of difficulty and crisis has been for many years the Income Tax. Fortunately, during the last four years, it has been possible to reduce it by 1s. on the standard rate. Owing to the complicated form in which Income Tax is now levied, largely through Pay-As-You-Earn, it would not, in any case, be possible at this time of the year to make an increase in the tax without serious difficulties and hardships; for any substantial rise in this year's rate of tax, when it came to be levied in what remains of the financial year, would fall too heavily upon the weekly wage packet. It would also mean a readjustment of several million direct assessments of tax which have already been made; and that might well lead to serious delays in the regular collection of revenue.

I do not, therefore, propose to take any immediate steps on the Income Tax."

months, that you want to be able to adjust your course?——I did not mean that we needed twelve months before we were prepared to say there bad been any change, but in general one would expect that the changes would not be so violent that the other instruments at our disposal would not be sufficient to deal with them. If one looks at it entirely from the point of view of control of the economy, the more things one can change, the better.

13319. And the better spaced out they are?——Yes. We think about these things. Last Autumn we thought about what was at our disposal and what we could do. There is in a sense a bit of a conflict between my interest and the general administrative convenience; there has always to be a certain amount of give and take in it.

13320. *Sir Reginald Verdon Smith*: The arguments which apply to income tax would not necessarily apply particularly to indirect taxes, and in particular to purchase tax?——*Sir Roger Makins*: The normal position is that major changes in the purchase tax are made at the time of the Budget. They could be made at other times, but it would be straining the ordinary practice.

13321. *Sir John Woods*: That has been done?——*Sir Roger Makins*: Yes.—*Sir Robert Hall*: From some points of view it would be very nice if we did not change purchase tax in the Budget, to get people out of the habit of telling us that business has come to a standstill because of the approach of the Budget.

13322. *Chairman*: But if there were a scheme of twice-yearly times when the tax was likely to be changed, you would double the inconvenience you already get when people expect things to change once?——*Sir Roger Makins*: That is so.

13323. *Chairman*: We come now to question 4?——*Sir Roger Makins*: We wondered how far you wanted to address this question to the Treasury and how far you wished to address it to the Bank of England. We are prepared to answer your questions, but we thought that you might prefer to take the Bank witnesses on this.—*Mr. W. Armstrong*: It does, of course, affect us both; but when we discussed with the Bank how to divide this up we thought that we would rather leave this one to them. They have our figures and we are content that they should explain it.

13324. We naturally think of it as a joint subject. When we see them this afternoon we may take it that whatever they say to us may be regarded as expressing your point of view?——*Sir Roger Makins*: Yes.

Chairman: Then we will leave question 4 until we see the Governor this afternoon, and go on to the external questions now.

Mr. W. Armstrong *withdrew.*

F. J. ATKINSON, ESQ., a Senior Economic Adviser, H.M. Treasury, and M. H. PARSONS ESQ., an Executive Director, Bank of England, called and examined.

13325. *Chairman*: Then may we come to question 5?—*Professor Cairncross*: Is it your impression that there have been large short-term movements of capital to this country in the course of the last eighteen months? If so, do you think any substantial part has been uncovered in the forward market?——*Mr. Parsons*: There are no statistical data on this subject which will provide the information, and therefore we are to a large extent dependent on guesswork. Whether people will place their money abroad uncovered depends upon the local exchange regulations in their own country and the mental attitude of the operators concerned. As an example of the first, outward interest arbitrage from Sweden is not possible because the Swedish regulations do not allow forward transactions by authorised dealers except linked to underlying commercial transactions, so that a Swede wishing to place money abroad for purely investment purposes can only place it without forward cover. On the second point, mental attitude varies a great deal; we have seen over the last twelve or eighteen months considerable variations in the mental attitudes of short-term investors. It varies too from country to country. We have seen no signs of very substantial movements of uncovered short-term funds into London, but I think that there are indications that interest factors are tending to assume greater importance. This derives from two things: (1) the greater equality of desirability between leading currencies, which we regard as a very healthy development, and (2) the greater freedom of exchange movements which the authorities in the various parts of the world now permit.

13326. This question was directed to discovering whether you felt that it was now more important to keep short-term rates in this country in line with short-term rates elsewhere, because capital flows more freely in response to any differentiation. Your answer in part suggests that that is so. Has there been a marked change, and do you expect that there will be a further change, given confidence in the stability of current exchange rates?——I think the implication that you mentioned was present in my answer. We do see a gradual and continuing change in that direction. Whether there will be any further change I do not know, but I think the change has already gone quite a long way.

13327. If you take the whole period since September 1957, there were clearly long stretches of time when interest rates in this country were substantially higher than in the United States; but that did not appear from what you tell us to lead to any large scale movement to this country?——As I have said, this greater influence of one country's interest rates on movements of short-term funds from another derives to some extent from the greater equality of desirability of currencies. If that underlying situation is disturbed, then money does not move in the same way.

13328. The second point has been made quite strongly to us in previous evidence. We are more concerned to find whether the more recent experience suggests that comparative interest rates may now be playing a role which in the past they did not. From what you say there is some response, although not yet a very large-scale one?——Yes.

13329. *Chairman*: Now we come to question 6, about the importance to be attached to the European Monetary Agreement?——*Sir Denis Rickett*: We think that regional arrangements certainly have a part to play, although perhaps a limited part. The main purpose of the European Monetary Agreement is to provide, now that European currencies are in general externally convertible, a source of short-term credit on which member countries can draw if they get into balance of payments difficulties which might make it difficult for them to maintain the level of their trade and might therefore threaten the level of European trade. The function of the European Fund, and of the Agreement of which it forms a part, is thus to provide a framework for continued monetary co-operation in Europe. The European Fund set up under the European Monetary Agreement may grant credits at its discretion to members for up to two years out of the capital of the fund, which can be brought up to a total of \$600 mn. 55 per cent. of that total is due to be contributed by the members, and the other 45 per cent. comes from the residual assets of the European Payments Union. E.M.A. credits are not automatic credits related to the balances in Europe of the member countries and their monetary areas, as were those of E.P.U. But we think that the E.M.A. does provide a useful reinforcement of European liquidity in case of need. Of course the facilities of the I.M.F. are far larger, and available on a world-wide basis, and therefore one should think of the European Fund as complementary to the I.M.F.

13330. *Professor Cairncross*: You said a reinforcement of liquidity in case of need; need by whom? Do you contemplate that we might make a case before the O.E.E.C. for assistance from the Fund?——There is no reason to assume that in no circumstances should we make a case. We are eligible to draw if the need arises, as the others are.

13331. Do you think that as a matter of policy it would be as easy for us to have access to the resources of the fund as it was to the resources of E.P.U.?——It would

certainly not be as easy, because E.M.A. credits are not automatic as was the case with E.P.U. How easy we should find it would depend on the circumstances. At the present moment we have very large resources available from I.M.F. in the shape of our stand-by credit.

13332. The resources of the Fund are, as you indicated, limited; but, apart from that, is it not intended that it should be the weaker brethren who would make use of these resources, so that the stronger countries would be unlikely to be able to get access to them?——I think that was implied in what I said; it is intended to give help to people who are in balance of payments difficulties.

13333. From the general point of view you would agree that the disappearance of E.P.U. makes it more important to lay stress on the future of the International Monetary Fund?——I think so. The purpose of the European Fund was that we should not allow E.P.U. to go out of existence without putting something in its place; but we must think of the I.M.F. and the European Fund together, the I.M.F. being the more important of the two.

13334. *Chairman*: Then we come to question 7: would it be possible or desirable for H.M.G. to float a loan in the United States or elsewhere to reinforce the gold and dollar reserves on some appropriate occasion?——The Committee is aware that in 1956 the Government negotiated a credit of $500m. with the Export-Import Bank, and that half of it was drawn in October 1957. If what we are talking about is a commercial bank loan or bond issue, then I see no reason to think that it would be impossible for the United Kingdom to raise such a loan abroad, say in New York or Zurich. That has been done in recent years by other European countries and other sterling area countries.

13335. Has it been done by the United Kingdom since the first World War?——*Mr. Parsons*: I think not since the first World War. There was a commercial bank loan at the time of the sterling crisis in 1931. That was a loan raised on the New York market from the commercial banks. It was not put out, as I recollect, to public issue; it was arranged by a bank consortium.

13336. In the first World War, as I recollect, we actually put a loan on the New York Market?——*Mr. Parsons*: I think that is right, but I do not know the details of it— *Lord Harcourt*: The final repayment was in 1932.

13337. *Professor Cairncross*: What about the desirability?——*Sir Denis Rickett*: I think the answer to that is rather more doubtful. If we did float such a loan we should have to choose an appropriate occasion for doing so. We should certainly have to avoid the two extremes, of attempting to raise a loan at a time when we were so strong that people would wonder why we needed it, and of raising it at a time when our position was so weak that we could only do so on rather unfavourable terms. I do not suppose that difficulty would be insuperable, and I do not think this is a course which we would necessarily rule out altogether in any circumstances; but we would say that at present and in the foreseeable future it is probably better to rely on the facilities we have available in the International Monetary Fund, particularly the large stand-by credit which is immediately available. We think, and we certainly hope, that that will be enough to enable us to deal with any unforeseen contingencies.

13338. This question was put to you on the basis of earlier evidence suggesting that the Treasury thought that our reserves were inadequate. Reserves include any rights of recourse to the International Monetary Fund on stand-by credit or in any other way. If our reserves are thought to be inadequate, but we are currently adding to our external assets at a very rapid rate, there is at least some security for any external obligations incurred by this country?——When we say the reserves are inadequate we mean that no one would like to say that they are so large that no circumstances could arise in which we could have any sort of anxiety about the reserve position. I do not think that that means that they are so inadequate at this moment that we should think it right to raise a loan of this kind, in addition to the short-term borrowing from the International Monetary Fund, and the rather longer-term borrowing from the Export-Import Bank which we have already negotiated.

13339. Is it your view that there should be no provision in any balance of payments at which one aimed for a current surplus designed to improve the level of the reserves?——No, not at all. The figure we suggested in the answer to question 9 does in fact make an allowance for quite a substantial improvement in the reserves.

13340. In that situation do you regard the reserves as adequate?——I said that they were not adequate in all possible situations, but that I did not think they were inadequate in the sense that we need to reinforce them at this moment by further borrowing.

13341. *Professor Sayers*: Are you not meaning rather that you would prefer to add to them by a current payments surplus over the three years rather than a long-term loan now?——*Sir Denis Rickett*: I agree with that, but with the emphasis on the word "now". The idea of a loan certainly should not be excluded altogether, but we have borrowed on short-term from the I.M.F. a very considerable amount which we are in process of paying back, and we have close on $1,000m. more available on demand; therefore I should have thought that it was not necessary to think of further borrowing at this time.—*Sir Robert Hall*: If your question is not whether we ought now to go to the New York market to borrow a loan, because obviously that question does not arise, but whether, as a matter of policy in certain circumstances, we would or would not rule it out, the answer is that we do not rule it out.

13342. *Chairman*: That is making it rather difficult. I do not want to be too sensitive about the words "adequacy of reserves", but I think that on the occasions when the Treasury have been with us before we have had the general impression that owing to the lack of complete adequacy of reserves action has sometimes had to be taken by monetary authorities in this country to affect the domestic scene. Assuming that the reserves have not been fully adequate at all times and for all purposes, we wish to discuss whether there are certain measures that could relieve the strain and make things easier to handle in the future?——*Sir Roger Makins*: On this question of international liquidity we feel that it ought to be done by international discussion rather than by individual countries trying to make private arrangements. The move last year towards increasing the resources of the I.M.F. is an indication of our general thinking on this point.

13343. *Professor Cairncross*: May I ask one further question of detail? Is it technically open to this country to ask the International Bank for a stabilisation loan that would in fact be used to reinforce reserves?——*Sir Denis Rickett*: I think not. The purposes of the International Bank are to assist in reconstruction and development, as its full title implies, and I do not think that monetary stabilisation would be regarded as coming strictly within those purposes. That would be regarded as a matter more properly dealt with by the International Monetary Fund.

13344. I understand that the Bank lent to Belgium specifically for that purpose on one occasion?——*Mr. Parsons*: I doubt whether it was lent precisely as a stabilisation loan. It may have had that effect, but I doubt whether it was described as such. There have been one or two cases where one could have said that they had that effect, but I do not believe that they have ever been described as stabilisation loans.

13345. *Lord Harcourt*: It was lent as a project loan and it has never been admitted to have been a stabilisation loan?——Nor officially described as such.

13346. *Chairman*: Then we have your note on question 8.

Following is the note submitted on question 8:

1. The rate of investment by non-sterling countries and international institutions in the rest of the sterling area has been rising in recent years as is shown in the estimates below, drawn from the book on the "United Kingdom

Balance of Payments 1946-57" and the White Paper on the same subject in respect of 1956-1958 (Cmnd. 700).

R.S.A. CAPITAL ACCOUNT WITH NON-STERLING AREAS
(+ =Receipts)

	£ million				
	1954	1955	1956	1957	1958
I.M.F. drawings(1)	− 25	− 21	+ 1	+ 71	+ 13
I.B.R.D. drawings(2) ...	+ 45	+ 28	+ 27	+ 50	+ 84
Other capital (net)(3) ..	+132	+129	+129	+136	+271
Capital balance (4–8) ...	+152	+136	+157	+257	+368

(1) Net of repurchases, other than in gold.

(2) Net of repayments and of subscriptions in gold or U.S. dollars.

(3) Including any gold sales other than in United Kingdom, and changes in R.S.A. holdings of non-sterling currencies.

(4) The figures are net but the only important outflow from the R.S.A. was the repayment of the Lend-Lease silver loan in 1957 amounting to approximately £65 million.

(5) The figures include the changes in short-term balances of U.S. Government agencies arising out of assistance under Public Law 480. These balances are in process of being re-lant on long-term to the beneficiary countries although some may be transferred by way of grants.

(6) The figures exclude funds for capital development provided by way of grant. The total amount of grants has been running at around £100 million per annum in the last year or so and is not thought to have changed much in 1958.

(7) Loans from I B.R.D. were partly in sterling provided out of U.K. subscriptions.

(8) The figures are not fully comprehensive. For some Sterling Area countries accurate records of private investment are lacking. In particular, information about the provision of capital in the form of ploughed-back profits and investment in kind is incomplete.

2. These figures include private as well as official capital movements, though not grants. A good deal of information is available about the official borrowing of R.S.A. countries, that is loans from or to Governments or their official agencies. The rest of this paper is confined to official horrowing.

3. At the end of 1958 the total of official loans and credits arranged with the non-sterling world was over £1,700 million, of which about £1,007 million had already been drawn. Assuming that all loans will be fully drawn, this, when interest is added, will mean that the total liability of the R.S.A. countries will amount to around £2,300 million. Some of the loans, however, contain an option whereby repayment can be made in a local currency. If this option were used fully the non-sterling debt would be reduced by some £425 million. Table I annexed gives details of the sources of capital, and Table II of the recipients.

4. About a third of the total borrowed has been supplied from the International Bank (I.B.R.D.) for specific development projects. The United States government and its various agencies (e.g. Ex-Im Bank) have also made large contributions and account for almost a second third, again largely for financing special projects. It is amongst these U.S. loans that the option of repayment in local currencies is commonly found.

5. The remaining third consists of credits from the International Monetary Fund (I.M.F.) (£103 million) and public issues (£143 million). Drawings on the Fund are normally to help countries with balance of payments difficulties; public issues are also sometimes for this purpose; credits and loans from private banks and aid from governments of non-sterling countries, other than the United States, are usually to finance specific projects. This latter group has risen from nothing in 1956 to nearly 13 per cent. of the total in 1958—and in some cases they provide for repayment in sterling or local currencies. The chief recipients of such aid have been India and Ceylon.

6. The rapid growth of borrowing by the R.S.A. countries is a necessary condition for their economic advancement. But in the longer term it is important that the borrowing countries should follow policies which secure their continued creditworthiness in the eyes of the major lending countries, so that the flow of external capital to assist their development is maintained.

TABLE I

SOURCES OF LOANS AND CREDITS FROM NON-STERLING WORLD

Cumulative position at end–1958 £ million

	Total of loans authorised (*a*)	Amount drawn (*a*)	Amount of loans still available	Repayments (*a*)	Net liability on drawings to date
I.M.F.	103	90	13	1	89
I.B.R.D.	503	369	134	37	332
Official Sources: (*b*)					
U.S.A.	607	280	327	38	242
Elsewhere (*c*)	235	85	150	8	77
Public issues:					
(i) In U.S.A.	113	113	—	17	96
(ii) Elsewhere	30	30	—	1	29
Bank credit and loans:					
(i) In U.S.A.	50	36	14	7	29
(ii) Elsewhere	4	4	—	3	1
	1,645	1,007	638	112	895

(*a*) Includes all loans and credits not fully repaid by December 1956.

(*b*) Including loans with option of repayment in local currencies—approximately 50 per cent. of loans authorised in both categories, and loans repayable in commodities—approximately £20 million of each category.

(*c*) Loans promised to India in Washington at the August 1958 meeting are included whether the formal signing took place in 1958 or not.

TABLE II

ANALYSIS BY BORROWING COUNTRY OF NON-STERLING LOANS AND CREDITS

Cumulative position at end–1958

£ million

	Total of loans authorised (*a*)	Amount drawn (*a*)	Amount of loan still available	Repayments (*a*)	Net liability on drawings to date
Australia	236	224	12	29	195
New Zealand	26	26	—	2	24
South Africa	201	187	14	46	141
Rhodesia and Nyasaland	74	56	18	9	47
India(*b*)	801	367	434	13	354
Pakistan	136	54	82	5	49
Ceylon	26	6	20	—	6
Burma	39	10	29	2	8
Malaya	16	—	16	—	—
U.K. Colonies	30	23	7	5	18
Other countries	60	54	6	1	53
	1,645	1,007	638	112	895

(*a*) Includes all loans and credits not fully repaid by December 1956.
(*b*) Includes loans promised at the Washington meeting in August 1958 whether formal signing took place in 1958 or not.

13347. *Professor Cairncross*: You dwell rather heavily on Government borrowing, but there has been a great deal of private investment in the rest of the sterling area. The recent White Paper indicated that the current balance of payments of the rest of the sterling area was in deficit of more than £900 mn. in 1958, before taking account of gold exports, which no doubt should be taken into account. That indicated a scale of imports of capital from private sources outside this country that struck many people as very large. Have you any further information about that?——*Sir Denis Rickett*: The figures given in the first paragrapb of the note include private capital. The rest of the paper deals, as you say, with the borrowing from Governments and the official agencies.

13348. May I take it to mean that the £271 mn., which is the White Paper figure for 1958, cannot be broken down in any way?——*Mr. Atkinson*: That is the case.

13349. Would it be your impression that more capital is now entering the rest of the sterling area from non-sterling sources than from sterling sources?——That is my impression.

13350. This is a recent trend?——Yes.

13351. Is the bulk of that, in your view, private capital or Government borrowed?——I am not sure about that; I think the bulk is official capital.

13352. *Sir Oliver Franks*: This fact, which you have to regard so much as a broad fact and quite inexplicable, is at tbe same time an interesting fact. The fact that you cannot give us any answer now is not due to your thinking that there ought not to be an answer, or due to any lack of interest in the construction of it; it is simply that at the moment you bave not been able to get around to find out how in the broad it is made up?——That is so.

13353. But you will be doing so?——Yes; we can make further studies of the distribution of the inflow of private capital into the various members of the sterling area from outside.

13354. *Professor Cairncross*: Would you agree that this has a very marked effect on the position of sterling in the world, and that it represents a substantial transfer into sterling from other currencies?——Yes. On the other hand these countries spend most of it. One could not say that the reserves benefit by the amount of capital coming into the sterling area from outside. What benefits is the development of the countries concerned: they are able to buy that much more.

13355. Something depends on whether this capital is tied or not, and whether the money is spent within the sterling area, in this country or elsewhere. Have you any knowledge how far the capital which is coming into the sterling area is tied?——*Mr. Atkinson*: We have a certain amount of knowledge about the official lending. A proportion of it that is tied, the money from United States and Germany; I should say it is rather a small part.—*Sir Denis Rickett*: It is always rather questionable whether a loan can be effectively tied; wbile on the face of it it may be tied, so long as there are certain normal imports which the country takes from the place from which the loan comes the tying of the loan does not necessarily lead to any additional imports. It merely means that it is used to finance imports from that country which would have been taken anyhow. I am not saying there are never circumstances in which the loan leads to additional imports; I am only saying that it does not always follow.

13356. It is very difficult to trace the effect of that, but I should have thought this sharp rise in 1958, which is still continuing, did represent a strengthening of the reserves?——*Mr. Atkinson*: The big feature in this is Indian development, and there it is a case of a deficit country being supported by a number of other countries besides ourselves in a rate of expenditure which would not otherwise be possible.

13357. But which may show itself in some purchase of capital goods from this country?——Yes.

13358. *Chairman*: Then may we come to question 9?

Following is the note submitted in response to question 9:

Ever since the war, a great weakness in the external position of the United Kingdom has been the existence of short-term liabilities too greatly in excess of the reserves of gold and convertible currencies. This makes sterling vulnerable to confidence movements, because of the possibility that the reserves may approach or even fall below a comfortable working level. From a domestic point of view, an exchange crisis may compel more drastic action than would be desirable if there were more freedom of manoeuvre. It is therefore an important objective to reduce the excess of short liabilities over reserves. This means that surpluses on current account should exceed net long-term investment.

2. In considering the potential stability of the whole system, however, it is necessary to consider not only the arithmetical difference between total reserves and liabilities, but the ratio between them, and the composition of the liabilities themselves. The ability to withstand a drain will depend to a considerable extent on the absolute size of the reserves at the beginning of the drain. These reserves are needed to finance any temporary deficit in the United Kingdom balance of payments on current and long-term capital account combined, as well as to meet withdrawals of sterling balances. It follows from this that a reduction in any of the sterling holdings is inadequate compensation for an equal fall in the reserves. Experience has shown, moreover, that there is a significant

difference between the attitude of the various holders, which corresponds roughly to the difference between the sterling area countries (R.S.A.) and the rest of the world. In the crises through which sterling has passed, a major factor has normally been the liquidation of the balances held by non-sterling area countries. The sterling area on the whole has shown much more cohesion. Thus a reduction in the sterling holdings of the R.S.A. improves the position less, in relation to what may happen in a subsequent crisis, than an equal reduction in the holdings of the non-sterling world.

3. In order to increase the stability of the system, it is therefore desirable not only that the current surplus should be enough to match net long-term investment, but that in addition the balance of liquid assets and liabilities should be improved. This means that we should aim at a current surplus which makes provision for moderate reductions in the sterling holdings so that these reductions are not met out of the reserves. Indeed the reserves need to be increased. While it might not be feasible to cover a very substantial fall in sterling holdings over a short period out of the current surplus, the aim in such circumstances should be to improve somewhat the present *ratio* of reserves to liabilities, even if the absolute level of the reserves declines. A further requirement, in view of the instability of the holdings of non-sterling countries, is that any increase in these particular holdings should be matched by a corresponding increase in the reserves.

4. It is therefore difficult to formulate any simple statement of objectives. It has been customary to express the external monetary objective in terms of a particular value for the balance of payments surplus on *current account*. It was with considerations such as those set out above in mind, that the statement was made, in the Economic Survey for 1953, that "the annual surplus on current account needed to provide for commitments, and for some increase in the gold reserves, might amount to something like £300–£350 million". This was envisaged as providing for a surplus on current and long-term capital transactions taken together of the order of £150 million and hence for an improvement of this amount in the short-term capital position, predominantly in the form of a reduction in overseas sterling holdings and particularly those of the R.S.A.

5. It is scarcely necessary to emphasise that the estimated deficit on capital account which such statements imply must be a very uncertain quantity. There is a further qualification to be borne in mind. It should not be assumed that the current account and capital accounts are wholly, or perhaps even largely, independent of each other. It would be wrong, for example, to imagine that an equal improvement in the external monetary position could be secured by a given reduction in overseas capital investment. For the reduction in investment would normally result in some fall in exports. Indeed, in some cases, the connection between the current and the capital account is even closer. For example, to the extent that they are identified, profits earned and retained abroad appear in the current account as an item of income and in the capital account as an item of overseas investment.

6. Over the five years 1953–57 the average current surplus, as estimated, was nowhere near the £300–£350 million target and fell short by nearly £60 million a year of the average for identified net long-term investment. However, it would be reasonable to allocate to one or other of these sectors of the accounts the greater part of errors and omissions, which averaged a little more than +£70 million. Hence while there was little improvement in the external monetary position over this period, at least there was no deterioration. There was an increase, instead of the heavy fall expected, in the sterling holdings of the R.S.A., which outweighed a fairly marked reduction in those of non-sterling countries. Net purchases of dollars from the I.M.F. to the extent of some £160 million were matched by an increase in the reserves of much the same amount.

7. This performance can certainly not be accounted satisfactory. The sterling balances remained a continuing threat to our limited reserves, and acute difficulties arose in 1956 and 1957 even though our trading position was on each occasion sound. The experience of these years thus emphasised the great desirability, to put it no higher, of improving the external monetary position substantially, while it also underlines the difficulty of expressing the requirement in terms of figures.

8. 1958, with its exceptionally favourable factors, brought about a great improvement in our position. The current surplus, estimated at £455 million, exceeded net long-term investment by over £200 million. There was an increase of £284 million in the gold and convertible currency reserves, but short-term liabilities to the non-sterling world rose by some £150 million, while there was a fall of over £80 million in R.S.A. sterling holdings. 1959 is likely, however, to be less favourable. The current surplus will probably revert to more normal levels, net private long-term investment and Government lending to overseas countries are likely to be high, and the additional subscription payable to the International Monetary Fund, together with the resale of dollars purchased from the Fund in 1956, may carry with them either a fall in the reserves or an increase in overseas sterling holdings. Against this we shall have secured a very substantial addition to our second-line reserves in the shape of our I.M.F. drawing rights.

9. Looking beyond 1959 it is extremely difficult, for the reasons which have already been outlined, to foretell what size of current surplus is likely to be required. As always, great uncertainty attaches to movements of overseas sterling holdings, which in the case of the R.S.A. reflect, broadly speaking, the net outcome of all R.S.A. transactions with the rest of the world including the United Kingdom, and in the case of the non-sterling world depend in the short-term largely on confidence. Moreover, whether we can achieve any given target is only partly within our own control, since it may be incompatible with the targets of other countries with which we trade. For example, it is not possible both for us to reduce the balances of Sterling Area countries and for them to build them up—indeed, the present need of R.S.A. countries to restore their position is a major and legitimate reason why the United Kingdom's surplus is expected to be smaller in 1959, just as the continuing deficit of the United States and the depletions of R.S.A. sterling balances were major factors contributing to the very large surplus of 1958.

10. But although the surplus which is either desirable or attainable cannot be precisely foreseen, it is clearly necessary to make some assumption about it, since our own actions can make it impossible to attain this surplus even if external circumstances do not rule it out. In recent studies of the longer term growth of the economy, this assumption has been that resources should be found for a surplus on current account averaging about £450 million a year in the early 1960s. This would allow for the possibility of a substantial increase in Government lending and private investment, especially in oil, above the level of recent years. It would also leave a substantial margin for reducing short-term liabilities and building up the reserves.

11. This figure of £450 million should be regarded as illustrative only. It may, for example, take insufficient account of United States investment in the United Kingdom which reduces the net outflow of capital from this country. Nor can the scale on which the Government may wish to lend abroad in future years be foreseen. Moreover, the fact that the figure contains a substantial margin for increasing the reserves and/or reducing external liabilities means that it cannot be appropriate to all years, because these particular aims cannot be carried out except when conditions both at home and abroad are suitable.

12. For the reasons already given, it is not certain that an average surplus of this size can be achieved. The figure must not be regarded either as a forecast of what is likely, or as a standard by which actual performance should necessarily be judged. For this will depend on external as well as on internal conditions. In relation to past performance it is probably a good deal less formidable than it sounds, because of the increase in the national income since 1953. The strain on United Kingdom resources is also lessened because of the improvement in the terms of trade which has taken place in the last few years, and which at the worst we should not expect to be wholly reversed. Moreover as the scale of United Kingdom investment overseas increases new opportunities are created for our exports. The figure means that in present circumstances the United Kingdom should conduct its internal policies in such a way that the resources

necessary to attain a current surplus of this order would be available if required.

13. In addition to making the resources available, we must do all that we can to improve our competitive power. But it is an important condition of success that other countries should pursue expansionary policies, and that there should be sufficient international liquidity to enable these to be followed without bringing about a world shortage of reserves.

13359. *Sir Denis Rickett*: I should like to underline what I think the paper makes clear about the nature of this figure. The figure that we have given is in no sense a forecast of what we think is likely to happen, nor is it a statement of a minimum requirement or even of a requirement which, were it not fulfilled, would lead to serious consequences. It is an assumption, which we have to have if we make any long studies of the United Kingdom economy. One has to make some assumption about the amount of room which must be left in the economy for the external surplus; that is what this figure is. It includes a fairly substantial allowance for an improvement in the external monetary position of the United Kingdom, both by the repayment of short-term debt and by the running down of the overseas sterling liabilities, and also through a rise in the reserves. If you were to ask what the consequences would be if we did not get this surplus of £450 mn., I should say that in the first place one would need to know what other items in the balance of payments were changing at the same time; but one of the things that might be happening is that we should not get quite such a satisfactory improvement in the external monetary position as is implied in this figure.

13360. *Sir Oliver Franks*: That really means that, with the qualifications and the consequences of the use of the figure which you have given, it really becomes the sort of figure whose proper use is in Ministerial statements of policy?——*Sir Denis Rickett*: I would not limit it quite to Ministerial statements; we have to use it in the forward planning which we make of the internal economy.—*Sir Robert Hall*: Even if we do not get the exports, at least we have to leave room for them. This is the sort of figure we think we ought at least to allow for, and some of the considerations showing that it is not just a number brought out of the air. But I agree with Sir Denis that one should not deduce from this figure either that this will be achieved in any particular year or that this amount is particularly necessary. For one thing, the achieving of this figure depends not only on what we ourselves do but on what a lot of other people do. Take a simple example: a sterling area country which wants to build up its London balances may impose restrictions against our imports. We have left room for the exports, but the actual result is not within our power.

13361. *Professor Cairncross*: You do not mention here as part of an estimate of the "desirable" surplus any investment in export credits of one kind or another. If our exports are expanding, particularly our exports of durable equipment, should we not need to visualise some possible addition to the credit extended to the countries buying that equipment?——*Sir Denis Rickett*: We have allowed for an expansion in overseas investment both private and governmental, and that would include an allowance for export credit, even though we have not mentioned it specifically.

13362. The current rate of capital investment abroad is surely substantially higher than you visualise for the future in making this calculation? Our long term capital balance last year was £236mn., and that was probably lower than the figure that one would expect, given the continuing upward trend of the past few years?——We assume that private investment (including particularly oil company investment which is to some extent self-financing because it is made out of ploughed back profits) will continue to rise. As far as governmental investment goes, one cannot make a firm statement about that, but I think the policy of development assistance loans which was described at Montreal allows for the possibility of a rather higher level of governmental investment over the next year or two than there was in the past. In 1958 I think we have done quite a lot in that way.

13363. The previous £350mn. figure was based on £200mn. for long-term investment; are you thinking in larger terms now?——We are thinking of an increase of something like £200mn. for net overseas private investment; it might be £210mn. a year compared with £190mn. in 1958. As regards governmental lending, we have made it clear that we cannot be committed to any particular rate; it must depend on circumstances, the needs of the country and the resources we have available. But taking into account an expansion in governmental lending and the fact that in 1960 we shall begin to repay the Export-Import Bank credit we think the net outflow on government lending may be £90mn. against £46mn. in 1958.

13364. If you are thinking not of the next year or two but of the early 1960s, ought not part of the £450mn. that you indicate to us as a desirable surplus to be available for repaying short term liabilities and building up reserves?——We have allowed £150mn.

13365. That was the previous figure; so that you are now reckoning on a larger element of investment and repayments?——*Mr. Atkinson*: Yes.—*Sir Roger Makins*: I should like to stress that this is an assumption that we have given you. We have, so to speak, exposed the workings of our minds on the problem that you put to us, but it is not necessarily something that we expect to do, nor something which, if we failed to achieve it, would lose us some essential objective. These are assumptions which we have to make. If these figures were to get enshrined in the public mind as being something other than what they in fact are, misinterpretations could be very dangerous. I would therefore like to stress the qualifications which Sir Denis made when he was explaining this paper to you.

13366. It is not very clear whether this figure means in your minds the continuance of existing restrictions on investment or some change; nor is it plain whether you are contemplating a more liberal policy of export credit or the same policy as at present. Are not these two quite definite points of policy where your views would be rather guided by calculations?——*Sir Denis Rickett*: I am not sure whether the present policy in regard to overseas private investment could be called very restrictive. It is true that there is an exchange control over direct investment abroad, and that we do not allow portfolio investments; but on the whole I think it is administered fairly liberally. As regards export credits E.C.G.D. has fairly large resources, and they are likely to be expanded as time goes on.

13367. My information is that only one non-governmental overseas borrower has been allowed access to the London market in the last ten years. That does not seem liberal to me?——*Sir Denis Rickett*: I was thinking, I am afraid, of direct investment by companies in foreign countries: the build up of new enterprises and additions to existing organisations abroad.—*Professor Cairncross*: I agree that the scale of direct investment is large. I was thinking more of the restriction on coming to the London market which applies not simply to private borrowers but to authorities other than central governments, even though they may be guaranteed by the central government.

13368. *Chairman*: Is not that a very severe restriction compared to anything in our history before 1939?——*Mr. Parsons*: It is a very severe restriction; but what matters here is the actual level of overseas investment, taking public and private together. On that score I should have thought that we were doing quite well.

13369. *Professor Sayers*: Besides issues on the London market is not portfolio investment by U.K. residents in foreign securities rigidly restricted?——*Sir Denis Rickett*: More than that; they are not allowed

13370. *Professor Cairncross*: We do not want to get involved in discussing policy at this stage, but we are concerned to know whether, in making the particular calculations that you have made, you have allowed for any relaxation or are still assuming that these restrictions will continue into the middle 1960's?——*Mr. Atkinson*: These estimates were based on present policy in regard to exchange control permission for private portfolio investment. They simply allow for the growth of private direct investment abroad, and then make a fairly generous allowance for bigger government lending. These forecasts do not allow for a large liberalisation of our policy on U.K. investment in the non sterling area.—*Sir Roger Makins*: It is inevitable when work of this kind is being done that it should be done, broadly speaking, on the basis of existing policies.

13371. Figures of this kind are taken as a basis in the formulation of policy ; if they already imply the continuance of that policy, may not subsequent efforts to change it present difficulties.——As Mr. Atkinson said, certain allowances are made. I think that, if we then extended this work to take into account the sort of policy changes that you have in mind, that would encounter some difficulty.

13372. *Chairman* : Then we come to question 10, about the restrictions on our additional subscription to the I.B.R.D.——*Sir Denis Rickett*: The whole of our additional subscription to the International Bank will be subject to the same restrictions as applied to the uncalled 80 per cent. of our existing subscription ; in other words, the whole of the additional subscription will be subject to call only if it is needed by the Bank to enable the Bank to meet its obligations for funds which it has borrowed or guarantees which it has given.

13373. *Lord Harcourt*: We in fact subscribe no additional capital, but we add to our uncalled liability?——Exactly. The fact that this subscription will not be called rests on a resolution by the Governors of the Bank to the effect that in this case the first 20 per cent. of the additional subscription is not to be subject to call for lending but only for the same purposes as the 80 per cent. in the original subscription. If that resolution were to be rescinded which we do not expect it to be, then the Bank would be able to call 2 per cent. in gold and 18 per cent. in sterling as before.

13374. *Professor Cairncross*: If the International Bank wished to raise a loan in the London market would it need the agreement of Her Majesty's Government?——Yes.

13375. *Chairman* : Then we come to question 11.—*Professor Cairncross*: The White Paper issued in February, quoting the report of the executive directors to the Board of Governors of the I.M.F. said that "the question whether drawings in the currencies of the most important trading countries could or could not be repaid in the same currencies would tend to lose much of its practical importance as convertibility is attained or approached". Can you tell us what is the practical importance of this point, given external convertibility?——If I may answer first the question in the terms in which it was stated to us, a convertible currency is for Fund purposes the currency of a member country which is not availing itself of the transitional provisions of Article XIV but has undertaken to comply fully with the provisions of Article VIII. Sterling is not therefore a convertible currency for this purpose at present, because we are still under the transitional provisions of Article XIV. If and when the Government decides to move from Article XIV to Article VIII, then it would be convertible in that sense. But even if it was convertible in the terms of this definition, it would still not be eligible for use in the repayment of drawings so long as the Fund held more than 75 per cent. of the U.K. quota in sterling. In your supplementary question you asked what was the practical effect of this. Whatever the rules of the Fund, I suppose that, if sterling is not eligible for repayment of a drawing at this moment, it is very easy to use it to buy another currency which is.

13376. It is in our interests as a large trading country that the currencies at the disposal of the Fund should be regarded by potential borrowers as interchangeable ; but the practical importance of the present position must be that they do not regard them as interchangeable. Their obligations, if they borrow, are to repay in dollars, whatever currency they borrow, and the fact that they could acquire the dollars now does not necessarily mean they would have the same confidence that they could acquire them when the time came to repay?——*Sir Denis Rickett*: I rather doubt that. I can follow your argument as applied to a period in which sterling was inconvertible, but now that sterling is externally convertible I should have thought that that argument could not apply ; indeed it has not applied for some years past because of the high degree of convertibility.——*Mr. Parsons*: The key to the situation now is the point that Sir Denis made, that in any event, even if we move to Article VIII, as a matter of practice at present countries could still not use sterling for re-purchase unless the Fund's holding of sterling was below 75 per cent. of the U.K. quota. That situation could only be changed if, in fact, the Fund's holdings of sterling declined quite substantially. So in practice the country then drawing sterling would still have to contemplate that it would have to re-purchase in some other currencies, perhaps dollars or marks, and therefore they would in that sense be taking an exchange risk if they drew sterling. But I agree with Sir Denis that, as a practical matter, if countries are prepared to ignore that element of exchange risk, there is now no reason why they should not draw sterling from the Fund.

13377. Is it your view then that, as matters stand, without seeking to alter Articles VIII and XIV, the position in practice that will obtain will be exactly the same as it would be if they did not exist?——*Sir Denis Rickett*: Not exactly the same because, as Mr. Parsons has said, so long as a country is drawing in one currency and repaying in another it is carrying an exchange risk. If the time comes when we go over to Article VIII and the Fund's holding in sterling has been reduced, then they will be able to draw and repay in sterling.

13378. The exchange risk is surely the material point. That is the factor which does inhibit the countries from borrowing in one currency and then switching?——I should not have thought the risk would bulk largely in their minds that they would not get dollars. I imagine the question is price.

13379. We are not speaking of the situation in 1959. We are thinking of the situation that is going to obtain over a long period, in which the confidence of countries in one currency and another will fluctuate ; and it is precisely those fluctuations of confidence which create the need for the reserves of the Fund. Can one then talk in terms of the views of the countries on exchange risks as if the present situation were a permanent one?——No, but nor can we talk about the present position vis-a-vis Articles VIII and XIV as being a permanent one, *ex hypothesi* since Article XIV provides for transitional arrangements.

13380. I have seen it argued that if sterling were a fully convertible currency this would have repercussions on the reserves of some of the members of the sterling area, because it would alter their obligations and they might be asked to make repayments. Is this so?——*Sir Denis Rickett*: I do not know that they would necessarily incur an immediate obligation to re-purchase. If sterling were regarded as convertible by the Fund, the "net official reserves" of the other sterling area countries would be calculated on a different basis ; their reserves would be higher in that sense.——*Mr. Parsons*: There is a provision in the Fund agreement that in the year in which a currency becomes convertible the holdings by other countries of that currency are not regarded as acquisitions during the year for re-purchase purposes.

13381. How much is involved in this? Is this a large figure or small?——*Sir Denis Rickett*: I would not like to say offhand.

13382. It might be substantial?——*Mr. Parsons*: It must be substantial, in the sense that the sterling holdings of those members of the sterling area who are also members of the Fund will begin to rank as part of their reserves for Fund calculations. But again, if as a consequence they incur a re-purchase obligation, there comes up this question of whether the Fund already holds more than 75 per cent. of the U.K. quota in sterling, and that can negative any re-purchase obligations that they have.

13383. *Chairman*: Then we come to question 12. We would very much like some order of magnitude, if we could get it, on this question of "leads and lags" and trade displacements?——*Mr. Parsons*: The estimate to which the question refers is one that we would not quarrel with, although I stress that it is an estimate. It is one of those estimates where the uncertainties attaching to it are such that one must not put too much weight on it. In our view the maximum possible swing would be substantially larger than this figure, but again I could not give a reliable estimate as to what that figure could be. If I was asked to give an illustration of the scale of transactions involved, I could say that the gross turnover of current transactions inward and outward between this country and the non-sterling world is of the order of £500 mn. a month. Current transactions between the rest of the sterling area and the non-sterling world probably add another £350 mn. So if sterling area current payments were accelerated by one month and sterling area current receipts were delayed by one month, the cost could

theoretically be somewhere between £800 and £900 mn. But we regarded the 1957 crisis as having been a fairly serious one; so the gap between what is theoretically conceivable and what is reasonably likely could clearly be a fairly wide one. It casts some doubt on the value of a theoretical calculation. Past experience suggests strongly that there are other forms of confidence movement which are important in this field. "Leads and lags" is one important item, but there is the question of the running down of commercial balances, which is another important element, and official balances too; and then there are movements of short-term investment funds. If I were asked to put them in order, that is the order in which I would put them.

13384. *Professor Cairncross*: You state that the figure in this question, if taken as plausible, casts doubt on the value of a theoretical calculation. I am a little puzzled by that remark, because I thought that the crisis of 1957 was a comparatively short affair and did not necessarily work up to the climax that it might have reached if it had continued for another couple of months. Whatever figure is put down as an estimate of the displacements in 1957 surely does not in any sense represent the maximum that one might anticipate?——I think that is a fair comment, except to say that the crisis of 1957 was sufficiently sharp to bring about a very sharp reaction of official policy.

13385. All that that implies, surely, is that you do not need to get anywhere near the maximum to see official policy move? It does not mean that it might not go a great deal further than £90mn. to £100mn.?——That is so; it could certainly go further.

13386. You suggested that you thought the maximum was substantially higher than £100mn. Would I be right in thinking that when you say substantially higher you mean several times higher?——*Mr. Parsons*: I think as a theoretical possibility, several times, yes.—*Sir Denis Rickett*: Always assuming that official action was not taken sufficiently soon and sufficiently effectively.

13387. Have you made any attempt to break this down? There must be many types of trade where the possibility of postponement is very restricted and other types where it is comparatively easy?——*Mr. Parsons*: We have not so far attempted that. I daresay it could be done, but I am not sure that a very useful purpose would be served by doing so.

13388. Is not that a little surprising, since you put this first in the order of the factors that may cause the reserves in this country to undergo violent fluctuation?——I do not want to put this ahead of the running down of the sterling balances; I rather want to put those two causes ahead of movements of short-term investment monies.

13389. Did sterling balances in 1957 run down in the two months July and August, taking into account seasonal and other very exceptional effects, by as much as these figures?——*Mr. Atkinson*: They did.

13390. After making allowance for factors which would be known well in advance?——Yes, even after making allowances for E.P.U. and German deposits and things of that kind which were known to be happening at the time.

13391. It must have been well known at the time that the figure would show a deficit well before the autumn, and that the Indian figure would be affected?——I am speaking of the non-sterling-area sterling holdings, which fell in the third quarter of 1957 (after allowing for the adjustments I have mentioned) by more than the £90 to £100mn. estimated for "leads and lags". That is one reason for putting the main emphasis, as Mr. Parsons has done, on the running down of sterling balances.

13392. Non-sterling-area sterling balances fell by more than £100mn.?——Yes.

13393. I do not think we have seen these figures?——They are not published; all we publish are the crude figures. I have made adjustments to those to allow for the E.P.U. changes and for the build up of German balances which was taking place at that time, and which rather obscured the commercial position.

13394. We had been left with an impression on the basis of figures supplied to us that balances of sterling area countries underwent a very marked drop that quarter, but balances of non-sterling-area countries were rather well maintained. If that is not so I think we would like something on the record?——*Sir Roger Makins*: We will see what we can do on this*.

13395. To go back to the point I had in mind, this fluctuation in "leads and lags" would not perhaps come first; but it would certainly come near the top in the factors governing the movement of the reserves. In those circumstances is it not rather important to know both anything one could discover about where the "leads and lags" occur and also about the scale on which they might occur in future?——*Mr. Parsons*: I think we would all agree that the more light we can get on this subject the better; but it is not altogether the easiest subject on which to get light, because there is such a complex of factors involved in it. I can say that we have a general opinion that it is "lags" rather than "leads" that bulk larger in this. I think that is understandable, possibly because more of the "lagging" is on the sterling basis and more of the "leading" would be on the currency basis.

13396. *Professor Sayers*: You have suggested the theoretical limit as several times this estimate of £90 to £100mn.; and yet in August/September, 1957, when there was a great deal of talk internationally about sterling, that was the scale of it. Does it not seem worth trying to narrow it down? The "actual" figure of £90 to £100 mn. casts just as much doubt on the multiple "several times", I suggest, as the "several times" casts on the £90 to £100 mn. Surely it is possible with the knowledge there is in the Bank and elsewhere in London to narrow down the possible "leads" and "lags" having regard to trade practices, exchange regulations in other countries, the practices of the overseas banks and so on, and get some idea? Would not this be a very relevant figure to the question of how adequate our reserves are?——I agree that it is obviously worth trying to find out something more about this; I am only suggesting that it is not altogether easy. It is quite a complicated problem. One has to be quite sure that at the end of it one can make use of that information in framing policy. This is only one way by which non-residents can diminish their holdings of sterling. It must not be assumed that, if this way could be seriously minimised or entirely prevented, there would be a corresponding lessening of the reduction in sterling holdings. One cannot say that it will be so much on "leads and lags" and so much on the running down of sterling area balances; there is an interconnection between the two.

13397. *Chairman*: Then may we come to question 13? Perhaps you would tell us what the "pool" of dollar securities is, how it is formed and how it is added to?——*Sir Denis Rickett*: It is a pool because our exchange control regulations do not allow United Kingdom residents to buy foreign securities except from other residents; to that extent the securities that can be dealt in are those which are already in the ownership of U.K. residents.

13398. It originates with the state of things as they were in 1939?——Yes. As regards how it has varied, I do not think it is possible to give a figure for that; but I think one could say in general terms that it has been increasing.

13399. What are the causes that would lead to its being increased?——I suppose one general cause would be a desire by United Kingdom residents to acquire United States securities.

13400. That is straight evasion, because no licence would be given?——A licence would not be given but, as you may remember, there was a gap in our exchange control, arising from the nature of the sterling area, in that there were certain "free" markets in the Persian Gulf and in Hong Kong, through which these securities got inside the ring-fence. That gap was closed by action which we took in July 1957. That was one channel through which securities were being acquired by U.K. residents at a time when they were very anxious to do so. There is a variety of other channels by which the "pool" is increased. First of all, the value of the "pool" can increase because of an increase in prices. There may also be an increase through good management; that is to say, that we manage to hold those which show the greatest price increase. Secondly, the "pool" can be added to legitimately by means of legacies and gifts of securities.

13401. Would that be at all a sizeable contribution?——*Sir Denis Rickett*: I would not think so. There are

* See Appendix to Minutes of Evidence.

also imports by immigrants, who come here and bring their securities with them. If we are talking of a "pool" of dollar securities, there can be a switch from non-dollar securities or out of direct investment or unquoted securities. There may be an addition to the "pool" through the investment of certain foreign currency funds of a capital nature accruing to a resident in the United Kingdom for example, the capital proceeds of mortgages, real estate, mineral rights, life and endowment policies, and in certain circumstances blocked foreign currency balances arising from income. Finally, as announced in Parliament, on various occasions the Treasury has disposed of a small part of the Government-owned securities to U.K. residents for sterling; those were added to the pool. That, I think, covers the increases. There may be decreases from the "pool" through exports by emigrants and repatriates, again by legacies, and just by straightforward sales, the dollars realised from the sale being surrendered to the Exchange Equalisation Account. That is only likely to take place when there is not a premium on dollar securities.—*Mr. Parsons*: Of the considerations that Sir Denis has outlined I should have thought the increase in prices was undoubtedly the largest single consideration for the increase in the "pool".—*Sir Denis Rickett*: Certainly. That only leaves the actual size of the "pool", about which we know least of all. All we can give is what we hope is a reasonably well informed guess that it is currently of the order of $4,000 mn.

13402. *Professor Cairncross*: You have a register of some kind of these securities?——They are required to be deposited with authorised depositaries, but it is not the case that we have an itemised list of all the securities there are.

13403. *Professor Sayers*: Can the Treasury estimate by how much the size of the "pool" varies?——I do not think we know. We can make a guess at the size of the "pool", but no guess at the size of increases in the "pool".

13404. *Professor Cairncross*: You said that the gap in 1957 had been closed. Did you include Hong Kong in that?——Yes, the gap was closed, both in the case of Hong Kong and the Persian Gulf territories.

13405. *Sir Oliver Franks*: Do you think that all the Eastern Exchange Banks feel equally convinced that it was completely closed? One has to distinguish, for example in the case of the Government's measures in September 1957, between the effects of governmental measures and the consequences of the trend of events in the world; possibly in the case of a gap like this the change of taste, whether people want to acquire securities so much or not, has quite a lot to do with the sureness with which the gap is or is not closed. The impression, when one considers all the evidence that we have listened to, is that without any desire to controvert or dispute anything you have said, it requires the aid of circumstance as well as the weight of official action before one can be quite sure that a gap is closed?——I would agree with that. We took action to close the gap. Time alone would have showed whether it had been closed, and I agree that, whereas the premium on dollar securities was as high as 20 per cent. not long after that action, for many months past there has been no premium on dollar securities. So our defences have not been put to the test that they would have been put to in different circumstances.

13406. *Lord Harcourt*: Sir Denis has said a good guess is that the size of the "pool" may be $4,000 mn. at the moment; but surely immediately after the requisitioning of all privately held foreign securities in 1940 the "pool" of privately held foreign securities must have been nil, with the exception of private direct investment?——*Mr. Parsons*: Speaking now from memory, there were two things: the Government requisitioned certain foreign securities, and subsequently borrowed certain other foreign securities. The requisitioned securities were retained by the Government, and still constitute the basis of the Government's holding of dollar securities. The borrowed securities were in due course returned to their owners and that constituted the "pool".

13407. *Professor Cairncross*: The figure of what was returned to owners would be the original size of the "pool"?——I think so.

13408. *Lord Harcourt*: That, plus direct investment which was not mobilised?——*Sir Denis Rickett*: Direct investments are not included in this "pool".

13409. I was meaning that there could have been switches from direct investment to portfolio investment?——*Mr. Parsons*: There undoubtedly have been.

13410. *Professor Cairncross*: $4,000 mn. is not intended to include Treasury holdings of any kind?——*Sir Denis Rickett*: No, we have excluded the Treasury-owned dollar securities.

13411. *Chairman*: Is there anything in the last question about restrictions or conditions which are imposed as to the types of dollar securities which may be acquired by residents of the United Kingdom?——That can only apply to those that can be acquired through the switch market. The conditions are that they must be quoted on a recognised market in North America.

13412. *Professor Cairncross*: Have there been any protests to you about that condition in the last few years?——*Mr. Parsons*: I cannot recall that there have been any protests about it. I am sure that there are people who would be glad to see it removed.

13413. The Association of Investment Trusts, in giving evidence to us, did not seem happy about it.* They were thinking not merely of their freedom to acquire unquoted securities but of the possibility of making direct investments with the proceeds. Do you see any real objection to freedom of that kind?——*Sir Denis Rickett*: If this was some form of direct investment for which we should not make dollars available, I should have thought that we should equally not wish to release marketable securities.—*Mr. Parsons*: One of the difficulties here is that under our present system, as you know, all these holdings in private hands are deposited with authorised depositories, and I suppose that in theory they are mobilisable. If we allowed switching out of these into unquoted securities it would then be difficult to draw a line as to what they would go into. They might buy real estate, for instance, and we should lose track of that in effect.

13414. Is there not some inequity in this, when you allow the profits of direct investment in America or elsewhere to be re-invested in any direction in which people choose? We are discussing here switches, not fresh investment?——We are discussing switches; we are also discussing the degree to which the authorities are able to keep track of the resulting switch. It is very easy to keep track of a switch into quoted securities because the documents are deposited in London. It is not easy to keep track of a switch into unquoted securities which may be real estate.

13415. *Chairman*: Then I think that completes our questions, Sir Roger. We do not expect to have to call on you again; so may I take this chance of saying how grateful we are to the Treasury for all the work that you have done for us?——*Sir Roger Makins*: Thank you, Mr. Chairman; may I in turn express our thanks for the courtesy with which we have been always treated by your Committee. I am sorry that owing to the lapse of time our cast has had to be changed: we hope the performance has not suffered!

* See Questions 7539 to 7560 and 7580 to 7593.

The witnesses withdrew.

(Adjourned until 2.30 *p.m.)*

The following representatives of the Bank of England, called and examined:

THE RT. HON. C. F. COBBOLD, Governor.

H. C. B. MYNORS, ESQ., Deputy Governor.

L. K. O'BRIEN, ESQ., Chief Cashier.

W. M. ALLEN, ESQ., an Adviser to the Governors.

13416. *Chairman*: Mr. Governor, we should like to ask you one or two questions about domestic monetary policies and events in 1958 and 1959, by way of bringing up to date your earlier evidence. The Treasury this morning said that they would be happy for you to deal with the subject, and that whatever you said we could take would represent their point of view as well. Would you like to say anything as a start?——*Mr. Cobbold*: In view of the lapse of time since the Bank's main evidence was given, I should like to make three observations.

I would first recall that the Bank's written evidence was prepared in the spring of 1957. As I then stated in my covering note,* these papers "were written against the background of a continuing battle against inflation. If the tide should turn and we should find ourselves fighting a slump, a new set of problems would arise, certainly no easier to handle". In the last twelve months the tide has in fact been a different one, though it is fortunately something less than a slump that we have had to fight. Had the papers been written in 1959 instead of 1957, the emphasis might therefore not have been quite the same; but I do not think that we should have wished to amend the general tenor of our evidence.

Secondly, whilst a part of our oral evidence was given in the autumn of 1957 and therefore to some extent covered the events of September of that year, I ought perhaps to confirm, in the light of later experience, the broad views which I expressed about those events, then very recent history, towards the end of the hearing on 5th November, 1957, for example on Questions 2031, 2037 and the following ones.

Thirdly, on the question of Issue Department policy and our attitude towards long-term interest rates, I should like to confirm the statement made by the Chief Cashier at my request in answer to Qn. 11919, and his subsequent replies to Qns. 11920, 12000 and 12001, to the effect that, whilst the main evidence which I gave on the subject (Qn. 1762 *et. al.*) stands, restraint on the rise of long-term security prices by funding operations was exercised more consciously in 1958 than in the period previously under review.

Turning to the general monetary experience of the last eighteen months, although the problems have been different from those of the period covered by our main evidence, we have not found anything which would lead us to modify the broad lines of that evidence. In this period, as in the earlier period, when considering Bank Rate and other aspects of monetary policy, we have had to take into account the realities of the domestic economy, the problems of Government finance, the exchange position and relative interest rate movements overseas, and also psychological reactions at home and abroad.

In the six months following September, 1957, our main concern was to consolidate the improvement of confidence in the currency, both at home and abroad. We were anxious to take no step which, by too early relaxation, might suggest any weakening in the resolution shown by the measures of 19th September.

From March, 1958, onwards we had to set this anxiety against the need for an easier money policy to help in fighting the developing threat of recession. On the one hand was our general concern not to set in motion any new wave of distrust in the currency or in fixed interest securities—a distrust which we felt to be always not far round the corner—while on the other were the slackening in the economy, the continued strength of sterling and the downward movement of interest rates in other centres. With all these considerations in mind, Bank Rate was reduced in three stages to 5 per cent. by midsummer, the change being delayed on each occasion for psychological reasons for a few weeks after it would have been justified by purely market considerations, and thereafter in two stages to 4 per cent. by Christmas. I have discussed these matters in rather more detail in various speeches (at Grosvenor House on 26th March, 1958, the Mansion House on 16th October, 1958, and in Leeds on 23rd January, 1959), of which copies have been made available, and I should be grateful if the relevant extracts might be on the record.*

Parallel action was taken in other monetary fields, notably by the relaxation of the credit squeeze in the early summer—giving rise to a significant, and still continuing, rise in bank advances—and by changes in the hire purchase field in the summer and autumn. Over this period long-term interest rates were tending to fall gradually, but as has already been stated an active funding policy was pursued, both on its merits and, in a more conscious way than earlier, to act as a brake on the rising tendency of long-term prices. Funding operations took the form both of net sales and of lengthening the debt by selling longer-term against shorter-term securities.

In the early part of this year serious consideration was given to a further reduction of Bank Rate, which for several weeks was constantly expected and which would have been justified by market pressures and by some inflow of foreign funds. But it was decided not to make a move, mainly on the grounds that we did not judge it likely to have much effect at that time on business activity, that bank advances were still rising steeply, that interest rates in the U.S.A. were hardening, and that it seemed wiser to wait until the effects of the Budget could be seen. During this period, though funding operations continued, they were pressed less strongly, and no difficulties were put in the way of banks selling securities to restore their liquidity and so maintain the increase in their advances; long-term interest rates showed little change.

That, I think, brings the main lines of the story up to date. We are preparing, and will make available, a brief historical note bringing the Exchequer and banking figures up to the end of 1958.†

13417. When you referred to the psychological reasons that delayed the reductions of Bank Rate which took place, what had you in mind?——We were concerned with the idea of not giving any feeling of too quick relaxation; we wanted it to be felt in the market that the pressures were building up so that we more or less had to make this move, and not to look as if we were in a great hurry to make this move.

13418. *Professor Sayers*: Would it be fair to say that you were anxious not to allow any impression that previous policies were being reversed, and therefore waited until, consistently with the principles which had dictated previous policy, you could change your front?——I would almost accept that, though of course conditions were a little bit changing. As I have said here, we were trying to meet two perhaps slightly conflicting objectives; we wanted gradually to ease a little but we did not wish to do it too quickly, for the reasons which you give.

13419. It was the change of conditions that allowed the change of policy; it was not a departure from views about how the September situation should be treated?——Not at all.

13420. *Chairman*: I wonder if I could put it in another way, to see if I could get your mind on this: when market conditions look as if they might justify or require an alteration of Bank Rate, it is your policy not to give the impression that those market conditions lead to that result?——I should prefer to put it more *ad hoc* for the particular decisions we were talking about. I think our feeling was that, if we reduced Bank Rate, on any of those three occasions, in the first week or so in which the public and the market and the Press were beginning to talk about a reduction of Bank Rate, that might give the feeling that we were very anxious to relax very quickly. We therefore preferred to let this talk go on for a while, to accustom people's minds to the fact that market conditions

* Memoranda of Evidence Part I, No. 1.

* See Memoranda of Evidence Part I, Appendix 1.

† See Appendix to Minutes of Evidence.

were suitable and in fact encouraged some reduction, and only after that had been going on for a few weeks then to make the move.

13421. *Sir John Woods*: When you talked about the psychological reasons, you said you did not want the market to sense any weakening of the resolution which had inspired the previous measures. Did you mean the markets at home only, or were you also concerned with foreign markets?——I meant the public generally, both at home and abroad; possibly abroad more than at home at one or two stages.

13422. *Chairman*: That brings me back to something which we have asked you questions on before, but about which I am not quite clear in my own mind: what is the real difference between an alteration of Bank Rate for technical reasons and an alteration of Bank Rate for general reasons?——I think there are always some technical reasons for any alteration of Bank Rate. There are occasions when the technical reason is the main and almost the overriding reason, and when there is no real policy significance to be read into the change. That was certainly the case in one or two of the changes which we have talked about earlier.

13423. In that case the condition of the market suggests by itself that a change would be the reasonable and natural course?——And we reach the view that there are not likely to be any strong policy effects of making that move. It implies those two things to make it what we would call a "technical" change.

13424. *Professor Sayers*: You are saying, I think, that the market has developed a certain situation, and you feel that that situation constitutes a technical condition in which a Bank Rate change is highly desirable, perhaps even inevitable. What markets are you thinking of?——In my opening statement, speaking about the reduction in three stages to 5 per cent. by midsummer, I said that it was "delayed on each occasion for psychological reasons for a few weeks after it would have been justified by purely market considerations". The sort of things I have in mind there are partly the exchange position, and the exchange market; partly the movement of foreign funds; partly the movement of the Treasury Bill rate; possibly on occasion (I could not be certain whether that applies in any of these three occasions) the movement of short-term rates generally other than Treasury Bill rates; and general market gossip and City opinion: feeling in the stock markets.

13425. Do you not regard the Treasury Bill rate as very much under your control?——Finally to a considerable degree under our control. Pressures can certainly develop in one direction or another, and we then have to come in, if we wish to, to control them; these pressures give us a line on the way that that particular market is thinking and acting.

13426. How do you sense those pressures?——Partly from what people tell us and what we hear and what we read, and partly from the operations of the people concerned.

13427. But would not the operations of the people concerned very largely reflect, after Bank Rate had been put down to 4 per cent., their anticipations of what you might do next?——Their anticipations of what we might do next are a part of their general anticipation of future conditions, and that is all a part of the general market sentiment.

13428. There is a difference between what has happened in the last five months and what happened in the five months March to August, 1958. In both periods you had the development of market feeling that Bank Rate should come down; is that right?——Yes, but not throughout the whole of the second period. I would have said that the period in which there was a strong expectation of further reduction of Bank Rate in the early part of this year was not more than three or four weeks.

13429. For that period of three or four weeks the market expected it to come down, and you knew that; that was one of the market circumstances of the moment. But you had the other reasons for ignoring that market condition?——We regarded the other reasons as overriding.

13430. *Chairman*: And those were what you would call policy reasons?——As I said in my opening statement, "... we did not judge it likely to have much effect at that time on business activity, bank advances were still rising steeply, interest rates in the U.S.A. were hardening, and it seemed wiser to wait until the effects of the Budget could be seen". Those were all policy reasons, though I do not know whether hardening of interest rates in the U.S.A. is a policy reason; that is more a market reason on the other side.

13431. *Professor Sayers*: When you say that it is a market reason you are thinking, I suppose, of the danger that if London rates dropped much further there would be more borrowing in London, some stopping of the movement of funds into London, and so on?——Or possibly a reverse movement.

13432. Yes. Was there a very big movement of funds into London uncovered?——We think that there was quite a considerable movement, but it is very difficult to quantify. Before September 1957, and at the moment of the crisis, everybody had run their normal London funds right down to the bottom, and by and large nobody was carrying any sterling balances beyond their minimum day-to-day requirements; so there was a good deal of natural building up to a normal level before one got to talking about an influx of hot money or anything of that sort. We would judge that since November or the turn of the year there has been a bit more than that, and something more has come into London than the mere restoration of an ordinary level of balances; but, as I say, it is very difficult to quantify.

13433. And this relationship of international interest rates was an important factor in your minds in not dropping bank rate further?——Yes, partly from the comparative interest point of view, and also from the psychological point of view that, if when rates were hardening in other places we were going the other way, that might be interpreted as a change in our determination to maintain the September 1957 policies.

13434. Do you envisage this tying together of international interest rates as something that is likely to continue, and perhaps develop further?——It is always a factor that has to be borne in mind and cannot be disregarded.

13435. *Sir Oliver Franks*: Can one perhaps go a little further on that, and say that, so far as major currencies are all in a relatively healthy state, the interest rates in the different centres do more to determine people's actions?——Yes.

13436. And fears about the currencies correspondingly affect their actions less?——I think that that is absolutely accurate and very important.

13437. This interest comparison has been a factor over the period?——Certainly; in fact a much stronger factor than in the earlier periods when people were more concerned with possible crises in one or other of those currencies.

13438. So that, while clearly what future years may be like cannot be known with any certainty, if the state of affairs which has prevailed in the last six or seven months were broadly to continue, the sort of view which one might take about monetary measures generally would be rather different in its emphasis than it was over most of the years between 1947 and 1957, in that the relation of interest rates would become a comparatively more important factor?——I agree.

13439. *Professor Cairncross*: You did say that you found it very difficult to quantify this factor. It may be rather important to us to have some conception of the size of the differential that you think begins to have a real effect on the movement of funds, particularly the differential between New York and London rates. Do you feel you are constrained by the movement of rates in New York at all times?——We have to have regard to the movement of rates in New York at all times; "constrained" would be rather a strong word.

13440. I put it in quantitative terms: if the New York rate were to rise to 5 per cent., would you feel that the London rate, except in abnormal circumstances, would have to be kept above the New York rate?——I should find it very difficult to answer that without saying something about American policy, which I could not say for the record.

13441. Then I will not press the question; it is more a matter of knowing whether you feel in general terms that

London short rates are likely to have to remain above New York rates, not just in the immediate future but during the 1960s?——They are practically level now; the difference is absolutely marginal. The main consideration there is the relative confidence in currencies, which would very much affect the answer to that question.

13442. Do you visualise that the response to a difference in rates is of a character that exhausts itself quickly and is once for all, or do you think of it as being a continuing pressure on our resources of foreign exchange?——May I take it in much more general terms than any particular rates in any particular centre? I should not be bothered about the rates in any centre being materially above ours if there were other factors suggesting any discouragement of a movement of funds to that centre, so that there were circumstances in which the rates in other centres could be materially higher than our own rates without encouraging a flow of funds in that direction.

13443. We are in some difficulty here, because the evidence suggests that the movement of funds in response to a difference in interest rates is not very large; and that rather implies that one can afford if necessary to ignore the difference. At the same time we are faced with the evidence of the last year or so which may point to a larger flow of funds in response to an interest differential. Do you feel that the scale on which funds would flow could become really so large as not to be capable of being withstood?——As Sir Oliver Franks was saying, the more you get general steadiness and a sentiment that, other things being equal, all currencies are equal, then I think the importance of this factor increases all the time. Where there are doubts about inflation in one country or other sorts of difficulties in another country, then I think that this factor is much less important. I cannot prophesy about the movements in the world over the next five years, but if the sort of atmosphere on currency matters that we have had over the last twelve months, and in particular in the last six months, were to become more permanent, and general opinion were to take a much more equal opinion about currencies, then this factor might become much more important, and a wider variety of people and institutions might think in those sort of terms. Up to the present I should say that it is very technical money that moves for interest rate differentials, so long as those differentials are very small; but, as Sir Oliver says, if you get a more widely developing feeling of confidence about the world, then those movements might increase very considerably.

13444. *Lord Harcourt*: I think we all recognise that what you call technical money will move very fast from one centre to another; can you give us any idea, presupposing an absolute level of confidence in two currencies, what differential begins to move money, other than what you might call the professional money, in large sums across the exchanges?——I do not find that an easy one, but I will hazard a guess: I should think at about ½ per cent. or 1 per cent, lasting for a period of a few months. I do not think that it would move at ¼ per cent. or ⅛ per cent. lasting for two or three weeks.

13445. Because people do not think it worth while to go through the operation?——People do not look at it.

13446. *Professor Sayers*: Is the order of magnitude of what Lord Harcourt has called the professional money sufficiently small not to make a great dent in the reserves?——As of today it would not embarrass us unduly.

13447. *Chairman*: You spoke a little while ago about the run-down of overseas sterling balances in September 1957 being an important element; in your view had they run down to the minimum possible by mid-September? I am actually thinking of sterling balances held by non-sterling countries?——So far as the big banking and commercial institutions were concerned, my general experience was that they had run very low indeed; but there are of course all sorts of other sterling balances which for one reason or another were not or could not be run down.

13448. If they could not be, then I want you to regard them as excluded from my questions: were there other forms of sterling balances, apart from the ones of which you have spoken, held by non-sterling countries, which were capable of moving but still had not moved?——Certainly.

13449. *Professor Cairncross*: When you spoke about the magnitude of the differential to which people respond, had you in mind also a switch of borrowing operations?——Certainly; I regard the two things as different sides of the same penny. In fact, as I have said in earlier evidence, at certain times we have been more impressed by the switch of borrowing than by the switch of short funds.

13450. *Professor Sayers*: So that, although the restoration of confidence in sterling frees us from embarrassments due to the exhaustion of reserves when confidence in sterling falls, the build-up of confidence in the maintenance of exchange parities generally tends to expose us more completely to international monetary conditions; is that right?——I would put it in a slightly different way: the extension of freedom of currencies, of which confidence in currencies is a part, tends to unite the world in these matters.

13451 What had you in mind in saying that one of the factors for not dropping Bank Rate further was that bank advances were still rising steeply? Was it that it was taken as a sign that business was picking up or would pick up, or was it something else?——It was taken as a sign that a further "shot in the arm" was not necessary, because the expansion of credit was happening without the further shot in the arm which a reduction of Bank Rate might at times be.

13452. Would you have expected a further reduction in Bank Rate to cause a further expansion?——As I say, we judged that it was unlikely to have much effect at that time on business activity, partly because bank advances were going up in any case.

13453. *Chairman*: Is there anything you would like to add on the question of the Bank's attitude towards long-term interest rates?——I have referred to the fact that our funding policy during the past eighteen months has rather more consciously kept in view its moderating effect on the rise in gilt-edged prices; that was the subject of some discussion you had with the Chief Cashier and the Government broker.* Perhaps I might enlarge on that a little.

In a period when general policy has been moving from restriction to expansion, there were clearly arguments in favour of lower long-term interest rates. We have welcomed a gradual reduction: in fact between September 1957, and March 1959 the yield on 2½ per cent. Consols has declined, in round figures, from 5½ per cent. to 4½ per cent., on first class industrial debentures from 6½ per cent. to just under 6 per cent., and on industrial equities from 6½ per cent. to 5½ per cent. It is however true that the slowness of the movement has helped to keep up the cost of investment in certain directions. It is therefore arguable that the rate of movement could with advantage have been faster, although we should judge that minor changes in the cost of borrowing would not have had an influence on investment plans at all comparable with the influence of industrialists' judgement about the future level of demand and their desire to see how all the investment they have done in recent years works out.

But we took the view that our prime objective should be to encourage savings and to consolidate and maintain confident markets; and that in the somewhat longer term this was the best contribution we could make in this field to investment and development. Meanwhile, as relaxation became possible, it could be made in the availability of credit and new capital as effectively and with less risk than in concentrating on the cost of long borrowing.

It must be remembered that the gilt-edged market had been having a very bad time, and there had been dangerous signs of a general flight from fixed interest securities. The patient was making a good recovery, but needed careful nursing over a long period. A relapse might have had very grave consequences.

In the absence of official action, gilt-edged prices would doubtless have risen more than they did. An opportunity would have existed for gilt-edged speculators, which would have accentuated the rise; but the reckoning would have come at the end of a few months. We should then have had either to allow natural forces to reassert themselves, with a big setback in the market, or to prop the market up more or less where it had got to, which would have entailed financing Exchequer needs and debt maturities by

* See Questions 11919 *et seq.*

increasing the floating debt. The first course would have meant another crisis in gilt-edged and fixed interest securities generally—a recurrence of the illness. The second would have held it off for a time, but with a return of inflation fears it would have become inevitable in the end.

All through this time it was necessary to minimise the risk of a return of inflation fears. If movements had been faster than people thought safe, nervousness would have appeared again both in the gilt-edged market and in the exchange market. They would have reacted on each other.

Moreover, although in the ruling circumstances this would not have been an overriding consideration, from the point of view of "funding" it is helpful to have a gilt-edged market which feels that, as regards reductions in Bank Rate in particular and interest rates in general, there may be more to come. Once the market feels that rates have touched bottom, this underlying reason for strength no longer exists, and more or less continuous "funding" becomes much more difficult. There is thus a tactical advantage, from this angle, in moderating the fall in yields.

It is perhaps fair to mention in support of the policy adopted our experience since Bank Rate was last reduced, to 4 per cent. on 20th November last. Expectation of a further reduction has certainly been evident at times, but has become less strong more recently. Meanwhile the banks are known to have been sellers of gilt-edged on a considerable scale—mainly, it is true, at the short end—and it has not been possible, or indeed necessary, to continue "funding" on the scale of earlier months. Yet the market has faced up well under the impact of these sales; the patient seems now able to lead a more normal life, and the market remains reasonably healthy.

13454. It is apparent from what you say that for eighteen months the Bank has exercised consciously something like a controlling influence?——A restraining influence, I would say, rather than a controlling influence.

13455. But because of your feeling that it was right to restrain, you have effectively succeeded in achieving the restraint of a rise in the long-term gilt-edged market?——We have certainly moderated it.

13456. Do you say that that effective restraint which you achieved was possible only under certain special conditions and is not to be regarded as something which, by and large is generally possible for the Bank?——The conditions of the last eighteen months, and certainly the first twelve months after September, 1957, were conditions in which it was possible to do that much more than on most other occasions.

13457. There was a market which was really too low, as I understand it, and therefore your funding was on a larger scale?——We had a 7 per cent. Bank Rate and a pretty high rate structure all round. It must have been pretty obvious to everybody that we should not wish to maintain the 7 per cent. Bank Rate indefinitely, or indeed for longer than we had to. That must have meant that short-term rates were likely in a foreseeable period to come down sharply. That would give an inference to the market that long-term and medium-term rates would fall at least to some extent. The natural market tendencies were therefore to buy gilt-edged over that period. As I said in my main evidence on Issue Department policy, we always have this funding problem before us, and we are known to be always, or almost always, potential sellers of the long term securities. In circumstances such as those in the period I have mentioned, we obviously had more freedom of choice to continue our funding policy more or less vigorously. We have much more variety of possible courses of action in a period like that than we should have normally.

13458. *Professor Sayers*: If your description of the state of opinion after the 7 per cent. Bank Rate is right, why did not insurance companies, other financial institutions and private investors buy gilt-edged on a simply tremendous scale? Must there not have been some doubt to account for the fact that you did not sell on a vastly greater scale than you did?——Certainly there was a doubt that inflation might remain; as I said "the patient had only just recovered from a major illness and wanted a long period of nursing".

13459. And that implied a doubt as to whether rates of interest were really coming down?——Or whether they were going to stay down.

13460. If there had been an expectaton that they were going to come down, even though they might not stay down, then people would surely have had an incentive to charge into the gilt-edged market on a huge scale?——That is something very like what I said, that if we let this go absolutely we should have had a very big speculative market in gilt-edged.

13461. When you were describing the state of opinion, you were saying that people did in fact think that rates were coming down; but surely that cannot have been the general expectation, or people would have bought on a much greater scale than they did even at the prices ruling in the spring of 1958. After all, people who bought in the spring of 1958 have been able to make a handsome profit; why did not more people do it? Must they not have been impressed by the fact that long rates were not coming down so very quickly?——I think you are saying the same thing as I am: that there would have been a major speculative boom if we had not followed the policy we did follow.

13462. Is not the moral that the market's expectation of the future course of rates was influenced by your action in keeping rates up?——I think it was.

13463. *Professor Cairncross*: In that sense it was not an altogether abnormal situation?——The underlying facts were surely abnormal, because rates were so high.

13464. But the market's view of what you were likely to do might have also been different in other circumstances?——It might.

13465. I think you were more specific in what you said to Professor Sayers: the dominating fact was that the market knew you were funding, and therefore was influenced by your actions?——Yes, certainly.

13466. But it was not perhaps as obviously influenced in previous situations where long rates were coming down?——We did not have a previous situation where anybody was expecting a Bank Rate movement from 7 per cent. to 5 per cent. or 4 per cent. over a fairly foreseeable period.

13467. There had been periods of very rapid falls in the long-term rate.——*Professor Sayers*: In 1921, for instance.—I am afraid that I cannot remember about 1921.

13468. *Chairman*: But your general position on this would not lead you to dispute that the fact that the Government is a consistent borrower in the long-term market, as it has been in these years, gives it an influence on the course of gilt-edged prices that it never had before 1939?——I would not wish to go beyond my main evidence on this subject. It has an influence, because of the known need to sell long-term over a period, and because of the continuous funding and Issue Department operations which are a part both of new issues and of refinancing; and that influence is certainly greater than it was in the old days.

13469. *Professor Sayers*: And is recognised as being greater?——I would say so.

13470. *Professor Cairncross*: Towards the end of your remarks you spoke about the market in the later part of the period as having been able to absorb quite a large quantity of gilt-edged fairly smoothly; you were speaking, if I remember rightly, about sales on the part of the joint stock banks. Was it your experience over that period that it was easy to put large quantities of short bonds on the market? Was there a free market?——*Mr. O'Brien*: We helped to make a free market, in the sense that the banks were large sellers, and where the market could not absorb those sales immediately we absorbed them and then sold the stock later on; we did that with success.

13471. It was suggested to us by the clearing banks that there had been a period of some difficulty in disposing of short bonds?——*Mr. Cobbold*: Not in the latest period.

13472. *Professor Sayers*: What about the closing months of last year?——*Mr. O'Brien*: I would not have said that there has been any real difficulty since last October. It is not made utterly painless, but there has been no real difficulty.

13473. *Professor Cairncross*: You were willing to assist with switching operations; I take it that that meant in practice that outright sales were also facilitated?——Indirectly. It is a fact that a large part of the sales made by the joint stock banks were made when the market was in a poor state.

13474. *Professor Sayers*: Were other buyers active at this time?——Not precisely at the same moment, but over the period they have been.

13475. During the last months of last year?——Yes.

13476. The discount houses?——It is not possible to be precise about who the buyers were, but the fact is that the stock which we had to absorb in the first instance was sold subsequently, to all sorts of buyers.

13477. You are talking about short bonds?——Short to short-medium.

Chairman: Then I think that completes our questions, Mr. Governor. As this is likely to be the last time we meet you as a Committee, I should like to say that we are very much obliged to you and your colleagues, not only for your visits to us but for all the work you have done and the paper you have given us.——*Mr. Cobbold*: Thank you very much, Mr. Chairman; it has been very interesting to us.

(*Adjourned*)

APPENDIX

Supplementary Notes Submitted by Witnesses in response to Questions in Oral Evidence

Question 15 (Bank of England)

The Committee of London Clearing Bankers announced on 5th December, 1946, that

"taking into account the general disposition of bank assets now ruling it has been agreed in consultation with the Bank of England that the daily ratio of cash balances to deposit liabilities will be maintained on the basis of 8 per cent."

Question 412 (Bank of England)

The discount houses did not gain resources at all; they lost substantial amounts over the first quarter of the year 1957, as is indeed the normal pattern. Their holdings of Treasury Bills, however, fell further than did their total assets, the movement in Treasury Bills being partly offset by a sharp increase in their holdings of short bonds. In effect they exchanged for short bonds part of the bill portfolio with which they would have been left despite the seasonal Exchequer surplus and the demands of the banks for Treasury Bills. Their motive was presumably the expectation that with falling interest rates, holdings of bonds would be more profitable than holdings of bills. The ultimate source of the great bulk of the additional bonds they acquired was no doubt the Departments; and the Departments would have completed the circle by using the proceeds of their sales of bonds to buy in Treasury Bills from the market.

Question 560 (Bank of England)

1. The growth of a Canadian capital and money market, which began in the early years of the century, was speeded up with the establishment of the central bank in 1935 and by the great expansion of Government debt—particularly short-term debt—which occurred in the Depression and World War II.

2. A large number of firms have been active dealers in Government securities for many years. They have underwritten new bond issues by provincial and municipal governments and by corporations, maintained secondary markets (on an over-the-counter basis) in all types of outstanding bonds, and carried trading positions in seasoned Government issues. (The stock exchanges do not deal in bonds and these specialised bond dealers are not stock exchange members, although they are often closely connected with member firms.)

3. A tender for Treasury Bills, approximately fortnightly, later underwritten by the Bank of Canada, began in 1934 and the chartered banks purchased bills which they used as second line reserves to maintain their statutory cash ratios. The liquidity of the bills was guaranteed by the Bank of Canada's willingness always to buy at a rate close to the latest average tender rate involving no penalty; to prevent an excessive supply of Treasury Bills in the hands of the banks, the amount outstanding was kept relatively constant ($450 mn. from 1945 to the end of 1952) and the Bank of Canada submitted a regular tender for its own account. While the amount of Treasury Bills held by the banks was sufficient to allow the adjustment of short run and seasonal fluctuations in their positions, sale of the bills to expand loans to customers would have left them with inadequate second line reserves and they were also discouraged from running down their holdings by the Bank of Canada's frequent refusal to sell bills, although they would always buy. The banks dealt almost exclusively with the Bank of Canada and not with each other, while non-bank holdings of bills seldom exceeded 20 per cent. of the total outstanding and were not as a rule the subject of transactions with the banks. Inadequate facilities were available to dealers to finance money market portfolios as call loan rates were appreciably higher than short-term government bond yields and a certification charge (charged by banks for certifying dealers' cheques against funds to be received later on in the day) discouraged dealings in short-term securities. The Bank of Canada did not act as lender of last resort to the dealers and the chartered banks received the proceeds of bills sold to the Bank of Canada immediately and naturally saw little reason for persuading their customers to invest their deposit balances in bills.

4. In 1952 consideration was given to the setting up of a more active Money Market, the establishment of which presented a number of advantages. The Bank of Canada would have greater control over the credit base because there would be a reduction in the excess cash reserves of the chartered banks; in addition, and though not contemplated at the time, it greatly facilitated the subsequent establishment of a secondary reserve ratio. The chartered banks would be able to increase the proportion of their earning assets to their deposit liabilities and thus increase their profits (as another aspect of their ability to reduce their excess cash). The Government would find a broader and more diversified market for their short-term securities and the public would be better able to invest their short-term funds.

5. It was central to Canadian thinking from the first that their money market should be designed to develop a substantial non-bank interest in short-term paper, including Treasury Bills, short-term Government bonds and short-term commercial notes and debentures. They had noted that the London mechanism of the discount houses was primarily concerned with dealings with banks, including overseas and foreign banks, and they felt that their own circumstances required an outside source of money to be tapped in order to facilitate adjustment of the cash position of the various banks. The capital positions of the money market dealers would be far from adequate for this purpose, and in any case they felt that a better market would develop if some hundreds, and possibly thousands, of outside investors could be interested in placing short-term funds in the kinds of investments mentioned.

6. When in 1953 and 1954 the Bank of Canada took steps to stimulate the further growth of the money market by making central bank credit available to firms wishing to assume money market responsibilities (paragraphs 11 and 12 below) it would not have been practicable or desirable to limit the use of their facilities to new specialist entities comparable to the discount houses in London. There were important advantages in allowing the money market function to continue to be linked with the underwriting function and with established organisations. The diversified operations of the established firms reduced the overhead expense directly chargeable to money market activity and permitted finer dealing than would otherwise have been possible. This diversity also provided a buffer against possible unprofitable periods in money market operations. The established firms in the Canadian market maintain a network of branch offices across the country and already had a tradition of strong competition with one another which has been carried over to their money market acivity. Their highly competitive approach to their job has militated against the establishment or maintenance of restrictive conventions or of tied relationships, e.g., in security dealing between banks and money market houses, and has helped to foster a more flexible and responsive money market.

7. The Canadian Money Market, which operates both in Toronto and in Montreal, was built around the bond market and there are no discount houses as such. There is no physical market place, dealings taking place mainly by telephone. The main participants are the Bank of Canada, the 9 chartered banks and about a dozen investment dealers who are important jobbers in short-term Government securities. The Government themselves and certain corporations, finance houses and insurance companies are also involved but play a lesser part.

8. The main stock-in-trade of the market is short-term Government paper and Treasury Bills. There is some commercial paper of the large corporations and finance companies, which is normally placed by the dealers direct with the lenders, but the volume is not very large. As at the 29th October, 1958, the total Treasury Bill issue amounted to $1,495 mn. out of total Government obligations of $16,007 mn. Of this amount—

the Bank of Canada held ...	$86 mn. (6 per cent.)
the chartered banks between them held	$951 mn. (63 per cent.)
other investors (mainly corporations, insurance companies, etc.) held	$458 mn. (31 per cent.)

9. There is a weekly tender for three-month Treasury Bills. The tender is mainly supported by the dealers and the banks who tender not only on their own behalf but also on behalf of clients and customers. The Bank of Canada itself submits a sealed standby bill but there has, in practice, never been any difficulty about covering Government requirements in the market. The Bank of

Canada normally holds a sizeable amount of Bills maturing each week and if it assumes a strictly neutral course it will subscribe for the same amount of a new issue at a price at which it is reasonably confident of obtaining its requirements. But, in accordance with the demands of monetary policy, the Bank may from time to time bid for a larger or for a smaller amount of Bills and thus add to or subtract from the cash in the market as a supplement to its ordinary open market operations.

10. The chartered banks are required by the Bank Act to maintain in holdings of Bank of Canada notes or on deposit with the Bank of Canada, as a minimum cash reserve, a percentage of their Canadian dollar deposits. This may be varied between 8 per cent. and 12 per cent. but the figure has never been changed and at present is 8 per cent. In addition, the banks have agreed to maintain a liquid asset ratio (that is to say, cash, day-to-day loans and Treasury Bills as a percentage of total deposits) of not less than 15 per cent.; but unlike the statutory 8 per cent. cash ratio there is no legal basis for this and it depends for its effect on the co-operation of the banks. Both the statutory cash ratio and the agreed liquid asset ratio are based on a monthly average of daily positions and for individual banks may fluctuate widely during the month.

11. Both the chartered banks and the approved investment dealers have access within prescribed limits to the Bank of Canada at Bank Rate. The Bank Rate has, since November, 1956, been automatically set each week at $\frac{1}{4}$ per cent. above the average yield at the weekly tender for three-month Treasury Bills and under orderly market conditions is thus a penal rate. The Bank of Canada's advances to the chartered banks are made for seven-day periods and are subject to specified limits which vary with each bank, according to the level of its deposits, and which are subject to review from time to time. In practice, the banks are discouraged from coming to the Bank of Canada more often than once a month but if they have need of a second advance or a renewal or an increase in the specified amount, the Bank of Canada will provide the necessary cash but only on terms which are strictly subject to negotiation and at a higher rate than Bank Rate.

12. Accommodation for the security dealers takes the form of sales of short-term Government securities to the Bank of Canada under agreements to repurchase them within a specified time. Each dealer has a limit as to amount up to which the Bank of Canada will meet his requirements for a maximum of 30 days at prices which correspond to Bank Rate; dealers have the option of repaying these loans at any time. In practice, this costs dealers something if they bring in Treasury Bills but they may get a small running profit by bringing in Government bonds, which are eligible for this purpose if they mature within three years. The total of the lines of credit is far in excess of the use which is normally made of them and as the dealers take recourse to the Bank as a warning to trim sail the denial of the facility is a weapon which does not have to be used.

13. The chartered banks extend day-to-day loans to the dealers against Government securities maturing within three years. These loans are callable by either side up to 12 noon each day and if not called are automatically renewed. The dealers have agreed with the Bank of Canaoa that they will not allow the total amount of their day-to-day loans from the banks to exceed the amount of their unused line of credit at the Bank of Canada.

14. The Bank of Canada operates continually in the market to keep in touch with it and to regulate the supply of cash in the hand of the banks. Open market operations are therefore the principal method of monetary control and are conducted throughout the whole range of maturities. It may be noted that as one consequence of the free exchange rate for the Canadian dollar the Bank of Canada is not under any obligation to buy foreign exchange and thus put cash into the market. The Bank Rate has in one aspect limited significance because the banks infrequently use their facilities for borrowing from the Central Bank. In another aspect the fact that Bank Rate normally follows moves in market rates may help to make it clear that responsibility for changes in rates—including changes in long-term rates—lies with the market's actions in making loans and seeking cash. Additionally the Bank of Canada retains full discretion to adjust Bank Rate independently with a view to obtaining special results. The chartered banks can adjust their cash positions through purchases and sales of Bills and through day-to-day loans to the dealers. The dealers, financed by these loans (or, if necessary, by borrowing from the Bank of Canada) are enabled to finance an adequate portfolio of Bills and short-term Government securities from which they can normally meet demands for any particular maturity. The Bank of Canada's own dealing rates for Treasury Bills are spread wider than those in the market; the banks are thus encouraged to deal in the market first if they can before indulging in direct dealing with the Bank of Canada.

15. It is the practice of Canadian underwriters of new bond issues to concentrate on fulfilling their commitments through as rapid distribution as possible to ultimate investors. Some of them have found that operations in the money market have the useful by-product of helping them to appraise the basis and timeliness of their underwritings by keeping them in close contact with shifts in the liquidity of the banking system, of the various levels of government and of business generally. In Canada businesses have increasingly followed the practice of employing a substantial portion of temporarily surplus working capital in the money market through loans to dealers, or the purchase of short-term securities, frequently offset by resale agreements, and the proceeds of new capital issues are also often employed in the money market pending ultimate disbursement.

16. The Canadian Money Market is still in the development stage and it would be wrong to regard it as being built up according to any set pattern. The first objective in 1952 was to get a market going and many of the features described above have been added one at a time over the succeeding years partly in response to the appearance of a radically different monetary climate.

17. There may be some significance in the fact that limits have been set on the facilities available from the Central Bank to both commercial banks and security dealers. These limits have not so far had any practical effect because the market has not made use of the facilities to any great extent but they may be taken as indicating a desire on the part of the Bank of Canada to safeguard themselves against the possibility of unlimited monetisation of short-term Government debt.

18. As the Canadian market has emerged, however, its similarities to the London market are at least as notable as its differences and do not lend support to the suggestion that Canada has studiously avoided copying London. In particular the creation of a small group of security dealers (with limited access to the Central Bank as lender of last resort) to form the basis of a call loan market and to act as a buffer between the banks and the Bank of Canada; the agreement between the bank of Canada and the commercial banks for a minimum liquidity ratio and the penal level for the discount rate all bear a marked resemblance to the London model.

19. It would perhaps be more correct to say that in developing their money market the Bank of Canada have been concerned to build as effectively as possible on to their existing market framework, which already provided the valuable foundation elements of financial strength and a tradition of competition. They have not tried to copy or to avoid copying other systems but simply to develop the existing machinery along lines which seem best suited to local conditions and needs.

Question 602 (Bank of England)

The Report of the Deputy Master and Comptroller of the Royal Mint for 1955 stated:

"The estimate of the coin in circulation at the end of 1955 was:

	Value £ *mn.*	*Million pieces*
(a) Silver and Cupro-Nickel:		
Five Shillings	2·1	8·4
Halfcrowns...	46·3	370·7
Florins	40·2	401·6
Shillings	37·7	754·2
Sixpences	25·5	1,019·3
Threepences	·9	73·6
	152·7	2,627·8
(b) Nickel-Brass:		
Threepences	7·2	575·6
(c) Bronze:		
Pence	6·9	1,650·1
Halfpence	1·8	874·6
Farthings	·2	235·4
Total	8·9	2,760·1
Grand Total	£168·8	5,963·5

(These estimates were based on differences between the recorded issues and the recorded withdrawals of the respective denominations; deductions were made in respect of coins estimated to be in circulation in the Irish Republic, and, in the case of the bronze denominations only, for wastage by loss and destruction. The evidence suggests that wastage from these causes in the higher denominations is negligible)."

Question 619 (Bank of England)

This involves obvious difficulties but the following figures represent the best estimate we can make. No account can be taken in the calculation of compensation stock amounting to some £400mn. nominal issued for coal and road haulage assets and railway wagons, since the securities of the companies which previously owned these assets were not vested. For the rest, compensation stocks amounting to approximately £1,930mn. nominal were issued, of which approximately £200mn. nominal was in respect of the securities of bodies already publicly owned. Of the remaining £1,730mn. nominal of compensation stocks, £1,200mn. nominal, or roughly 70 per cent. was in respect of securities carrying some kind of equity interest and £530mn. nominal, or 30 per cent. in respect of loan stocks, debentures, etc.

Questions 709 *and* 710 (Bank of England)

A search of available records has revealed no case of default by a Local Authority, during this century at least; and enquiries of the Stock Exchange, the Public Works Loan Board and in the Market support our belief that no such default bas occurred.

As regards forgeries, in 1929 the Hatry Case revealed that Loans issued by the Corporation & General Securities Ltd. on behalf of the undermentioned Local Authorities had been deliberately over-issued by the creation of spurious scrip in excess of the amounts authorised by the borrowing Authorities:—

Local Authority		*Total amount of the loan* £	*Scrip issued* £
Swindon Corporation	...	500,000	750,000
City of Gloucester ...	...	500,000	750,000
Wakefield Corporation	...	750,000	1,150,000

Question 818 *and* 819 (Bank of England)

At the time under review, while buying and selling could take place freely in commodities other than grain, cotton or refined sugar either in sterling or in the currency appropriate to the country of the seller/buyer, coffee, cocoa and raw sugar of non-dollar origin if paid for in dollars or American account sterling could be sold only for dollars or American account sterling.

Question 827 (Bank of England)

Mr. Parsons's reply is confirmed.

Participants in all the commodity market schemes (except that for wool which covers terminal market operations only) are permitted to hold stocks of the commodity concerned freely anywhere in the world. No restriction is placed on the quantity or location of such stocks but participants are required under the scheme rules to make a monthly return to the Bank showing, as at the end of each month, the total quantity of stock held, together with their outstanding forward and futures commitments and their resultant net open position (long or short). These returns are examined and aggregated to ensure that there are no signs of an excessive position or unwarrantable speculation or any other undesirable situation or practice developing either on the part of individual participants or of the market as a whole.

Question 845 (Bank of England)

Since the answer was given we have considered what information we could provide that would be useful to the Committee, but we have been forced to the conclusion that it is not possible to produce a fair and reliable statistical analysis.

Questions 865 *and* 932 (Bank of England)

After the end of the war the United Kingdom rapidly resumed her role as a large overseas investor. During the twelve years 1946 to 1957 long-term investment probably totalled over £3,700mn. gross, of which about three-fifths was in the Sterling Area and the remaining two-fifths in the rest of the world (particularly the dollar area). Private investment accounted for some six-sevenths of the total, leaving only about one-seventh for Government or quasi-Government lending.

Details are given in the table below but they should be treated with caution, as the comments which follow will show.

United Kingdom Gross External Investment

£ mn.

	1946 to 1951	1952	1953	1954	1955	1956	1957	Total 1946 to 1957
Sterling Area								
Loans by U.K. Government to other Governments ...	40	3	5	15	13	8	11	95
Other official investment	46	9	12	11	12	11	11	112
Private investment	910	160	200	210	170	210	250	2,110
	996	172	217	236	195	229	272	2,317
Rest of World								
Loans by U.K. Government to other Governments ...	250	3	—	—	19	2	8	282
Other official investment	9	8	7	—	—	—	—	24
Private investment	380	80	70	110	140	210	140	1,130
	639	91	77	110	159	212	148	1,436
Total								
Loans by U.K. Government to other Governments ...	290	6	5	15	32	10	19	377
Other official investment	55	17	19	11	12	11	11	136
Private investment	1,290	240	270	320	310	420	390	3,240
	1,635	263	294	346	354	441	420	3,753

Statistics of private investment are extremely uncertain. The estimates for the Sterling Area are pieced together, partly from material prepared by Sterling Area countries themselves and partly from U.K. sources, whilst those for non-sterling countries come from exchange control sources and are rather more firmly based. In either case investment from retained profits is covered only partially and the resulting figures are known to be seriously incomplete. For this reason the statistics of private investment bave been rounded to the nearest £10 mn., but this should not be taken to mean that they are accurate to that extent. The figures for 1951 and earlier years are especially doubtful, and therefore separate figures for each of these years have not been given.

Apart from these limitations, external investment is shown gross, i.e. without offsetting repayments and realisations, but not all outward movements of long-term capital from the United Kingdom are included. No account is taken of repayments by the United Kingdom (£653 mn. in the period) of loans from overseas governments nor of the United Kingdom's subscriptions to international organisations (International Monetary Fund £470 mn., International Bank £90 mn., International Finance Corporation £5 mn.). The use made by other countries of sterling made available by the I.M.F. and I.B.R.D. out of the United Kingdom's subscriptions, amounting to £68 mn. and £31 mn. respectively, is also excluded.

30500 3 P

The purchase of an existing investment is classified according to the area where the seller resides which may not be the area where the assets are. Thus purchases of dollar securities from the Sterling Area countries are shown as investment under "Sterling Area" and not under "Rest of World".

Investment in the Sterling Area

The loans by the U.K. Government in the years 1946 to 1951 were largely to Burma for post-war reconstruction (and mostly later written off). The greater part of the loans in the years after 1951 were to the Colonies for general purposes, but loans were also made to the Australian Government to expand uranium production and to Jordan for development generally, and an E.C.G.D. credit was granted to Pakistan. Other official investment in the early post-war years was mainly by the Overseas Food Corporation in East Africa. More recently it has been mainly by the Colonial Development Corporation, but some loans have also been made by the Atomic Energy Authority to South African mining companies (not to the South African Government) to expand uranium production.

Private investment in the sterling area has taken different forms. First there have been private subscriptions to new issues of Commonwealth governments (totalling £378 mn. in the twelve years). Then investors have purchased existing securities from sterling area residents. Then again U.K. companies have raised money in London for development abroad; or remitted part of their own domestic savings; or reinvested profits earned abroad. It is not possible to say how much investment has been done in each of these particular ways.

Of the industries which have invested in the sterling area, oil has had the largest share even when allowance is made for the fact that certain major enterprises conduct their overseas business from the U.K. but are partly foreign owned. But there has also been substantial investment in branches and subsidiaries of U.K. companies making vehicles, chemicals, textiles, or other goods; in public utilities; and in various forms of mining. Investment in rubber, tea and other primary products has probably been less important.

Investment in the rest of the world

In the period 1946 to 1951 settlements of debts arising from the provision of supplies during the war and in the intermediate reconstruction period took the form of loans from H.M.G. to other Governments, the greater part going to Germany. Substantial loans were also made to Denmark (to take the place of the U.K. Government's holding of Danish kroner at the start of E.P.U.), and to U.S.S.R. and Yugoslavia. From 1955 to 1957, £19 mn. was lent to Argentina, £7 mn. through E.C.G.D. to Persia and £3 mn. to Turkey. (The remaining £3 mn. available to Persia has been drawn in 1958). All the "other official investment" outside the Sterling Area has been by way of loans to the Aluminium Company of Canada.

Private investment in non-sterling countries has thus since 1952, in contrast to the earlier years 1946–51, accounted for nearly all of total U.K. investment in non-sterling countries; and throughout the whole period only a small part has been represented by private subscriptions to new issues of foreign governmental, or other official, securities. The only foreign government to borrow on the London market has been Norway (£5 mn. in 1951). The I.B.R.D. raised £4 mn. in 1951 and £5 mn. in 1954. Investment by U.K. companies has been on a smaller scale than in the Sterling Area, although they have invested substantial sums in Canada in recent years.

The oil industry has again been the leading private investor, and accounts for most of the sharp rise in the total in the most recent three years.

Net external investment

It is suggested above that external investment by the United Kingdom amounted to more than £3,700 mn. gross during 1946 to 1957. In addition, the other outward capital movements referred to above totalled some £1,200 mn. Against this there were substantial capital movements in the opposite direction, including loans of some £1,700 mn. to the United Kingdom Government (mainly from the U.S.A. and Canada) and sales of United Kingdom assets abroad and repayments of loans made by the United Kingdom Government, which together totalled also about £1,700 mn. Net private long-term investment in the U.K. by other countries may, with extreme uncertainty, be put at about £200 mn., nearly all of which took place in the period 1952–57. Hence, over the twelve years, on this broad definition, net long-term external investment has been something over £1,300 mn., the figures for the two halves of the period being £100 mn. and £1,200 mn. Short-term movements are excluded from these totals though changes in some overseas sterling holdings, treated as short in British official statistics, could arguably be regarded as long-term investment or disinvestment in the U.K.

Question 1310 (*Treasury*)

Note by the Bank of England:

The Bank of England maintain close relations with the foreign banks in London, who are certainly expected to act in accordance with official policy. The various requests made by Chancellors of the Exchequer about bank advances have on each occasion been passed to the organisations representing foreign banks in London. In response, these organisations have on all recent occasions confirmed their readiness to cooperate with Government policy.

Question 1757 (*Bank of England*)

TABLE OF VARIATIONS IN MARKET TENDER RATES DURING THE TEN WEEKS FOLLOWING UPWARD CHANGES IN BANK RATE SINCE 1951

Date of Change in Bank Rate	8.11.51	12.3.52	27.1.55	24.2.55	16.2.56	19.9.57
From/To	2%–2½%	2½%–4%	3%–3½%	3½%–4½%	4½%–5½%	5%–7%
	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.	£ s. d.
	99 15 8	99 8 5	99 8 3	99 1 –	98 13 7	98 7 –
	99 15 6	99 8 5	99 8 5	99 1 –	98 13 11	98 7 –
	99 15 2	99 8 2	99 8 5	99 1 –	98 13 11	98 7 –
	99 15 1	99 8 2	99 8 5	99 1 –	98 13 11	98 7 –
	99 15 2	99 8 3		99 1 –	98 13 11	98 7 –
	99 15 1	99 8 2		99 1 –	98 14 6	98 7 –
	99 14 11	99 8 5		99 1 5	98 14 2	98 7 1
	99 15 2	99 8 3		99 1 1	98 14 2	98 7 1
	99 15 2	99 8 2		99 – 8	98 14 5	98 7 1
	99 15 1	99 8 1		99 – 6	98 14 5	98 7 8

In addition, there were reductions in Bank Rate as follows:—

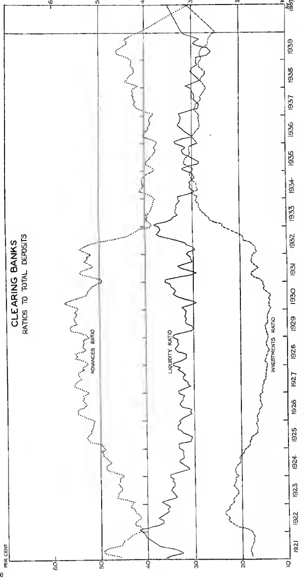
17.9.53 from 4%–3½%
13.5.54 from 3½%–3%
7.2.57 from 5½%–5%

Question 1822 (*Bank of England*)

It is reasonable to expect that on occasions when monetary, and general, action is needed to alter trends within the domestic economy, disorders in the balance of payment will also be present or be immediately in prospect. Frequent coincidence of balance of payments problems with movements of Bank Rate therefore does not imply that the movement of Bank Rate has been essentially a defensive measure to protect the reserves. In fact there was anxiety about the balance of payments at the time of every increase in the Bank Rate since 1951, though losses to the reserves were not occurring on every occasion. The exception was the rise from 4½ per cent. to 5½ per cent. in February, 1956. The reserves had then been rising since January, though they had shown falls in the preceding seven months. The passages in Paper No. 9 (paragraphs 98 and 100) concerning this change of Bank Rate record that the principal concern was with the domestic economy but that the external position was also a factor.

Question 1909 (*Bank of England*)

From the graph opposite, which shows the liquidity, advances and investment ratios for 1921 to 1939 (and the


CLEARING BANKS
RATIOS TO TOTAL DEPOSITS
ADVANCES RATIO
LIQUIDITY RATIO
INVESTMENTS RATIO
PER CENT
60
50
40
30
20
10
1921
1922
1923
1924
1925
1926
1927
1928
1929
1930
1931
1932
1933
1934
1935
1936
1937
1938
1939

average figures for 1957), it will be seen that between mid-1933 and end-1939 the liquidity ratio fluctuated between 26 per cent. and 34 per cent. Except for seasonal movements it does not seem to have risen clear of the 30 per cent. mark at all during these years, and from 1937 onwards it was dipping well below.

This, however, does little more than illustrate the general shortage of liquid assets prevailing during much of the period, and to confirm that regard for 30 per cent.—or any other figure—as a conventional minimum liquidity ratio was very much weaker then than it has been since the return to an active monetary policy. The advances ratio curve certainly suggests that the banks would have been ready to increase their advances during this period had attractive business offered itself. In the more recent period, as has been suggested in oral evidence, it is probable that liquidity considerations have at various times played a part in restraining lending, though it is not possible to assess the degree of their effect as compared with other forms of influence to restrict bank lending.

Questions 1923, 1926 and 2061 (Bank of England)

In January and February of 1952 overseas short-term borrowing* in London rose (in round figures) by £25 mn. In the period March/June the total of such borrowing fell by £60 mn. and from July to December there was a further fall of £55 mn. In the first of the above three periods overseas short-term assets in London (other than Central Bank funds, official funds, and the holdings of non-territorial organisations)† fell by £15 mn.; in the second period they fell by £10 mn.; and in the third period they rose by £15 mn.

Over January to April 1954 overseas short-term borrowing rose by 25 mn., continuing a rise that began in the last quarter of 1953 and which persisted over the summer of 1954. But over the same period (January/April 1954) overseas short-term assets in London, as defined in paragraph 1 above, rose by £85 mn.; this rise was very much greater than that in the preceding few months and appreciably greater than that in the subsequent period.

In answer to a request for similar figures in respect of subsequent changes of Bank Rate the Bank of England wrote:

The source of the figures we quoted in this answer is the monthly return of Overseas Sterling Holdings. While we felt that, for the dates originally specified, these figures, as defined in our answer, would provide sufficient of an indication of the movements into which the Committee were enquiring to make it an undue precaution for us to decline to answer the Committee's limited request, we consider the series is not good enough to be applied to the movement of short-term funds at all the dates about which you are now seeking information. The series was prepared for a quite different purpose, and detail does not exist to allow it to be recast for past dates to yield the information required. Extensive qualification of the figures, involving detail unsuitable for publication, would be needed if they were to be provided at all.

* "Overseas short-term borrowing" represents sterling claims on overseas so far as reported by U.K. banks, i.e. advances to, bills drawn upon, and acceptances given for account of, non-residents of the U.K.

† So far as reported by U.K. commercial banks, and comprising deposits, Treasury and other bills, and British Government securities if held for account of overseas banks.

The available figures of overseas borrowing and overseas assets are not fully gross.

While their use by the Committee could be safeguarded, we fear their publication would lead the public into using them for calculations for which they are neither designed nor suited. We have therefore concluded that we must ask to be excused from adding to our earlier answer in the way proposed.

Question 1958 (Bank of England)

There were no maturities of Government or Government guaranteed Stocks between the redemption of $2\frac{1}{2}$ per cent. National War Bonds 1949-51 on the 1st February 1951, and the 27th October 1952 when a trifling amount of $3\frac{1}{2}$ per cent. British Transport Guaranteed Stock 1952 was redeemed. The next sizeable redemption was that of $1\frac{3}{4}$ per cent. Serial Funding Stock 1952 on the 14th November in that year.

Questions 2164 to 2171 (Bank of England)

Although there was a downward drift in the market from January to July 1955, and sharp falls in February—at the time of the Bank Rate change—and in April, market conditions, as stated in paragraph 87 of Paper No. 9, were variable; and there were many short intervals when the market was firm and rising. Our sales during the period were largely made at these times, particularly during the middle of May. The small proportion of all sales made on falling markets was for the most part done in connection with switches being undertaken by the market.

We cannot give detailed information to show who bought the stocks that we and the banks were selling. All the evidence shows that the movement into Gilt-Edged stocks was widespread. As the Committee themselves have suggested, pension and life funds were important buyers, but as the market strengthened after each successive fall more buyers of all sorts came in apparently in the belief that prices had at last reached the bottom.

Question 2193 (Bank of England)

Estimates published in Cmnd. 273 (Balance of Payments White Paper, October 1957, Table 1, item 15.a.) suggest that the net outflow of "Other long-term capital" fell by £80 million between 1954 and 1955. Our information is far from complete; the following statements represent the approximations and estimates which have been made in the preparation of the balance of payments statistics. It is thought that nearly one half of this fall in the net outflow was due to a larger acquisition by overseas countries of assets in the United Kingdom described as long-term. The largest single item in this increase was represented by greater capitalisation of profits made by United Kingdom subsidiaries of overseas companies, and mainly in the motor industry. It is reasonable to relate this both to the development programmes of the companies concerned and to the conditions of borrowing prevailing in the United Kingdom. The next largest item was an increase in the holdings by non-residents of "blocked" sterling securities, an increase which probably was not closely related to borrowing conditions in the United Kingdom. A further significant item was purchases of local authority mortgages and industrial shares for the account of residents of the overseas sterling area: this may have reflected changes in interest rates. Also included in the statistics of overseas countries' long-term investment in the United Kingdom is an addition to the sterling funds of residents overseas due to sterling legacies and emigrants' funds.

Question 2248 (Bank of England)

Following is the information available for 1931:

£ mn.

	London Clearing Banks	Bank of England Banking Dept.	Scottish Banks	Other Home Holders‡	Overseas Official§	Total Market
March, 1931	129	10	8	223	64	434

‡ A residual item which includes the discount market and unidentified overseas holders.
§ Overseas central banks, currency boards, Crown Agents and certain other official bodies.

The following table gives details of holdings of market Treasury Bills between March 1951 and September 1958.

MARKET TREASURY BILLS

Holdings on the dates at which the London Clearing Banks make up their figures. Owing to rounding differences the changes derived from this table do not always agree exactly with those in Table III of Appendix 2 of the Bank of England's evidence (Memoranda of Evidence, Part I, Appendix 2).

£mn.

	London Clearing Banks	Discount Market	Bank of England Banking Dept.	Scottish Banks	Other* Home Holders	Overseas† Official	Total Market
1951 March 21	1,173	738	289	4	114	1,536	3,854
June 30	1,009	805	308	3	113	1,670	3,908
Sept. 19	1,143	756	263	5	90	1,593	3,850
Dec. 31	791	628	254	8	104	1,171	2,956
1952 March 19	678	579	230	2	71	972	2,532
June 30	981	769	191	2	81	851	2,875
Sept. 17	1,231	744	178	22	113	780	3,068
Dec. 31	1,182	705	211	24	217	861	3,200
1953 March 18	955	956	233	5	214	927	2,930
June 30	1,149	616	195	11	243	968	3,182
Sept. 16	1,322	652	207	19	268	960	3,428
Dec. 31	1,338	607	213	21	261	1,069	3,509
1954 March 17	995	528	179	9	306	1,086	3,103
June 30	1,080	462	238	12	373	1,109	3,274
Sept. 15	1,181	485	204	18	479	1,003	3,370
Dec. 31	1,199	615	222	16	525	1,021	3,598
1955 March 16	849	452	180	12	706	1,027	3,226
June 30	890	408	209	13	738	969	3,227
Sept. 21	1,063	471	167	19	721	992	3,433
Dec. 31	1,271	642	175	22	667	961	3,738
1956 March 21	946	421	138	15	746	921	3,187
June 30	1,031	470	171	21	724	910	3,327
Sept. 19	1,292	454	138	32	842	947	3,705
Dec. 31	1,275	523	139	25	618	927	3,507
1957 March 20	915	283	131	13	583	913	2,838
June 30	1,055	321	208	11	544	833	2,972
Sept. 18	1,159	342	150	15	528	887	3,081
Dec. 31	1,403	585	113	38	541	821	3,501
1958 March 19	1,082	466	140	23	702	765	3,178
June 30	1,112	386	150	22	747	810	3,227
Sept. 17	1,183	402	145	27	729	804	3,290

* A residual item which includes unidentified overseas holders.
† Overseas Central Banks, Currency Boards, Crown Agents and certain other official bodies.

Question 2255 (Bank of England)

For some years before 1931, when Bank Rate was 4 per cent. or higher for most of the time, and the rate paid by Clearing Banks on Deposit Accounts was generally 2 per cent. or higher, the proportion held on Deposit Account was rising. By 1931 it had reached 47 per cent. of total bank deposits; and in the first half of 1932 it reached a peak of 51 per cent. Thereafter, the rate paid on such deposits having fallen to ½ per cent., the proportion of bank money kept on Deposit Account fell steadily; and by 1938 it was around 45 per cent.

During the war the large increase in total bank deposits and the encouragements to save in forms that benefited the Exchequer directly combined to push the ratio very much lower; by 1945 it was down to 33 per cent.

Between 1945 and 1953 it rose again slowly to 36 per cent., at which level it has remained fairly stable until the increase in Bank Rate to 7 per cent. and the accompanying increase in Deposit rate to 5 per cent. The figures for October and November 1957 show a considerable rise in the proportion now held on Deposit Account; but it is too early to say whether this is a lasting consequence of the recent increase in rates.

Questions 2295 *to* 2299 (Bank of England)

There are general grounds for expecting that changes in the quantity of money will be associated with changes in interest rates. But there are several ways in which these movements may be related and other, separable, influences may also affect interest rates.

There is a connection between the extent to which the total supply of money exceeds the prevailing need to hold money for transactions purposes and the readiness with which the public will hold assets whose value is not fixed in money terms (i.e. stocks, shares, real property). A greater readiness to hold such assets shows itself in the form of acceptance of a lower yield from them, that is, acceptance of a lower level of interest rates and other yields. Money held for transactions purposes is that amount of cash and bank deposits which is felt to provide a working balance adequate to bridge ordinary receipts and expenditures.

The connection derives from the public's attitude as to the proportion of total assets which they feel suitable to hold in the form of money, additional to such money as they need essentially for transactions purposes. This proportion is itself influenced by a complex of institutional factors, by the level and structure of yields obtainable from income-earning assets, and by expectations about future prices and interest rates. But, broadly, it may be presumed that if there is an increase in the supply of money, relatively to prevailing needs for transactions purposes, the resultant tendency for the proportion of assets held in the form of money to increase is likely to be accompanied by greater readiness to hold assets in other forms, that is, interest rates tend to fall.

However, within this broad tendency, there may be divergent movements as between the yield from different kinds of assets. If for example, there is an inflation of prices and anxiety about its continuance, assets whose earnings do not keep pace with inflation become unattractive; the yield required from fixed-interest securities will, for example, then rise. On the other hand a period of inflation, once it is past, may prove to lead to somewhat lower fixed-interest rates. If serious inflation has occurred, the rise in the value of equity shares and of real property which will have accompanied it will also have left fixed-interest bearing securities a smaller proportion of the total of assets. Once anxiety about further inflation ceases, this diminution in the amount of fixed-interest bearing securities, relatively to equities and to real property, may enhance their value so that interest rates applicable to them tend to fall.

There are additional influences which modify even the broad tendency. The readiness with which the prevailing total of assets is held may change independently of alterations in the supply of money. Such changes may be initiated from the side of the holders, for example due to new saving, or from the side of the total of assets, for example due to capital expenditures.

Which influences predominate presumably varies from time to time. But the complexity of factors is such that it must be doubtful whether any confident unscrambling of their relative importance even at one particular time is

practicable. The graph opposite shows movements, between 1905 and 1956, in the yield from Consols and in the total of clearing banks deposits and currency in circulation expressed as a fraction of national income. It is not argued that this provides any full test, but the graph does at least suggest that there are periods in which any simple connection between money supply and long-term interest rates is lacking. A positive association appears, on the whole, during 1946-56. But none the less it may well be felt that this is little proof that a decrease in the money supply was in fact the predominating factor. The period was one in which anxiety about the course of prices and interest rates was present. There was also an increase in the volume of fixed-interest securities. Further, this increase followed upon a considerable war-time increase and, once war-time restrictions upon other forms of investment had lapsed, the Government securities issued during the war became less securely held as financial reserves were realised to meet the costs of new capital expenditures. These factors must be expected substantially to have contributed to the rising yield from Consols.

Question 2318 (Bank of England)

Since March, 1952, apart from a brief period in 1953, the rate of interest obtainable for United Kingdom Treasury Bills has been higher than that for United States Treasury Bills. From March, 1952, to early 1955, the difference was generally below 1 per cent. Between early 1955 and mid-1956 (and again since September, 1957) the difference rose, at times to around 3 per cent. But for many periods during these years the cost of forward exchange cover has, because of confidence factors, equalled or exceeded the difference in interest rates and thus left no margin of profit in favour of investment of funds in London rather than in New York.

In the spring of 1952 the cost of forward cover diminished, from about 3¼ per cent. to 1½ per cent., rose during the summer months and then fell again in the late autumn of that year. It did not, however, fall below the interest rate differential until late September, 1953. From then until mid-1955 there remained a margin in favour of London which on occasions, for example early in 1955, was high enough to attract funds. In mid-1955 confidence in sterling weakened and there was opinion that policy in respect to exchange rates might be altered (see Paper 9: para. 93); until September the cost of forward cover exceeded, with some intermissions, the interest differential. A small margin in favour of London reappeared in February and March, 1956, and again between May and August, 1956. But after August until the turn of the year, a period of crisis in the Middle East, the cost of forward exchange cover rose sharply and considerably exceeded the interest rate differential. This margin narrowed, but was not wholly eliminated, at the beginning of 1957.

It is not practicable to select a particular interest rate in London, and in foreign centres, which fully represents the difference in yields relevant to the movement of funds for interest arbitrage. The comparison of Treasury Bill rates made above must therefore be treated only as an indication. Similarly the existence of a margin of interest differential above the cost of forward exchange cover is only an indication that funds may be attracted. There are also certain other costs entailed in the movement of funds which may vary at different times. The margin required to attract funds also depends on general confidence even though the exchange risk has been covered. For example, in the event of risk of war, while forward exchange risks may still be covered through normal market machinery, no ordinary margin of profit may induce a movement of funds.

Question 2349 (Treasury)

Note by the Bank of England

Tap Treasury Bills held by the Issue Department certainly can pass into the hands of the market in the course of the Issue Department's operations and this does happen on occasion. Nevertheless the occasions are relatively rare since they only arise when the supply of money in the market has, for one reason or another, become so abundant that it is thought desirable to absorb some of the surplus by market sales of Bills. In ordinary circumstances the Issue Department is much more likely to be seeking to relieve a temporary shortage of funds by the purchase of Bills than to be acting as a seller of Bills

In addition, tap Treasury Bills held by the Issue Department may be transferred to the Banking Department; but, since the Banking Department does not sell Bills from its portfolio in the market, this does not provide a means for tap Treasury Bills to find their way into the bands of the market in the fullest sense of the term.

Question 2494 (Treasury)

We are not aware of any such borrowing on the New York market, but we know of the following cases of borrowings on other markets.

	Rest of Sterling Area Country	*Amount* $ *mn.*	*Form of Borrowing*	*Date*
South Africa	Anglo-American Corporation	11·7	Public issue in Switzerland ...	1950
	Orange Free State Investment Trust	5·8	" "	1952
	West Rand Investment Trust	5·8	" "	1954
	Anglo-American Corporation	8·2	" "	1955
Federation of Rhodesia and Nyasaland.	Anglo-American Rhodesian Development Corporation	7·0	Public issue in Netherlands ...	1955

Subject to compliance with the Exchange Control and Capital Issues Control (if any) in the country concerned, public companies are free to borrow by this method.

Question 2584 (Treasury)

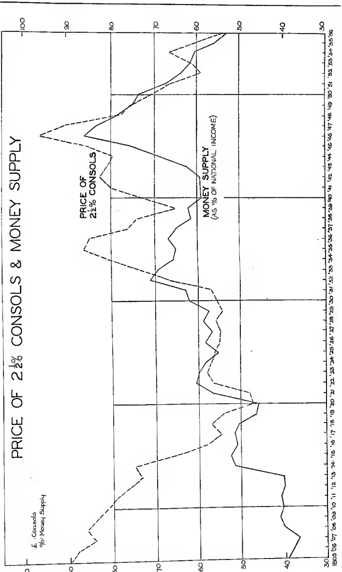
The table below covers nearly all sterling funds held by overseas Governments and Central Banks, the Crown Agents for Oversea Governments and Administrations, the Currency Boards, and the West African Marketing Boards. Some official funds, amounting to a small proportion of the total, are omitted, either because they are not distinguishable in the reported data or because no analysis of them is available.

The first column shows the total of deposits, Treasury Bills and other bills; the next four columns show the nominal value of British Government securities, classified according to the number of years from the dates shown to their final redemption dates.

This analysis covers three-quarters of the Overseas Sterling Holdings of all countries (but excluding holdings of international organisations such as I.M.F.) as officially published in Balance of Payments White Papers; in addition it includes some Dominion and Colonial sterling issues which are excluded from the Balance of Payments series. The remaining quarter consists mainly of amounts reported by commercial banks in the United Kingdom as being held for their overseas offices or customers. An analysis of these funds on similar lines is not available.

£ mn.

	Liquid funds	Maturity distribution of securities in years				Total	(Of which Dominion and Colonial sterling securities)
		0–5	6–10	11–15	Over 15		
31st December, 1954	1,214	637	335	354	316	2,856	(181)
31st December, 1955	1,096	731	382	380	242	2,831	(180)
31st December, 1956	991	835	263	428	251	2,768	(182)
	Totals expressed as percentages of grand totals						
31st December, 1954	43	22	12	12	11	100	(6)
31st December, 1955	39	26	13	13	9	100	(6)
31st December, 1956	36	30	10	15	9	100	(7)


PRICE OF 2½% CONSOLS & MONEY SUPPLY
£ Consols
% Money Supply
PRICE OF 2½% CONSOLS
MONEY SUPPLY
(AS % OF NATIONAL INCOME)

Rest of Sterling Area Balance of Payments

Note by the Treasury

Question 2606 (Treasury)

It has unfortunately never yet been possible to prepare a detailed overall balance of payments account for the Rest of the Sterling Area distinguishing the various sub-heads of the current and capital balances in such a way as to describe the evolution of the R.S.A.'s external finances as if it were a single economic unit. The main reasons for this are (1) the diversity of ways in which R.S.A. countries present their individual balances of payments, and (2) the incompleteness of the data about R.S.A. countries' capital transactions with the non-sterling World. Though the current and capital balances of the R.S.A. with the United Kingdom can be estimated using largely United Kingdom figures, because of these difficulties the R.S.A.'s current and capital balances with the Non-sterling World cannot be properly distinguished, and the combined R.S.A. balance with the Rest of the World (i.e. the United Kingdom and the non-sterling world together) cannot therefore be presented.

Nevertheless, the R.S.A.'s total balance current and capital, with the rest of the world is, for practical purposes, indicated by the change in its sterling holdings. This is inaccurate only to the minor extent that there has been some increase in R.S.A. countries' other reserves, gold, dollars etc. in recent years. The origin of changes in these sterling holdings can then be traced (*a*) to current and capital transactions with the United Kingdom, and (*b*) to transfers to the United Kingdom arising from R.S.A. transactions with the non-sterling world. The latter include gold sales through London (gold being conventionally treated as a non-sterling earning) and the R.S.A.'s other net earnings on current and capital account with the non-sterling world which eventuate in transfers of non-sterling currencies (or sterling) from the non-sterling world to London which are then converted into (or become) sterling on R.S.A. accounts. The figures are shown in Table I, and are all derived from our own Balance of Payments White Papers.

Also attached is a set of tables summarising the balances of payments of some principal countries in the R.S.A., and that of the Colonial territories. These are taken from the official publications of the countries concerned.

TABLE 1

Balance of Payments of the Rest of the Sterling Area§

£ mn.

	1946	1947	1948	1949	1950	1951	1952	1953	1954	1955	1956	1957 1st half
Transactions with Non-Sterling World:												
Gold Sales	+ 82	+ 84	+ 55	+ 68	+100	+ 78	+ 71	+ 78	+138	+176	+220	+105
Other current and capital transactions...	− 78	−364	+ 90	− 48	+387	+152	+ 95	+217	+ 37	− 41	− 61	+ 46
Total*	+ 4	−280	+145	+ 20	+487	+230	+166	+295	+175	+135	+159	+151
Transactions with United Kingdom:												
Current Balance	+ 28	−127	−254	−293	−287	−335	−363	−157	−282	−222	−299	−117
Long-term capital									+201	+139	+170	+150
Miscellaneous capital	− 60	+290	+ 14	+276	+191	+192	+103	+118	—	− 40	—	+ 10
Balancing item†									+ 32	− 57	− 53	−125
Total	− 32	+163	−240	− 17	− 96	−143	−260	− 39	− 49	−180	−182	− 82
Total (equivalent to change in sterling holdings, increase +)‡	− 28	−117	− 95	+ 3	+391	+ 87	− 94	+256	+126	− 45	− 23	+ 69

* Approximately equivalent to balance on current and capital account with non-sterling world.

† Reconciles estimates in lines above with change in overseas sterling holdings.

‡ Approximately equivalent to balance on current and capital account with rest of the world.

§ Since this table was compiled a number of revisions have been made to the figures. In addition estimates are now available up to the end of 1958. Revised figures and estimates for later years may now be found in *United Kingdom Balance of Payments 1946–1957* (H.M.S.O.) and United Kingdom Balance of Payments 1956 to 1958 (Cmnd. 700).

TABLE 2 (i)

Australia—Balance of Payments‡

(years ending 30th June)

£ mn.

	1950–51	1951–52	1952–53	1953–54	1954–55	1955–56	1956–57
1. *Current balance*							
Sterling...	−116	−313	+ 61	− 87	−165	−162	− 46
Non-sterling	+190	−162	+ 79	+ 62	− 55	− 39	+ 97
Gold production*	+ 10	+ 11	+ 13	+ 13	+ 13	+ 13	+ 13
Total current balance	+ 83	−463	+153	− 14	−207	−188	+ 64
2. *Capital*							
Long-term	+ 35	+ 50	+ 36	+ 41	+ 84	+109	+ 34†
Other (private)	—	—	− 5	− 5	− 6	− 9	+ 1
Total capital	+ 35	+ 50	+ 31	+ 36	+ 78	+100	+ 35
Total current and capital transactions ...	+118	−413	+184	+ 22	−129	− 88	+ 99
Balancing item	+ 21	+ 66	− 34	− 15	+ 16	+ 29	+ 70†
Change in gold and foreign exchange holdings (increase −)	−139	+345	−151	− 8	+114	+ 59	−169

Source: The Commonwealth Bureau of Census and Statistics.

* Excludes domestic consumption.

† Private long-term capital, other than direct investment from undistributed income, is included with the balancing item.

‡ Revisions to this table and to the other tables in this section are published in *The Commonwealth and Sterling Area Statistical Abstract* No. 78 (H.M.S.O.)

TABLE 2 (ii)

NEW ZEALAND—BALANCE OF PAYMENTS
(years ending 31st March)

£ mn.

	1950–51	1951–52	1952–53	1953–54	1954–55	1955–56
1. *Current balance*						
Sterling	− 3	− 58	− 7	+ 5	− 47	− 40
Non-sterling	+ 33	+ 27	+ 1	+ 23	+ 8	+ 8
Monetary gold	+ 1	+ 1	—	—	—	—
Total current balance	+ 30	− 29	− 5	+ 28	− 39	− 32
2. *Capital*						
Long-term	− 3	+ 8	+ 13	+ 8	+ 22	+ 11
Other	—	—	—	—	− 2	+ 6
Total capital	− 3	+ 8	+ 13	+ 8	+ 20	+ 17
Total Current and Capital transactions ...	+ 27	− 21	+ 8	+ 36	− 19	− 15
Balancing item	—	+ 1	+ 15	− 8	− 16	+ 6
Changes in gold and net overseas assets (increase −)	− 27	+ 20	− 23	− 27	+ 35	+ 9

Source: Report on the Official Estimates of Balance of Payments, compiled by the Department of Statistics, Wellington.

TABLE 2 (iii)

SOUTH AFRICA*—BALANCE OF PAYMENTS

£ mn.

	1950	1951	1952	1953	1954	1955	1956 (provisional)
1. *Current balance*							
Sterling...	− 81	−104	− 77	− 84	− 74	− 89	− 69
Non-sterling	− 66	−148	−133	−128	−135	−151	−157
Net gold output†	+147	+150	+152	+153	+164	+182	+197
Uranium exports	—	—	—	—	+ 15	+ 30	+ 39
Total current balance	—	−102	− 58	− 59	− 30	− 28	+ 10
2. *Capital*							
Identified private capital	+ 15	+ 6	+ 41	+ 28	+ 50	+ 14	+ 12
Official loans	+ 17	+ 5	+ 15	+ 5	+ 20	+ 13	− 3
Short-term liabilities	+ 1	+ 1	− 2	− 2	− 1	− 2	—
Total	+ 33	+ 12	+ 54	+ 31	+ 69	+ 25	+ 9
Total current and capital transactions ...	+ 33	− 90	− 4	− 28	+ 39	− 3	+ 19
Other capital balancing item	+ 38	+ 52	− 3	− 2	+ 5	− 17	− 11
Change in gold and foreign exchange holdings (increase −)	− 71	+ 38	+ 7	+ 30	− 44	+ 20	− 8

Sources: South African Reserve Bank Quarterly Bulletin of Statistics;
I.M.F. Balance of Payments Yearbook.

* Including the Territories of South West Africa, Basutoland, Swaziland and Bechuanaland.
† Excludes domestic consumption.

TABLE 2 (iv)

INDIA—BALANCE OF PAYMENTS

£ mn.

	1950	1951	1952	1953	1954	1955	1956
1. *Current balance*							
Sterling...	+ 50	+ 64	−114	+ 44	+ 37	+ 42	− 19
Non-sterling	− 9	−120	+ 95	− 11	− 39	− 11	−136
Total current balance	+ 42	− 56	− 19	+ 32	− 2	+ 30	−157
2. *Capital*							
Long-term	− 16	+ 20	+ 28	− 6	+ 4	− 1 }	+ 2
Other	—	+ 1	+ 4	− 3	+ 2	+ 2 }	
Total capital	− 16	+ 21	+ 32	− 9	+ 6	+ 1	+ 2
Total current and capital transactions ...	+ 26	− 35	+ 13	+ 23	+ 4	+ 31	−155
Balancing item	− 14	− 19	− 26	+ 2	+ 1	+ 4	− 2
Changes in net overseas assets (increase −)	− 11	+ 53	+ 12	− 24	− 3	− 36	+157

Sources: Reserve Bank of India Bulletins;
India's Balance of Payments 1948/49—1955/56
I.M.F. International Financial Statistics.

TABLE 2 (v)

FEDERATION OF RHODESIA AND NYASALAND—BALANCE OF PAYMENTS

£ mn.

	1950	1951	1952	1953	1954	1955	1956
1. *Current balance*							
Sterling...	...	...	...	− 37	− 36	− 38	− 43
Non-sterling	...	...	...	+ 14	+ 23	+ 27	+ 11
Total current balance	− 28	− 49	− 42	− 24	− 11	− 11	− 32
2. *Capital*							
Long-term	+ 8	+ 15	+ 18	+ 32	+ 23	+ 28	+ 23
Other	+ 5	+ 9	+ 2	+ 1	—	− 1	+ 2
Total capital	+ 13	+ 24	+ 20	+ 33	+ 23	+ 27	+ 25
Total current and capital transactions ...	− 15	− 25	− 22	+ 9	+ 12	+ 16	− 7
Balancing item	+ 20	+ 32	+ 23	+ 1	+ 2	− 7	+ 4
Change in overseas assets (increase −) ...	− 6	− 7	− 2	− 11	− 13	− 8	+ 2

Source: Economic Reports of the Federation of Rhodesia and Nyasaland.

TABLE 2 (vi)

PAKISTAN—BALANCE OF PAYMENTS

£ mn.

	1950*	1951*	1952	1953	1954	1955	1956
1. *Current balance*							
Sterling...	− 27	+ 3	− 68	− 32	− 36	− 16	− 29
Non-sterling	+ 16	+ 36	+ 5	+ 45	+ 17	+ 41	+ 28
Total current balance	− 11	+ 39	− 63	+ 13	− 20	+ 24	—
2. *Capital*							
Long-term	− 6	− 23	+ 1	+ 1	+ 9	− 8	+ 7
Other	+ 5	+ 26	− 5	− 6	+ 3	+ 6	+ 3
Total capital	− 1	+ 3	− 4	− 5	+ 12	− 2	+ 10
Total current and capital transactions ...	− 12	+ 42	− 67	+ 8	− 8	+ 22	+ 10
Suspense items and errors and omissions ...	+ 2	− 2	+ 2	—	+ 2	+ 17	− 2
Change in gold and foreign exchange reserves (increase −)	+ 11	− 41	+ 66	− 9	+ 6	− 41	− 8

Source: Economic Survey, Pakistan.

* Excludes transactions with India, Nepal and Tibet up to February/March 1951.

TABLE 2 (vii)

CEYLON—BALANCE OF PAYMENTS

£ mn.

	1950	1951	1952	1953	1954	1955	1956
1. *Current balance*							
Sterling...	− 19	− 25	− 40	− 25	+ 8	—	− 9
Non-sterling	+ 29	+ 32	+ 7	+ 13	+ 16	+ 24	+ 16
Total current balance	+ 11	+ 7	− 33	− 12	+ 23	+ 24	+ 6
2. *Capital*							
Long-term	− 4	− 11	− 2	+ 19	+ 3	− 4	− 7
Other	—	+ 2	+ 5	− 3	− 3	− 1	+ 1
Total capital	− 4	− 9	+ 3	+ 16	—	− 5	− 6
Total current and capital transactions ...	+ 7	− 2	− 30	+ 4	+ 23	+ 19	—
Balancing item	+ 1	+ 5	+ 4	—	− 2	+ 1	—
Change in gold and official overseas assets (increase −)	− 8	− 2	+ 27	− 3	− 22	− 20	− 1

Sources: Central Bank of Ceylon Bulletin, and Quarterly Bulletin of Statistics, Department of Statistics, Ceylon.

TABLE 2 (viii)

COLONIAL TERRITORIES—BALANCE OF PAYMENTS
(excluding Hong Kong, but including Ghana and Federation of Malaya)

£ mn.

	1950	1951	1952	1953	1954	1955	1956 (provisional)
1. *Current balance*							
Sterling	− 65*	− 27*	− 92	−116	− 70	− 99	−124
Non-sterling	+205	+197	+122	+ 78	+ 86	+ 67	+ 43
Total current balance	+140*	+170*	+ 30	− 38	+ 16	− 32	− 81
2. *Capital*							
Long-term	...	...	...	...	+103	+ 70	+ 90
Other	...	...	...	...	+ 3	+ 1	—
Total capital	...	...	...	...	+106	+ 71	+ 90
Total current and capital transactions ...	...	...	...	...	+122	+ 39	+ 9
Balancing item	...	...	...	...	+ 17	+ 21	− 10
Change in sterling assets† (increase −) ...	...	−202	−124	− 73	−139	− 60	+ 1

Sources: Colonial Territories 1952/53—1956/57, and Digest of Colonial Statistics.

* Including Northern Rhodesia and Nyasaland.
† Excluding Northern Rhodesia and Nyasaland.

Question 2613 (Treasury)

There are usually only a few borrowings by the Rest of Sterling Area Governments in non-sterling markets each year and the Committee may therefore like to have information covering a series of years, as follows:—

	Lender	*Borrowing Governments*	*Sterling equivalent (£m.)*
1952	Swiss Banks	South Africa	5·1
1953	Swiss Banks	South Africa	2·4*
1953	Swiss Banks	Australia	5·1
1954	Swiss Banks	South Africa	5·1
1955	New York Market ...	South Africa	9·0
1955	Canadian Market ...	Australia	5·4
1955	Swiss Banks	Australia	5·1
1955	Dutch Banks and Market	South Africa	4·7
1956	New York Market ...	Australia	9·0
1957 (Jan.–June)	New York Market ...	Australia	1·1

* Revolving credit refinanced in 1955–56.

In addition, sums have been raised from various official non-sterling sources. The table below summarises the trend of total non-sterling borrowing by the Rest of Sterling Area Governments in recent years. This includes borrowing by Governments or their subordinate authorities from private, governmental and international sources outside the Sterling Area and also borrowing by private individuals and institutions within the Sterling Area from official sources outside the Area. The latter type of borrowing is included since the guarantee or approval of the borrower's Government is necessary in such cases. Details of borrowing by private individuals, etc., from private sources outside the Area are not known in full and are not given. Short-term borrowing from the International Monetary Fund is also excluded. The information given has been collected from various sources and, while reasonably accurate, is not necessarily comprehensive.

	1952	1953	1954	1955	1956	1957 (Jan.–June)
	£ mn.	£ mn.	£ mn.	£ mn.	£ mn.	£ mn.
Total	90·7	59·1	50·6	88·9	103·8	31·3
Of which:						
From International Bank for Reconstruction and Development (amounts authorised) ...	44·5	30·1	30·9	38·7	69·0	30·2
Borrowing by Governments from Markets/Banks (see paragraph 1)	5·1	7·5	5·1	24·2	9·0	1·1
From U.S. Government and agencies (Export–Import Bank and International Co-operation Administration)...	41·1	21·5	14·6	26·0	25·8	—

Question 2937 (Treasury)

Note by the Bank of England

The normal instructions to the Government Broker are to buy the next maturing stock as it becomes available at acceptable prices and to sell longer dated stocks for which a demand arises and which the Departments may have available. He also stands ready to switch one stock for another where this suits the Bank's policy. If there is a persistent demand for any particular stock, this would be reflected in a tendency for its price to rise and the Government Broker would normally reap the benefit of any such rise in his selling operations.

Question 3121 (Board of Trade)

During the summer of 1957 the Board obtained from a sample of manufacturing companies provisional forecasts of their fixed capital expenditure during 1958. There is considerable difficulty in interpreting forecasts of capital expenditure, but the limited experience that we have had so far has indicated that a comparison of the forecasts for one year with those for a year earlier made at a comparable time a year earlier is likely to provide the most reasonable estimate of the change in expenditure between one year and another. On this basis the provisional forecasts of 1958 expenditure indicated virtually no change in total expenditure between 1957 and 1958, a small increase in expenditure on plant, machinery and vehicles (6 per cent.) being almost offset by a decline in expenditure on building work (10 per cent.), to give an increase of 1 per cent. in total expenditure. All the forecasts on which these estimates are based were received before the middle of September 1957.

At the middle of November 1957 manufacturing companies were again asked for forecasts of their expenditure during 1958. Estimates based on the information provided by companies which have so far replied indicate that, overall, companies have revised upwards the forecasts made earlier in the year. An upward revision also occurred between the first and second forecasts made in 1956 of expected expenditure during 1957, but the extent of the upward revision has been greater this year. In consequence a comparison of these later forecasts for 1958 with forecasts for 1957 made towards the end of 1956—following the method mentioned above—indicates an

increase in total expenditure between 1957 and 1958 of 3 per cent. The increase for plant, machinery and vehicles at 6 per cent. is the same as in the earlier estimates, but the decline in building work is now put at only 3 per cent.

The precise percentages changes given above cannot be regarded as statistically significant, and the picture presented by the later forecasts is still best interpreted as indicating about the same level of total expenditure in 1958 as in 1957. This follows substantial increases between 1954 and 1955, and 1955 and 1956 (23 per cent. and 18 per cent. respectively) and a provisional estimate of an increase of 6·7 per cent. between 1956 and 1957.

The changes between 1957 and 1958 based on the November request for forecasts are subject to revision in the light of a more complete response from the companies in the sample.

Companies operating in the distributive and service trades were not asked during the summer of 1957 for provisional forecasts of their 1958 expenditure. The figures so far received in response to the November request indicate that there will be little change in expenditure between 1957 and 1958.

Question 3189 (Board of Trade)

A commodity analysis of hire purchase debt is compiled and published quarterly in the Board of Trade Journal; this represents the maximum commodity detail which it has been practicable to collect from retailers and finance houses.* The figures include some estimation and, in the case of finance houses, are minimum ones since not all finance houses report quarterly figures to the Board.

* Apart from separate figures for industrial and farm equipment.

Following are the figures at the end of September, 1957:—

£ mn.

Commodities	Owing to Retailers, approximately	Owing to Finance Houses, at least	Total, at least
Furniture and furnishings ...	116*	13	213
Hardware, radio and electrical goods	84*		
Private and commercial motor vehicles and caravans ...	†	164	164
Industrial and farm equipment	†	16	16
Total, including other goods	200	198	398

* Including the debt owing to co-operative societies and department stores.

† Statistics are not collected of hire-purchase agreements financed directly by retailers in these categories of goods, but they are understood to be relatively few. Agreements financed directly by manufacturers and wholesalers are included as far as possible in the finance house figures.

2. Some further analysis of the debt owing to finance houses, as between personal and business debtors, has however been tentatively made. On the assumptions that one-third of the credit for new cars, and all the credit for commercial vehicles, is advanced to business users, while all the credit for used cars, motor cycles and caravans is advanced to personal users, it is estimated that about £124 mn. of the debt of £164 mn. owing to finance houses for motor vehicles in September 1957, was consumer debt.

3. In its memorandum of evidence to the Committee† the Board quoted estimates of total consumer and total business hire purchase debt which also assumed allowances for the amount of debt owing to finance houses which do not report monthly or quarterly figures to the Board. These estimates further assumed that the debt owing to finance houses for "other goods" (at least £5 mn. in September 1957) was divided equally between personal and business debtors.

† Memorandum of Evidence Pt. IV, No. 10.

Questions 3433, 3514 and 3515 (London Discount Market Association)

LONDON DISCOUNT HOUSES' MONTHLY FIGURES

Totals Outstanding

£ mn.

1957	Funds Lent		Funds Borrowed					
	Treasury Bills	Bonds	Bank of England	Clearing Banks	Other Domestic Banks	Overseas and Foreign Banks	Other	Total
16th January	376·4	359·1	·5	415·4	130·5	187·4	41·6	775·4
20th February ...	253·4	412·9	17·0	369·1	94·3	190·0	42·0	712·4
20th March	282·7	422·4	15·0	395·2	94·4	203·2	37·4	745·2
17th April	247·6	424·4	5·5	385·2	94·4	199·3	39·4	723·9
15th May	220·7	407·0	7·3	356·7	103·6	192·0	38·2	697·8
30th June	320·5	384·8	33·3	395·4	106·2	208·8	44·0	787·5
17th July	310·5	377·3	3·7	383·2	105·7	208·8	50·8	752·3
21st August	314·6	322·8	7·5	371·7	109·3	198·3	42·4	729·2
18th September ...	341·5	306·1	5·5	377·2	125·6	177·8	45·6	731·7
16th October ...	375·5	274·5	—	376·4	135·4	168·0	40·9	720·7
20th November ...	432·7	247·8	7·5	363·5	143·7	185·3	44·2	744·1
31st December ...	585·2	253·7	11·0	474·2	164·4	200·6	52·7	902·9

Note: Treasury Bills and Bonds are shown at nominal value. Bonds include Commonwealth and corporation securities.

Question 3518 (London Discount Market Association)

All values shown in the memorandum of evidence (Memoranda of Evidence, Pt. VI, No. 6) are at nominal value.

Question 3519 (London Discount Market Association)

We find it impossible to produce pre-war figures which would give a fair comparison with those of today.

Questions 3625 to 3629 (Committee of London Clearing Bankers)

It is not possible to give figures that would be of any value respecting the utilisation of overdraft limits. Such limits are generally speaking not formally renewable year by year but continued "until further notice", subject in many cases to annual review. Though the limits are thus formally open to be drawn upon throughout the year, in most cases that is on the understanding that the customer will only run up to his limit for customary seasonal requirements, and/or for the particular purpose agreed, and the banks' administrative arrangements are such that close supervision over the manner in which limits are utilised is ensured.

It is not possible, therefore, to provide the Committee with statistics that would indicate the extent (if any) to which borrowing limits were more fully utilised during the credit squeeze, but three of the "Big Five" banks can, from their experience over recent years, state that the credit squeeze has not caused any important fluctuation in the ratio between utilisation and limits.

Question 3849 (Committee of London Clearing Bankers)

Our cash balance is composed of two items: namely the cash in our branches and our balances at the Bank of England, and at full make-up dates (i.e., once weekly, fortnightly or monthly—according to any bank's particular practice) the precise relationship in total to the amount of current, deposit and other accounts is ascertained.

This approximates very closely to the required 8 per cent. despite the fact that on the make-up date the amounts of cash in the tills and current, deposit and other accounts are estimated figures only. The position disclosed as at the day in question serves as a guide for the period until the next make-up date and the fractional differences in the 8 per cent. ratio indicate that the banks' estimates are soundly based.

Each of the two constituents of our cash balance varies from day to day and, so far as the Bank of England balance is concerned, we try to keep it as constant as possible by means of the ordinary money market mechanism. That is to say, when dealing with known factors and unpredictable but perfectly normal factors, e.g., inter-bank clearings, we call as necessary from the market to adjust the position. This may happen any day of the week, Fridays included.

As regards cash in hand at our branches, of course there must be variation between one day and another and in particular those days when wages cheques are cashed and the succeeding day or days when the money comes back into the banks. Thus on a Friday the cash ratio of individual banks, and banks as a whole, may well be below a total of 8 per cent. (although in this connection it must be remembered that the current, deposit and other account item will almost certainly have been reduced). But, of course, the position will be restored, wholly or in part, perhaps on the Saturday or maybe on the Monday. There would be no point in dislocating the money market by making calls to meet what, at worst, should only be a minor and temporary reduction below the 8 per cent.

Question 3874 (Committee of London Clearing Bankers)

Note by Mr. Robarts

The discount market can and does on occasion borrow from the Bank of England against the security of bonds, but in my experience only in very exceptional cases has the Bank of England agreed to buy from the market some holdings of short bonds.

Questions 4081 *to* 4083 (Issuing Houses Association)

ISSUES MADE BY MEMBERS OF ISSUING HOUSES ASSOCIATION IN CATEGORIES UP TO £250,000

	1952		1953		1954		1955		1956	
	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount	No. of Issues	Amount
		£000		£000		£000		£000		£000
£1— 50,000	24	1,130	16	770	15	650	8	300	3	90
£50,001—100,000	3	280	9	770	11	990	10	930	2	160
£100,001—150,000	7	880	2	250	9	1,210	11	1,490	9	1,230
£150,001—200,000	6	1,090	3	540	12	2,250	11	2,050	9	1,650
£200,001—250,000	1	230	6	1,450	5	1,220	14	3,340	8	1,970

Question 4100 (Issuing Houses Association)

The balance of £87 mn. raised by non-members of the I.H.A. for overseas companies was spread as follows:—

	£ mn.	*Per cent.*
South Africa	64·7	*74·0*
Rhodesia and Kenya	6·9	*7·9*
Australia	9·7	*11·1*
Other Commonwealth	6·1	*7·0*
	87·4	*100·0*

Of the £64·7 mn. raised for South African companies, £50 mn. or 77 per cent. was for gold mining finance houses and companies.

The £52 mn. raised by members of the I.H.A. for companies registered overseas is accounted for as follows:—

(a) *Geographical summary*

	£ mn.	*Per cent.*
Africa	28·8	*55·4*
Canada	16·7	*32·2*
Australia	4·1	*7·9*
Jamaica	0·7	*1·4*
Bermuda	0·4	*0·8*
British Commonwealth ...	50·7	*97·7*
Holland	1·1	*2·1*
Eire	0·1	*0·2*
	51·9	*100·0*

(b) *Type of security summary*

	£ mn.	*Per cent.*
Debentures	26·4	*50·8*
Preference shares	3·8	*7·3*
Ordinary shares	21·7	*41·9*
	51·9	*100·0*

These figures, like all the figures given in the Association's memorandum of evidence, are as accurate as possible and are gathered from such statistical sources as are available. However the Issuing Houses Association does not keep statistics itself and it is possible that certain issuing houses or brokers may have made issues which are neither reported in *The Times* Issuing House Year Book nor included in the Midland Bank's summary. But it is not thought that any such omissions would make any material difference to the total figures given.

Questions 5210 *to* 5213 (Finance Houses Association)

TABLE 1

ANALYSIS OF LIABILITIES OF MEMBERS OF THE FINANCE HOUSES ASSOCIATION

Year ended 31st December	1954*	1955*	1956*	1957*	1958*
	£	£	£	£	£
Bank Loans	23,852,382	29,612,164	30,004,029	46,026,802	51,159,214
Acceptance Credits	9,195,000	14,386,096	11,437,500	15,785,000	13,388,101
Debentures	4,325,935	5,143,580	4,575,289	4,547,821	4,626,452
Current and Deposit Accounts	37,716,331	62,919,106	58,845,161	94,801,642	128,054,405
Bills Discounted	1,327,559	2,867,415	1,987,650	4,652,446	3,232,077
Unsecured Notes	350,000	350,000	526,000	526,000	776,000
Capital and Free Reserves	21,498,576	27,136,458	29,505,269	33,869,289	53,754,558
Tax Reserves	3,928,780	4,675,066	5,765,711	6,042,524	7,798,376
Other Liabilities	6,320,193	7,771,543	7,785,311	9,470,884	12,372,188
Totals ... ...£	108,514,756	154,861,428	150,431,920	215,722,408	275,161,371

* 1954 to 1957 figures for the twelve houses who were members of the Association on 31st December, 1957; 1958 figures for the thirteen houses who were members on 31st December, 1958.

In the case of the Lombard Group the member is Lombank Limited. The return submitted by this member was on the basis that the parent company, Lombard Banking Limited, is a bank in its own right. Thus Lombank Limited shows no deposits but substantial bank loans, of which by far the greater proportion are from the parent company. Lombank Limited does not accept deposits but its parent company does. The totals above for Bank Loans and Current and Deposit Accounts reflect these facts.

TABLE 2

ANALYSIS OF DEPOSITS WITH MEMBERS OF THE FINANCE HOUSES ASSOCIATION AT 31ST DECEMBER 1957*

	£
Industrial and Commercial Companies ...	62,293,321
Insurance Companies and other Financial Institutions ...	16,857,004
Private Individuals ...	7,141,570
Other Lenders ...	1,852,528
Total ...	£88,144,423

* The analysis does not include any figures for the Lombard Group.

Question 5329 (Industrial Bankers' Association)

TABLE 1

DISTRIBUTION OF LIABILITIES OF MEMBERS OF THE INDUSTRIAL BANKERS' ASSOCIATION

	1954*	1955*	1956*	1957*
	£	£	£	£
1. (*a*) Bank Loans ...	35,851	147,964	820,198	817,216
1. (*b*) Acceptance Credits	3,178	46,847	136,453	205,341
2. Debentures ...	7,200	7,200	6,200	6,200
3. Current and Deposit Accounts	258,148	754,288	1,262,912	2,096,633
4. Bills Discounted	—	—	—	—
5. Unsecured Notes	—	—	4,000	16,500
6. (*a*) Capital and Free Reserves ...	123,267	262,595	831,635	1,114,143
6. (*b*) Tax Reserves ...	18,686	37,151	60,674	103,088
7. Other Liabilities	121,227	148,243	249,918	355,424

* *Note as to dates for which members have provided figures for aggregation*

Belmont Finance Corporation Ltd. ...	30th April each year.
Campbell Discount Co. Ltd. ...	31st December each year.
Capital Finance Co. Ltd. ...	30th November, 1954, 1955 and 1956 and 31st January, 1958.
Equity Credit Co. Ltd. ...	First accounts made up to 29th February 1956. 29th February, 1956 and 28th February, 1957.
G. and C. Finance Corporation Ltd. ...	30th June each year.
Theo. Garvin Ltd. ...	First accounts made up to 31st March, 1956. 31st March, 1956 and 1957.
Hermiston Securities ...	First accounts made up to 30th June, 1955 30th June, 1955, 1956 and 1957.
Marlborough Finance Ltd. ...	30th June each year.
Milford Mutual Facilities Ltd....	31st July each year.
Overstone Ltd. ...	First accounts made up to 30th April, 1956. 30th April, 1956 and 1957.
Port Talbot (Auto) Services Ltd.	1st December, 1954, 31st March, 1956 and 1957.

TABLE 2

ANALYSIS OF DEPOSITS WITH MEMBERS OF THE INDUSTRIAL BANKERS' ASSOCIATION AT 31ST DECEMBER, 1957

	£
1. Industrial and Commercial Companies ...	169,598
2. Insurance Companies and other Financial Institutions ...	108,154
3. Private Individuals ...	1,853,737
4. Other Lenders ...	103,921
	2,235,410

TABLE 3

POSITION OF MEMBERS OF THE INDUSTRIAL BANKERS' ASSOCIATION AT 31ST DECEMBER, 1958

	£
Total deposits from the public ...	3,742,773
Total cash and Treasury Bills ...	403,620
Total balances outstanding on hire purchase and other credit documents...	8,942,283

Question 5361

18 own offices and 20 agency offices in August 1958.

Questions 6002 *to* 6007 (Accepting Houses Committee)

The Accepting Houses Committee has furnished certain statistics to the Committee; these are included in the Statistical Appendix to volume 2 of the Memoranda of Evidence. In the light of these figures the Committee has invited the Accepting Houses Committee to comment on certain aspects of the answers given to Qns. 6002 to 6007.

The figures given in that appendix for 31st December 1957 differ in certain respects from those given in Qn. 6003. Both sets of figures were compiled in the same way. The differences are mainly due to the fact that the headings "Cash" and "Discount" in Qn. 6003 included in both cases assets expressed in other currencies than sterling, whereas the figures in the appendix include (as requested) only assets expressed in sterling.

A subsidiary reason which accounts for part of the difference under the heading "Discounts", is that in the return on which the answer to Qn. 6003 was based balance sheet values were given (that is to say that discount in respect of the period that the bills still had to run was deducted in each case from the nominal values) whereas in the later return on which the statistics in the Statistical Appendix were based nominal values were given.

The Committee has asked whether Sir Edward Reid wishes to reconsider his answer to Qn. 6002 in the light of the more recent figures. As he indicated, on the question of liquidity it has to be remembered that individual accepting houses have businesses which differ very much from each other. As stated at the end of the answer to Qn. 6002 "our business is such that we can use our commonsense looking at our liabilities."

Taking the figures of the 31st December 1958 as an example it will be seen that the total of sterling notes and coin and balances at the Bank of England, balances with other banking offices in the United Kingdom, money on loan in the London money market and to U.K. local authorities and U.K. Treasury Bills and other sterling bills discounted (items 1, 2, 3 and 4 in the table in the statistical appendix) amounted to £129·8 mn. as against current and deposit accounts of £212 mn., and if cash and bills expressed in foreign currencies were included the liquidity ratio would be even higher.

It is true that acceptances are a liability as well as deposits but as indicated in the answer to Qn. 6005 and as Professor Sayers said in Qn. 6006 "the accepting houses had liabilities under both headings but they are not purely additive". The liability for acceptances is of a different nature from the liability for deposits: while deposits represent the money of others which has to be paid out whenever it is demanded, the liability for acceptances is more in the nature of a contingent liability which only becomes actual if the customer fails to provide cover for the bills. Moreover all acceptances do not mature on the same day but on any given date the total outstanding will be spread over the next three or four months. A degree of liquidity has to be maintained against these as it is always possible that on any particular day some of the acceptances maturing on it may fail to be covered by the customer of the accepting houses, but it is not the same degree as that which is necessary against deposits.

With regard to holdings of gilt-edged stocks, as Sir Edward Reid implied when he said in answer to Qn. 6007 that he could not speak for all the houses, the divergent businesses of the accepting houses must again be taken into account. These stocks are not held proportionately by each of the accepting houses but some houses will hold a great deal more and some a great deal less according to the nature of their business. It does appear to be true that the tendency during the past few years has been to hold more securities with longer than five years to run, but (as was implied in Sir Edward Reid's answer to Qn. 6007) it seems likely that a fairly large part of the securities with over five years to run were securities which would become five years securities in say two or three years' time.

With regard to advances to residents the Committee has asked for an explanation of the increases in advances during periods when the joint stock banks were under especial pressure from the authorities to restrict the volume of their advances. The Accepting Houses Committee does not think that the increase of £2·9 mn. between 30th June, 1955, and 30th June, 1956, is of much significance. Although an increase of £6·7 mn. between 30th June, 1957, and 30th June, 1958, is greater it is still not a very large figure, and it must be pointed out that during the period between 30th June 1957 and 30th June 1958, acceptances for account of residents declined by £9·3 mn., so that the total of advances and acceptances on resident account in fact fell by £2·6 mn. in that period.

It has however to be borne in mind that the business of the accepting houses is fundamentally different from that of the clearing banks. At the time of the credit squeeze both the Accepting Houses Committee and individual accepting houses consulted the Bank of England about its application and it was made clear that advances for the purpose of financing exports or for the purpose of financing imports of essential raw materials were not meant to be reduced. A very large part of the business of the accepting houses consists of advances and credits in these two categories and the accepting houses, while they have hire purchase credits which of course were in the category covered by the directive, have not the personal loans or consumer advances which the clearing banks have, the reduction of which was the main object of the credit squeeze. Apart from this, owing to the nature and size of their businesses the accepting houses do not have to make as many hard and fast rules as the clearing banks who on occasions like this have to issue directives for the guidance of their branches. Consequently the accepting houses could differentiate in each individual case between advances which were meant to be reduced and advances which were not.

From the accepting houses' knowledge of their own customers' businesses some of them were from time to time aware that in the course of the credit squeeze some advances were refused by the clearing banks under an overall directive which were not in the category which the credit squeeze was meant to affect. The Accepting Houses Committee is satisfied that there was no great diversion of borrowing from the banks to the accepting houses, but it is probable that there were cases where advances to importers were continued by the accepting houses while they were reduced by clearing banks.

Question 6200 (Capital Issues Committee) see page 974 for additional statistics of applications for consent.

Questions 6625 *to* 6627 (Retail Distributors Association)

In fulfilment of the promise given to try and help, a questionnaire was sent to a representative sample of sixteen member firms. Of these, only five were able to supply figures as far back as 1925. Their experience was as follows:

	Cash	*Monthly Credit*	*Instalment Credit*	*Total*
1925	55·7	44·3	—	100
1930	53·9	45·4	0·7	100
1935	57·9	41·1	1·0	100
1950	70·9	27·9	1·2	100
1955	71·3	25·0	3·7	100

A further three firms were able to supply figures as from 1935. For the years 1935 to 1955, the combined experience of the eight firms was:

	Cash	*Monthly Credit*	*Instalment Credit*	*Total*
1935	43·8	53·2	3·0	100
1950	60·6	37·8	1·6	100
1955	60·0	36·1	3·9	100

Obviously, these figures must be treated with discretion. Clearly, as is illustrated by the variations in the data for five firms and that for eight, the sample is too small to enable any conclusions to be drawn as to the precise role of credit in the financing of sales.

Thus, if it was practicable to secure more representative information, it is confidently believed that the proportion of sales financed by hire purchase would be much higher; for 1955 the figure would probably lie between five and ten per cent.

As regards trends, however, the indication of a much greater use of cash in recent years as contrasted with pre-war is believed to be an accurate reflection of what has taken place.

30500

This conclusion is reinforced by the experience of certain other firms not included in the above analysis which, while unable to distinguish between monthly account and instalment credit, supplied figures showing the division between cash and total credit.

Thus one provincial firm recorded a distribution of 58·6 per cent. cash, 41·4 per cent. credit in 1935, as compared with 85·9 per cent. cash, 14·1 per cent. credit in 1955, while, similarly, one central London firm reported figures of 8·28 per cent. cash, 91·72 per cent. credit for 1935 and 20·38 per cent. cash and 79·62 per cent. credit for 1955.

Question 6917 (Director, Post Office Savings Department)

NATIONAL SAVINGS CERTIFICATES

Estimates of holdings based upon a sample taken from the files adjusted to the circumstances as at 31st December 1957.

Total number of "live" holdings (i.e., holdings in which there are counterparts of certificates which have not yet been repaid) ...	about 10 millions
Total number of units in the files ...	2,672 millions
Total purchase price of units in the files...	£1,897 millions
Average value of each unit ...	£0·71
Average value of each holding ...	£189

38·65 per cent. (3,865,000 holders) held from 1 to 25 units representing 1·15 per cent. of total purchase price, i.e. £21·8 mn.

22·97 per cent. (2,297,000 holders) held from 26 to 125 units representing 5·33 per cent. of total purchase price, i.e. £101·1 mn.

15·29 per cent. (1,529,000 holders) held from 126 to 400 units representing 13·7 per cent. of total purchase price, i.e. £259·9 mn.

10·45 per cent. (1,045,000 holders) held from 401 to 650 units representing 20·6 per cent. of total purchase price, i.e. £390·8 mn.

5·57 per cent. (557,000 holders) held from 651 to 1,000 units representing 17·07 per cent. of total purchase price, i.e. £323·8 mn.

7·07 per cent. (707,000 holders) held more than 1,000 units representing 42·15 per cent. of the total purchase price, i.e. £799·6 mn.

SUMMARY

Per cent. of holders	Holding	Per cent. of total purchase price	Total purchase price	Average value of holding
			£ mn.	£
38·65	1 – 25	1·15	21·8	5·6
22·97	26 – 125	5·33	101·1	44·8
15·29	126 – 400	13·7	259·9	170·0
10·45	401 – 650	20·6	390·8	374·0
5·57	651–1,000	17·07	323·8	581·0
7·07	over 1,000	42·15	799·6	1,131·0
100 per cent.	—	100 per cent.	£1,897 mn.	£189

The above estimates of holdings take nn account of interest which is neither calculated nor paid until the certificate is encashed. The estimated accrued interest as at 31st December, 1957, was £520·7 mn.

Question 7337 (Building Societies Association)

Extract from the Building Societies Association booklet *Financial and Accounting Procedure* (edition of January 1957).

"*Investments*

24. The making and realisation of investments is one of the most important duties of a board of directors, and it is only the directors who are in a position to reach decisions (after taking such advice as they consider necessary) for they alone are aware of all the many complex factors which must be taken into account. Some of the main general considerations to be borne in mind are however mentioned below.

25. Powers of investment are contained in section 25 of the Building Societies Act, 1874, but these powers were extended by sections 16 and 17 of the Act of 1894. The funds of a society 'not immediately required for its purposes' may, provided that the rules so permit, be

3 Q

invested in any securities in which trustees are for the time being authorised by law to invest. The present law on the subject of trustee securities is contained in the Trustee Act, 1925, the Trusts (Scotland) Act, 1921, and the Colonial Stock Act, 1900. Under these Acts a very wide range of investments falls within the category of trustee securities.

26. The liquid funds of a building society consist, both for the purposes of the Association's Regulations and also in the generally-accepted sense, of trustee investments and cash. The division of the resources between these two items should be the subject of a reasoned periodical decision by each board of directors to ensure that adequate funds are retained in the form of cash at bank and investments at very short call. The maintenance of a sufficient balance of liquid funds capable of realisation without undue loss is of course a matter of prime importance. It is a vital factor in budgetary control and requires constant consideration, as certain classes of investments may lose very rapidly their virtue of ready realisability without serious loss.

27. As the purpose of holding trustee investments is to set aside profitably part of a society's liquid resources, the overriding consideration in selecting investments must be ease of realisability with little or no risk of loss. It follows that in no circumstances should a society ever invest in securities which are either irredeemable or redeemable only at the option of the issuer. Such securities are not subject to the steadying influence of an ultimate redemption value and they are those most likely to suffer heavy depreciation in a time of stringency or crisis. Any society holding such securities should, as a matter of prudence, write off any depreciation as soon as possible

28. Where investments are made in securities quoted on a Stock Exchange, the securities chosen should be those which must be redeemed at an early date, even though they may provide a lower yield than investments with a longer life. A society's investments should however be well spread, so that the portfolio contains securities redeemable on different dates over a reasonably short period ahead.

29. Most societies consider it prudent to spread their investments not only over different securities but over different types of security, among which the following may be considered suitable—

Trustee securities quoted on a Stock Exchange

Treasury Bills

Loans to Local Authorities (if of trustee status) with a life of not more than 7 years

Tax Reserve Certificates.

Societies may also deposit money in a joint-stock bank and in the Post Office and a Trustee Savings Bank. In no circumstances should advances on mortgage (whether to members or to non-members) on the security of freebold or leasehold estate be regarded as liquid funds. It may be added that they are not regarded as such for the purposes of the Association's Liquidity Regulations.

30. The apportionment of a society's investments over the securities mentioned above (and any others which may be considered suitable) can be determined only in the light of the circumstances of each society and of the time. It is however a subject which should command constant attention by the directors and on which experienced advice should be sought.

31. Notwithstanding every precaution that may be adopted, the financial circumstances prevailing at the date of a society's Balance Sheet may sometimes result in the market value of the investments being less than the book value. If this should arise, thought should be given to the desirability of writing down the book value or, alternatively, of referring to this matter either in the annual report of the directors or in the chairman's address (or both) in order to make the position clear. Members might be informed (assuming such to be the case) that the quoted securities held by the society were all securities which must be redeemed by a fixed date and that they stood in the society's books at not more than their redemption value. Attention might also be called to the society's general reserve and to any specific reserve or provision made against depreciation of investments."

Question 7338 (Building Societies Association)

TRANSACTIONS OF BUILDING SOCIETIES IN BRITISH GOVERNMENT SECURITIES

Years	Amount Invested in British Government Securities			Amount realised by the sale or redemption of British Government Securities
	By direct subscription to new issues	By the purchase of securities on the market	Total	
	£000	£000	£000	£000
1946 ...	8,531	3,211	11,742	29,824
1947 ...	1,219	5,648	6,867	27,983
1948 ...	3,530	7,862	11,392	17,746
1949 ...	Nil	3,857	3,857	13,260
1950 ...	205	13,090	13,295	11,062
1951 ...	44	10,812	10,856	8,694
1952 ...	408	8,053	8,461	1,753
1953 ...	2,802	8,670	11,472	8,146
1954 ...	307	34,520	34,827	29,302
1955 ...	289	15,940	16,229	7,027
1956 ...	187	26,283	26,470	8,023
1957 ...	35	39,769	39,804	24,183
Totals...	£17,557	£177,715	£195,272	£187,003

Notes: (1) The foregoing figures relate solely to securities of the British Government. They exclude Treasury Bills, Tax Reserve Certificates and Post Office Savings Bank Deposits.

(2) The figures have been supplied by about 200 societies whose assets represented about 90 per cent of the total until 1955. The percentage in 1956 and 1957 was about 80 per cent.

Question 7383 (Building Societies Association)

RATES OF INTEREST RECOMMENDED BY THE COUNCIL OF THE BUILDING SOCIETIES ASSOCIATION

Year	Maximum Rate on Shares	Maximum Rate on Deposits	Minimum Rate on Loans
	Per cent.	Per cent.	Per cent.
1946	2¼	1¾	4
1952	2½ (April)	2 (April)	4½ (March)
1955	3 (July)	2½ (July)	5 (July) 5¼ (Nov.)
1956	3½ (July)	3 (July)	5½ (April) 6 (July)

Notes: (1) The rates on shares and deposits are for investments which are subject to the composite rate of income tax.

(2) The rate on loans is that recommended for new loans.

Question 8215 (Association of Municipal Corporations)

No separate figures of capital expenditure financed out of revenue are available for municipal corporations. The following figures are in respect of all local authorities (including drainage and river boards, harbour boards and certain other bodies) in England and Wales :—

£ mn.

	Revenue monies used for capital purposes	Expenditure on land, works, etc., met from capital monies	Total
1954–55 ...	17·3	510·4	527·7
1955–56 ...	21·5	522·1	543·6
1956–57 ...	27·3	533·5	560·8

Question 8309 (Association of Municipal Corporations)

MUNICIPAL AUTHORITIES' MORTGAGE AND SHORT-TERM BORROWING

Table 1. *Amounts raised by mortgages in financial year.* £000s.

	FINANCIAL YEAR 1954–55				FINANCIAL YEAR 1957–58			
	19 County Boroughs	31 Non-county Boroughs	6 Metropolitan Boroughs	Total (56 Boroughs)	19 County Boroughs	31 Non-county Boroughs	6 Metropolitan Boroughs	Total (56 Boroughs)
Building societies	4,917	1,670	—	6,587	4,359	381	—	4,740
Savings banks	2,628	1,995	820	5,443	2,100	660	330	3,090
Insurance companies	1,271	415	34	1,720	1,516	308	465	2,289
Friendly societies	1,809	272	50	2,131	873	550	600	2,023
National boards	705	95	—	800	270	105	—	375
Co-operative societies	160	206	50	416	419	55	100	574
Joint stock banks	195	55	—	250	279	53	50	382
Other local authorities	686	80	—	766	500	32	—	532
Industrial and commercial companies ...	733	73	—	806	2,868	275	100	3,243
General public	533	143	—	676	13,406	3,202	886	17,494
Other bodies*	1,467	243	243	1,953	2,713	443	435	3,591
Total	15,104	5,247	1,197	21,548	29,303	6,064	2,966	38,333

Table 2. *Amount of mortgages outstanding at end of financial year.* £000s

General public	8,013	2,844	—	10,857	34,174	7,082	923	42,179
All other bodies*	90,318	26,848	3,603	120,769	122,720	34,316	10,616	167,652
Total	98,331	29,692	3,603	131,626	156,893	41,398	11,539	209,831

Table 3. *Amounts† borrowed for less than one year outstanding at end of financial year.* £000s.

General public	115	—	—	115	1,063	329	8	1,400
Industrial and commercial companies ...	8,535	2,570	400	11,505	38,177	9,200	1,371	48,748
Financial institutions and other bodies*	4,876	2,786	150	7,812	23,907	736	1,165	25,808
Total	13,526	5,356	550	19,432	63,147	10,265	2,544	75,956

* Excluding Government sources. † Excluding internal advances.

Question 8331 (Association of Municipal Corporations)

It is confirmed that all arrangements about issues of stock are finalised with the Bank of England, but preliminary discussions may take place with local authorities' own bankers.

Question 8498 (County Councils Association)

Loans bureaux have been founded with the object of putting a local authority which has money available for lending into touch with an authority which might like to borrow money. The transactions are almost entirely limited to temporary borrowing although some loans for longer periods are negotiated in this way. In the past year or two, with the higher rates of interest for long term loans and the consequently greater emphasis on short term borrowings, there has been an increase in the activity of the bureaux and a considerable volume of loans has been negotiated through them.

The bureaux are organised in a number of different ways: to cover a county or a larger area, or to cater for a group of authorities on a functional basis, for example, county councils. All the bureaux are, however, operated on a similar basis and one or other of them serves most parts of the country.

Question 11078 (The Electricity Council)

In 1948–49 the prevailing rate of interest on gilt-edged stocks was 3 per cent. per annum. This rate increased and fluctuated over the ensuing years and is reflected in the interest rates which had, from time to time, to be paid on the respective issues of British Electricity Stock.

Until August 1955 it had been practicable to provide the industry's long-term finance by way of issues of British Electricity Stock, but early in 1956 the Government (as a temporary measure and with a view to facilitating the management of the Government credit and funding operations) took over direct responsibility for financing the long-term borrowing requirements of the nationalised industries. The Finance Act, 1956, provides for Exchequer Advances to certain nationalised industries (including Electricity) of sums which they were empowered to borrow by the issue of stock. This arrangement has since been extended.

The advances are made (usually twice-monthly) at rates of interest adjusted from time to time to reflect the prevailing cost of Government borrowings. At the end of each financial year the advances so made are consolidated and are funded by way of a loan repayable in equal annual instalments of principal over a period of 25 years with interest on the outstanding balance at the rates attaching to the amounts originally advanced.

The rate of interest used in making economic comparisons of new projects has been the best estimate of the rate that will prevail during the period over which the capital commitment is being made—which broadly is the construction period of the project.

It may be helpful to point out, however, that the rate of technical and design development of conventional generating plants over the last ten years has been such that the unit capital cost of new works has been held practically constant whilst the economic operating performance of the plants being offered improved rapidly with each successive design.

The capital cost of alternative designs of like plants did not differ as greatly as the operating performance.

The comparative economic assessment takes account of capital charges and operating costs.

However, the most massive source of economic gain has been the improvement in performance.

Questions 11110 *and* 11111 (The Electricity Council)

Clearly the precise answer will depend upon the Capital Cost per Kilowatt of the Nuclear Power Station and upon the number of units of electricity sent out from the station per annum per kilowatt of capacity. Taking as an example a station costing £120 per kilowatt operating at 75 per cent. load factor, the difference in the cost per unit assuming 3 per cent. interest instead of 5 per cent. p.a. would be a reduction of 0·088 pence per unit. The total generating cost per unit under the given conditions and with interest at 5 per cent. p.a. would be approximately 0.7 pence per unit; hence a reduction in the interest rate to 3 per cent. p.a. would reduce the generation cost per unit by 12.5 per cent.

The foregoing calculation is based upon the assumption that the total capital is borrowed at the respective interest rates.

Question 11752 (Dr. M. W. Holtrop)

The amended Act on the Supervision of the Credit System no longer provides for the approval of the Minister of Finance of directions to credit institutions. The power of the Minister to give directions in accordance with Article 26 of the Bank Act has never been exercised.

Question 13268 (Committee of London Clearing Bankers)

It is confirmed that the monthly statements of the eleven clearing banks relate only to branches in England, Wales, the Channel Islands and the Isle of Man, save only in the cases of Lloyds Bank, whose statements also cover a few branches in India, Pakistan, Kashmir and Burma, and of the National Bank, whose statements cover branches in Northern Ireland and the Republic of Ireland as well as branches in England and Wales (the National Bank has no branches in the Channel Islands or the Isle of Man).

The publication of figures which would in effect disclose the magnitude of the business of the two banks concerned in the areas in question would be liable to prejudice their position in relation to their competitors in those areas and elsewhere. It would not therefore be desirable to publish separate figures relating to the banking offices of these two clearing banks situated outside England, Wales, the Channel Islands and the Isle of Man. It can, however, be stated that the deposits held at those banking offices, and included in the monthly statements of the two banks concerned, are very small in relation to the total deposits of the clearing banks and that movements in the figures relating to those branches would not be significant in relation to any conclusions which might be drawn from the movements of the aggregated monthly figures of the eleven clearing banks as to the trend of banking statistics in England, Wales, the Channel Islands and the Isle of Man.

Question 13394 (H.M. Treasury)

The published figures show the total sterling holdings of countries outside the sterling area as rising by £14 mn. (from £569 mn. to £583 mn.) between end-June and end-September, 1957. During this period, however, there was an increase of £72 mn. in the balances temporarily held by the central banks of other members of E.P.U. (because of the fact that under E.P.U. arrangements balances acquired by them in any given month were, broadly speaking, frozen until the settlement took place in the following month). At the same time Germany had established, under an agreement concluded earlier in the year, a £75 mn. sterling account earmarked for repayments of Government debt, of which one repayment, to the amount of £7½ mn., was in fact made during the period.

The total change in these balances was thus made up as follows:—

	£ *mn.*
Temporary movements pending E.P.U. settlements	+ 72
German debt repayment account ...	+ 67
Other movements	−125
	+ 14

The figure of −£125 mn. for "other movements" is probably too high as a measure of changes due to the confidence factor, because there is reason to believe that part of the sterling used to establish the debt repayment account had been accumulated for that purpose before the beginning of the quarter on other German accounts. A round figure of £100 mn. might therefore be of the right order of magnitude as an estimate of the effects of confidence.

Question 13416 (Bank of England)

Exchequer and Banking Figures, March, 1957—*December,* 1958.

1. In June, 1957, the Bank submitted a paper (Memoranda of Evidence Pt. I, No. 9) on Some Features of Monetary History between 1951 and 1957; together with an Appendix (Memoranda of Evidence Pt. I, Appendix 2) giving Exchequer and banking figures for the same period, ending in March, 1957. This Appendix has been revised and extended to the end of December, 1958; this paper constitutes a short additional commentary on the figures for the period March, 1957, to December, 1958.

21*st March*, 1957, *to* 30*th June*, 1957.

2. Distinctive features of Exchequer financing during this first quarter of 1957-58 were a further weakening of the gilt-edged market, continuing that which had set in a month earlier (cf. Paper 9, para. 122), and a reduction in the total of Treasury Bills held by Overseas Official and by "Other" holders outside the clearing and Scottish banks, discount market and Banking Department. The Exchequer requirement on account of the Budget and external transactions, after allowing for receipts from extra-Budgetary funds, was £254 mn. This was moderate and rather less than in the same quarter of 1956-57; notwithstanding, although receipts from small savings remained relatively high, the rise (£140 mn.) in the clearing banks' holdings of Treasury Bills was greater than in any April/June quarter since 1953.

3. On account of Stock transactions a net £69 mn. was paid out to the market. In part this was directly associated with Stock maturities, for on the 15th June £300 mn. 5 per cent. Exchequer Stock, 1957, and £101 mn. 2¾ per cent. Funding Stock, 1952-57, fell due for redemption. The greater part of these Stocks was already in departmental holdings before the opening of this period but there were also departmental purchases of 2½ per cent. Serial Funding Stock, 1957, which was due for redemption in November. More important was the anxiety felt in security markets that further inflation of costs and prices generally might develop. The price of a long-dated Stock, 3 per cent. Savings Bonds, 1965-75, fell from 76·4 in March (average of month) to 71·2 in June and that of 2½ per cent. Consols from 54·0 to 50·6. The index of ordinary share prices rose from 151·9 to 163·9. In these conditions, redemptions of maturing Stock were not covered by net sales of other securities even though an issue, made early in May, of £100 mn. 4½ per cent. Conversion Stock, 1962, was very largely taken up by the market. The weakness of the market showed notably among domestic and "unidentified overseas" holders outside the clearing banks and discount market. For net purchases of Stock (£55 mn.*) by Overseas Official rather more than counterbalanced sales and redemptions by the discount market and a small decline (£4 mn.) in the Investments of the clearing banks. This left a reduction of about £70 mn. in the Stock holdings of this residual "domestic and 'unidentified overseas'" category, in contrast to the considerable addition which had been made to their holdings in the early months of 1957.

4. The rise in market Treasury Bills (£134 mn.) was wholly concentrated towards the end of this quarter, when both the Exchequer requirement and payments on account of Stock redemptions and net purchases were greatest. The Treasury Bill rate declined from early April until May, then rose and levelled off around 3$\frac{13}{16}$ per cent.; from March until the beginning of June the discount market was pressed by shortage of funds continually to resort to market advances from the Bank. There was a marked change in the composition of holdings of market Treasury Bills. The total held by the discount market first fell and then rose, with a net increase of £38 mn. over the quarter; holdings by Overseas Official and "Other" together fell by £119 mn., almost entirely in the first two months of the quarter. These falls in April and May

* The figures in this Paper of changes in Overseas Official holdings of Stock are those submitted earlier to the Committee (see Statistical Appendix to Memoranda of Evidence, volume 2). They relate to calendar quarters, but are a fair indication of transactions in the periods referred to in this Paper.

were largely reflected in a rise in the clearing banks' holdings of Treasury Bills at that time, a rise which continued in June along with the increase in total market Bills. Over the quarter as a whole the clearing banks' Treasury Bills rose by £140 mn. and total liquid assets by £159 mn.

5. Bank advances, other than those to nationalised industries, which had begun to rise swiftly in the early part of 1957 (Paper 9, paragraph 125) increased by only £10 mn. during April and May but then again rose rapidly, by £75 mn., in June. A substantial part of this increase probably was a seasonal feature of the end of the half-year, as the movement was reversed in July. Advances to nationalised industries rose over the quarter by £18 mn. The total net increase in the banks' non-liquid assets was £99 mn. and this, in conjunction with the increase in their liquid assets, was associated with an increase of £259 mn. in their net deposits, the largest increase in the June quarter in any of the years since 1951 which have been reviewed. The clearing banks' Liquidity Ratio rose from 32·6 per cent. in March, 1957, to 33·4 per cent. at the end of June, 1957.

1st July, 1957 to 18th September, 1957

6. The Exchequer requirement for the Budget in the July/September quarter remained moderate, £226 mn. after allowing for receipts from extra-Budgetary funds, and £25 mn. less than in the September quarter of the previous year: but the total requirement fell sharply. For in these summer months apprehension of further inflation became still more widely spread and, combined with exchange pressures arising out of a change in the French franc rate against foreign currencies and rumours of upward revaluation of the deutschemark, led to an acute exchange crisis. The exchange reserves, which had risen moderately in each month since February, 1957, fell slightly in July. In that month, existing Exchange Control permissions which allowed United Kingdom residents to acquire foreign currency securities from residents of the overseas sterling territories were withdrawn. In August, the loss of reserves was £81 mn. and in September the rate of loss increased further. In the whole period from the 1st July to the 18th September, the loss of exchange reserves brought £158 mn. sterling in to the Exchequer. Thus the total Exchequer requirement for the Budget, extra-Budgetary funds and External transactions fell to £74 mn.

7. None the less, Exchequer borrowing through market Treasury Bills increased by £109 mn. Tax Reserve Certificates had brought in £53 mn. but small savings, which had been running well since the summer of 1956, swung round to a small net cash withdrawal and Stock transactions caused an outpayment to the market of £84 mn.

8. In each month of the quarter there were net outpayments on account of Stock transactions but the greater part occurred during the closing weeks. There were no maturities of Stock, but departmental purchases of the £503 mn. of Serial Funding Stock maturing in November were quite considerable; they were not offset by net sales of other Stock as the gilt-edged market weakened still further. The price of the long-dated 3 per cent. Savings Bonds, 1965-75 fell from 70·9 at 30th June, 1957, to 70·3 on the 18th September, 1957, and of 2½ per cent. Consols from 50·3 to 48·1. The prices of medium- and of short-dated Stock also declined; the Treasury Bill rate, which had been level during June and July, began to rise sharply from the beginning of August. The prices of ordinary shares reached a peak in July, but then fell back in August and early September. The clearing banks added noticeably (£31 mn.) to their Investments during the quarter but there were net sales of Stock by Overseas Official and a substantial reduction in the discount market's holding of short-bonds, associated partly with a switch into Bills, partly with a decline in their total assets accompanying a reduction in their call-money from overseas sources and lesser recourse to advances from the Bank. Holdings of Stock by the residual category "Other" (both domestic and unidentified overseas) continued to decline, though at a much lesser rate than in the preceding quarter when there were Stock redemptions.

9. The rise in market Treasury Bills was almost equally matched, over the quarter as a whole, by the rise (£104 mn) in those held by the clearing banks, with offsetting movements occurring in other holdings. The clearing banks' total liquid assets rose by £112 mn. In contrast, their Advances and Other Accounts fell sharply, by £125 mn. Of this, £88 mn. occurred in early July and was at least partly a seasonal movement in reversal of the rise at the end of June. In addition the banks continued to exercise restraint in the granting of advances, the need for which had been stressed by the Chancellor in his Budget Speech of April, 1957, when the Capital Issues Committee also was asked, when examining proposals, to consider whether bank overdraft was the appropriate method of finance. On the 10th July and the 25th July the Chancellor again stated that credit restraint would continue to operate. The rise in the clearing banks' liquid assets and the fall in their Advances was accompanied by the increase in their Investments mentioned above. These together left only a small net increase in their total assets, and in their net deposits, of £19 mn.; their Liquidity Ratio, however, rose to 35·4 per cent., two points higher than at the close of the preceding quarter.

19th September, 1957, to 31st December, 1957

10. On the 19th September, 1957, several measures were announced to meet the exchange crisis and the need to check the trend towards inflation of costs and prices, a trend expected to persist notwithstanding the signs of relaxation, in many countries, from fully extended boom conditions. The Chancellor announced that in the public sector steps were being taken to limit current expenditure and to hold capital expenditures at the level reached in 1957-58. It was later made known that the Government, as an employer, had resolved that any necessary increases in wages and salaries should be offset by economies elsewhere. For the private sector, additional evidence of the Government's determination to create a climate in which prices would stop rising was given by the Chancellor's declaration that the Government were prepared to take all necessary measures to restrict monetary conditions. The average level of bank advances during the ensuing twelve months was to be held, subject to special considerations which might arise with respect to export credits, at the average level of the preceding twelve months. The Chancellor had informed the clearing bankers of this requirement and they had given their assurance that they would do their best to achieve this result, an assurance that was forthwith given by other bankers. The Chancellor also asked the Capital Issues Committee to take a more restrictive attitude towards applications to raise capital and, in particular, towards applications for large amounts.

11. On the same morning as these announcements, Bank Rate was raised from 5 per cent. to 7 per cent. The increase in Bank Rate and the other action taken were followed by an improvement in confidence in the foreign exchange market and in the gilt-edged market, while the prices of ordinary shares fell. Short-term interest rates rose sharply. The Treasury Bill tender rate rose from £4 6s. 1d. on the 13th September, 1957, to £6 15s. 5d. on the 20th September, 1957, and remained near that level until the middle of November, when it began to fall. The clearing banks' deposit rate was raised from 3 per cent. to 5 per cent., and their minimum rate for loans to the discount market against Treasury Bills from 3½ per cent. to 5½ per cent. The yield on 4½ per cent. Conversion Stock, 1962 (a representative short bond) rose from £4 19s. 11d. per cent. on the 18th September to £6 7s. 2d. per cent. on the 20th September, then fell, apart from a fluctuation in October. There was relatively little increase in yields on medium- and long-dated Stocks, which now became lower than yields on short-dated Stocks. The yield on 2½ per cent. Savings Bonds, 1964-67 (a medium-dated Stock) rose from £5 1s. 11d. per cent. to £5 12s. 9d. per cent.; the yield on 2½ per cent. Consols rose from £5 3s. 11d. per cent. to £5 12s. 2d. per cent. and remained close to this level until the middle of December, when it also began to decline.

12. The improved confidence in the gilt-edged market soon led to increased departmental sales of a wide range of Stocks, but departmental purchases of the £503 mn. 2½ per cent. Serial Funding Stock, 1957, and cash redemptions on the 14th November, 1957, of market holdings of this Stock caused a net outpayment to the market on account of Stock transactions until that date. In the weeks remaining to the end of the quarter, there were considerable net sales of Stock, but over the quarter as a whole the net outpayment to the market was £102 mn. There was virtually no net change in the holdings of Stock by the residual category "other domestic and 'unidentified overseas'" and the clearing banks added a further £29 mn. to their Investments: but there was

a large redemption and sale of Stock (£85 mn.) by Overseas Official, and a further substantial reduction, up to the time of the redemption of the Serial Funding Stock, in the short-bond holdings of the discount market.

13. This October-December quarter is one in which Exchequer requirements for the Budget frequently are large; they proved in this year to be £448 mn., after allowing for extra-Budgetary funds, an amount slightly larger than in the December quarter of 1956. External transactions now began to add to the Exchequer's total sterling requirement.

14. The wave of currency speculation ceased at the end of September and there were steady monthly increases in the exchange reserves. The increase during October was about matched by the drawing, in that month, of £89 mn. under the line of credit which had been arranged with the Export-Import Bank of Washington in February, 1957, but over the whole period external transactions cost the Exchequer a net £43 mn.

15. The Exchequer thus needed to raise a total of £593 mn. for Budget, external transactions and Stock redemption. Of this, £150 mn. was found from the seasonal addition to the Fiduciary Issue; £23 mn. from small savings and Tax Reserve Certificates combined; and the remaining £420 mn. from market Treasury Bills.

16. Accompanying the increase in the total of market Treasury Bills, there was a large reduction, £66 mn., in those held by Overseas Official. "Other home and 'unidentified overseas'" holdings rose during October and November and then fell at the end of the year, leaving only a small net increase on balance. Holdings of the Banking Department were reduced by £37 mn., largely reflecting a seasonal increase in notes held in reserve. Thus rather over £500 mn. of Treasury Bills was taken up by the clearing and Scottish banks and by the discount market. Two-thirds of this total was reflected by a rise in the Treasury Bills and call-money of the clearing banks and the remainder was largely financed through the discount market, partly, it would appear, by additional call-money from overseas and domestic sources other than the clearing banks, partly by their switch out of short-bonds. The liquid assets of the clearing banks rose by £385 mn., and at the 31st December, 1957, the total of the clearing banks' liquid assets was the highest since 1951.

17. The clearing banks' advances, other than to nationalised industries, continued to fall rapidly, by £107 mn., and on the 31st December, 1957, were £2 mn. below their level on the 31st December, 1956. Advances to nationalised industries rose, however, by £34 mn., but on the 31st December they also were below, by £29 mn., the level of the previous year.

18. Net deposits of the clearing banks rose £333 mn. and on the 31st December, 1957, were at their highest level (£6,494 mn.) since December, 1954.

1st January, 1958, to 19th March, 1958

19. The Budgetary surplus in this quarter, the seasonal period of Budget surplus, was large and brought the year's deficit on the overall Budget to a level about £100 mn. below that of 1956–57. Between the 1st January and the 19th March, 1958, the Budget surplus, with extra-Budgetary funds was £741 mn. External transactions continued to call for Exchequer finance, to the amount of £182 mn., because of the continuing large increase in the exchange reserves. The net Exchequer surplus on Budget, extra-Budgetary funds and external transactions, therefore, was £559 mn.

20. Of this surplus, £150 mn. was taken up by the reduction in the Fiduciary Issue and £230 mn. by encashment of Tax Reserve Certificates, both seasonal features. Small Savings again provided a net receipt for the Exchequer (£23 mn.) the net total of these leaving £202 mn. for reduction of marketable Government debt.

21. The reduction in marketable debt took the form of, on the one hand, a reduction by £324 mn. in market Treasury Bills and, on the other hand, new issues and sales of Stock of £122 mn. Two new Stock issues were made. On the 14th January, 1958, an issue for cash of £500 mn. 5½ per cent. Exchequer Stock, 1966, and on the 14th February, 1958, an issue for cash of £300 mn. 5½ per cent. Funding Stock, 1982-84, the latter, at the time of issue, very largely replenishing departmental Stock holdings. There were considerable departmental purchases during this quarter of the next Stock to mature, the £676 mn. 4 per cent. Conversion Stock due on the 15th June. These purchases, and the initial acquisition by the departments of the new issues in order to meet the large prospective market demand for Stock, substantially accounted for the increase of £659 mn. in departmental holdings of Stock during this period.

22. The gilt-edged market was confident. Yields throughout the whole range of Stocks continued the tendency to decline shown since late in 1957, the tendency being most marked in the shorter-term yields, which again fell below medium- and long-term yields. On the 19th March, 1958, the yield on 4½ per cent. Conversion Stock, 1962, stood at £5 3s. 7 per cent; on 3 per cent. Savings Bonds, 1965-75, at £5 14s. 5 per cent.; and on 2½ per cent. Consols at £5 3s. 3 per cent. The yield on Treasury Bills had fallen further during January and February, 1958, then rose very slightly until the 14th March, 1958, when it stood at £6 3s. 4 per cent. The discount market had encountered a large demand for Treasury Bills during this time, but the fall in the Bill rate was moderated by their need to borrow a large amount at the Bank, particularly during February, 1958.

23. Taking the period from the 1st January to the 19th March, 1958, as a whole, the main purchasers of Stock were represented by the category "Other domestic and 'unidentified overseas'", who appear to have taken between £90 mn. and £100 mn. of the net sales of £122 mn. For while the clearing banks increased their Investments by £45 mn. and there was a small addition to the discount market's holding of short-bonds, these purchases were offset, to the extent of nearly one-half, by a reduction of £22 mn. in Overseas Official Stock holdings.

24. The reduction (£324 mn.) in the total of market Treasury Bills was accompanied by a large increase (£160 mn.) in the holdings of Treasury Bills by "Other domestic and 'unidentified overseas'". This increase in turn apparently was matched, to the extent of about one-half, by a reduction in call-money in the discount market from overseas sources and from domestic sources other than the clearing banks. This apparent switch from call-money to Treasury Bills, which went on throughout the quarter, was encouraged by expectations of a continuing fall in the Treasury Bill rate and of a lowering of Bank Rate. Part of the rise in these "Other" holdings may also have been associated with the large increase, which occurred at this time, in non-official overseas holdings of sterling. There was, however, a further fall (£56 mn.) in Overseas Official holdings of Treasury Bills. In the outcome, Treasury Bills held by the clearing banks fell by £321 mn.; they also reduced their call-money by £87 mn. Their total liquid assets fell by £504 mn., thus substantially more than reversing the large increase of the preceding quarter.

25. The total of clearing bank Advances and Other Accounts increased by a net £36 mn., those to nationalised industries falling by £28 mn. and those to other borrowers rising by £64 mn. A rise to "other" borrowers is normal at this season; the clearing banks' advances remained below those of corresponding months a year earlier. Thus the total non-liquid assets of the clearing banks rose by £81 mn.

26. The net deposits of the clearing banks fell by £422 mn. and their Liquidity Ratio fell from 38·4 per cent. to 33·9 per cent. Over the year 1957–58 as a whole, their net deposits now had risen by £189 mn., their liquid assets by £152 mn., their Investments by £101 mn.; while Advances and Other Accounts fell by £59 mn. Their Liquidity Ratio on the 19th March, 1958, was 1·3 per cent higher than on the 20th March, 1957.

20th March, 1958, to 30th June, 1958.

27. On the 20th March Bank Rate was reduced from 7 per cent to 6 per cent. The Governor of the Bank, in a public speech made in the following week, said "Last week's adjustment of Bank Rate seems to have been accepted at its face value—not, that is, as any reversal of the general direction of monetary policy, but as an adjustment from a rate which was required at a moment of high crisis to a rate more appropriate when that immediate crisis has been surmounted. . . . On purely technical ground, . . . with the relative development of short-term rates here and overseas, a move from 7 per cent. to 6 per cent. would have been justified at any time since January. . . . But on more general grounds we have felt it wise to proceed cautiously."*

* 26th March, 1958, speech at Machine Tool Trades Association; see Memoranda of Evidence, Pt. I, Appendix 1.

28. This reduction in Bank Rate was followed by a fall in the Treasury Bill rate from £6 3s. 4 per cent. on the 14th March, 1958, to £5 13s. 6 per cent. on the 21st March, 1958, the yield continuing thereafter to decline until the beginning of May, when it rose and levelled off until the 22nd May, 1958. The clearing banks' deposit rate was reduced to 4 per cent. and their minimum rate for loans to the discount market to 4½ per cent. The yield on short-dated Stock followed the movement in the Treasury Bill rate fairly closely until May. The yields on medium- and longer-dated securities were a little slower to fall, but declined from the end of March until May, 1958. The dividend yield on ordinary shares, which had been rising since September, 1957, to a peak (over 7·1 per cent) at the end of February, 1958, declined irregularly until the middle of April and then rose in May. The reversal of yield movements in May, 1958, was around the time of some wage negotiations, and strikes in London.

29. The Chancellor, in his Budget Speech, on the 15th April, 1958, stated that "I do not suggest that any intensification of our disinflationary measures is needed. The September measures succeeded in their first object of restoring confidence in the £, and I was able, last month, to approve a reduction in the Bank Rate from the exceptionally high level of 7 per cent. But the moment has not yet come for any general relaxation of credit policy. It is still necessary for the banks to hold down the level of advances and for the hire-purchase restrictions to be kept on. The Capital Issues Committee will continue for the present to maintain its critical scrutiny." The Chancellor introduced certain measures financially to assist projects for development in areas where unemployment was substantially above the average, including directions to the Capital Issues Committee and notification that bank advances made for this purpose would be put on the same basis as medium-term credit for exports, and so be excluded from the total of advances which the banks had undertaken to seek to hold at the average level of the year ending September, 1957. The Chancellor also stated his determination "to maintain the effort to meet Exchequer requirements without increasing the floating debt. This means a continuing very tight hold on public expenditure, vigorous funding, and, I hope, an increase in Exchequer receipts from small savings." The limit on holdings of the then current issue of National Savings Certificates was raised and a new seven-year Defence Bond, with a yield to maturity of £5 7s. 2 per cent. was introduced.

30. During April and May, 1958, the exchange reserves continued to gain ground steadily, with a strong balance of payments position, and interest rates were still easing abroad. There was a general steadying of prices; employment and output fell slightly, principally associated with lesser accumulation of stocks and a lower volume of exports. The gilt-edged market basically was strong, and prices in that market had already discounted some further fall in short-term rates. On the 25th April, 1958, two new Conversion Issues were announced, 4½ per cent. Conversion Stock, 1963, and 5¼ per cent. Conversion Stock, 1974, in exchange for 4 per cent. Conversion Stock, 1957-58, which was maturing on the 15th June, 1958. £353 mn. of the former Stock and £299 mn. of the latter were issued on the 5th May, 1958, together representing £652 mn. out of the £676 mn. of 4 per cent. Conversion Stock maturing.

31. Against this background, Bank Rate was reduced from 6 per cent. to 5½ per cent. on the 22nd May, 1958. This move was based on the same general considerations as the reduction in March and, as on that occasion, an earlier reduction could have been justified on market grounds. It was again on more general grounds that it was felt wise to proceed slowly and cautiously.

32. A further stage in the reduction of Bank Rate followed within a month. On the 19th June, 1958, Bank Rate was lowered from 5½ to 5 per cent., the move being made on the same general grounds as the two preceding reductions. From the market standpoint the reduction had been expected for some time. The Treasury Bill rate had fallen rapidly since the reduction of Bank Rate in May; the change in yields on Stocks had been much less marked, but there had been some downward drift. These downward trends continued, and, early in June, 1958, the dividend yield on equity shares began much more definitely to fall.

33. By the end of June, 1958, the yield on Treasury Bills was £4 7s. 4 per cent; on 4½ per cent. Conversion Stock, 1962, £4 12s. 3 per cent.; on 2½ per cent. Savings Bonds, 1964-67, £5 4s. 5 per cent. The yield on the long-dated 3 per cent. Savings Bonds, 1965-75, was £5 10s. 11 per cent. and on 2½ per cent. Consols, £4 19s. 9 per cent. The dividend yield on industrial equities was £6 10s. 3 per cent.

34. Net sales of Stock by the departments continued throughout most of this quarter, though with an intermission in May, a time when the gilt-edged market temporarily weakened, when the Conversion Issues had lately been announced, and during which departmental purchases of the 4 per cent. Conversion Stock maturing in June continued. Notwithstanding the maturity of £676 mn. of this Stock on the 15th June, £61 mn. of net receipts from Stock transactions accrued to the Exchequer over the quarter as a whole. It seems that more than half of these receipts represented net purchases by the category "other domestic and unidentified overseas", but other holdings of Stock showed considerable change. Those of Overseas Official fell by £90 mn., while the clearing banks' Investments rose £87 mn. and there was a large addition to the short-bond holdings of the discount market.

35. The Exchequer also obtained a large amount from Tax Reserve Certificates (£107 mn.); continued receipts from small savings (£28 mn.); and £100 mn. from an increase in the Fiduciary Issue. However the Budget requirement was fairly large for this quarter (£224 mn., including extra-Budgetary funds) mainly because of the incidence of capital advances "below-the-line" to nationalised industries. Additionally External transactions required, because of the continuing rise in the exchange reserves, £121 mn. Thus market Treasury Bills rose by £49 mn. despite the finance received by the Exchequer from other sources.

36. The clearing banks' total liquid assets rose by £31 mn., but within this total, their Treasury Bills and call-money rose only £18 mn. This was distinctly less than the increase of Floating Debt in the market, for holdings of Treasury Bills both by Overseas Official and by "Other, including unidentified overseas" rose sharply (in total, by £90 mn.). Even though the discount market's holdings fell almost equally sharply (by £80 mn.), the discount market's total assets appear to have declined slightly while their call-money from non-clearing bank sources appears to have increased. These movements in Treasury Bill holdings and call-money presumably were in part associated with a large rise in non-official sterling balances which occurred during the quarter.

37. The clearing banks' advances to private borrowers rose (£92 mn) by slightly more than in this quarter of 1957. None the less these remained in total below those of the previous year. Their advances to nationalised industries rose £20 mn. These increases, together with the increase of £87 mn. in their Investments, raised their non-liquid assets by £199 mn. Net deposits rose by £233 mn., and the clearing banks' Liquidity Ratio fell to 32·8 per cent, 0·6 per cent. below the level twelve months earlier.

1st July, 1958, to 17th September, 1958

38. In the course of the July–September quarter, 1958, monetary and financial conditions were considerably eased in response to the change in economic conditions, including the outlook for the stability of the currency, which had by then developed. Early in July the Chancellor announced that, as from the end of that month, the banks need no longer limit the total of their advances. The limit of exemption from capital issues control was raised and the guidance given to the Capital Issues Committee altered so as to permit a generally much less restrictive attitude towards applications for new capital issues and to encourage approval of proposals likely to contribute to the stability of the hire-purchase financial system. In August, Bank Rate was reduced to 4½ per cent.; certain increases in public sector capital expenditures were authorised. In September, hire-purchase terms control was relaxed.

39. A scheme under which the Bank of England might call for Special Deposits to be made with the Bank, and whereby the liquidity of the banks could be controlled should the need arise, was announced in July at the

time of the withdrawal of the quantitative restriction on bank advances. The scheme was provisional pending the Report of the Committee on the Working of the Monetary System. The clearing banks and the Scottish banks agreed to give this scheme their co-operation. No calls for Special Deposits have been made.

40. During this quarter there were developments in banking practice. Several banks began to offer unsecured fixed-term "personal loans", repayable by instalments, to credit-worthy customers. One London clearing bank and a Scottish bank introduced a "personal cheque" scheme which offered customers a limited banking service at low cost. Nearly all the clearing and Scottish banks acquired an interest in hire-purchase finance companies.

41. Both bill rates and Stock yields rose in July but this rise was temporary and by early August a reduction of Bank Rate to 4½ per cent. was widely expected. The yield on Treasury Bills had fallen, on the 8th August, to £3 18s. 5d.; the exchange reserves were holding up well; interest rates in the United States were beginning to harden, but not elsewhere. On the 14th August, 1958, the Bank Rate was reduced from 5 per cent. to 4½ per cent. The move was regarded by the authorities as one in step with the recent credit relaxations; justified by internal trends and by the continuing strength of sterling despite seasonal pressures; and also as providing greater freedom of movement in either direction as circumstances might later require.

42. The yield on Treasury Bills fell to £3 15s. 6d. after the reduction in Bank Rate, and then fluctuated, with only a small net further fall by the end of the quarter. There was a very slight fall in yields from medium- and long-term Stock. This was followed by some hardening of yields towards the end of August, probably associated with expectations that any early further fall in Bank Rate was unlikely, but thereafter the slow decline in yields resumed. The dividend yield on ordinary shares began to fall more rapidly.

43. Receipts from Stock transactions (£67 mn.) were a little larger during this quarter than in the preceding one. Purchases of Stock by the group "Other domestic, including 'unidentified overseas'" exceeded the total of departmental sales. For Overseas Official holdings of Stock fell by a further £42 mn., and this more than counterbalanced continuing purchases of short-bonds by the discount market and a small addition to the clearing banks' Investments in Government and Guaranteed Stock. During this quarter the clearing banks' net purchases of Government and Guaranteed Stock halted; in the closing month September, 1958, they made net sales of these, but added about £12 mn. to their trade Investments

44. Market Treasury Bills rose by £63 mn. The Exchequer total requirement was not large. External transactions required only £22 mn. sterling, the increase in the exchange reserves being small, but continuing. The Budget requirement also was low, £160 mn. including extra-Budgetary funds, partly because Local Authorities were making net 'below the line' repayments to the Exchequer. Small Savings also had begun further improvement, yielding £46 mn. But there was a reduction of £50 mn. in the Fiduciary Issue and receipts from Tax Reserve Certificates (£56 mn.) fell off from the high level of the preceding quarter.

45. The rise (£63 mn.) in market Treasury Bills was more than matched by the rise (£71 mn.) in the clearing banks' holdings. The discount market's holdings of Treasury Bills also rose, by £16 mn. This increase, together with the increase in their holdings of short-bonds, was none the less accompanied by a decrease in their call-money taken from the clearing banks; call-money in the discount market from overseas and other domestic sources appears to have increased and the discount market's holdings of commercial bills slightly to have fallen. Treasury Bill holdings by Overseas Official fell £6 mn. and those by 'Other, including unidentified overseas' fell by £18 mn. There was some continuing increase in non-official sterling holdings during this period but not so large as in the previous quarter.

46. The rise in the clearing banks' Treasury Bills was largely offset by decreases in their call-money, cash and Other Bills, so that their liquid assets as a whole rose only £30 mn. There was very little net change in their advances —a fall of £2 mn.—but this was due to divergent movements within the quarter. In the four weeks ending mid-September, 1958, the clearing banks' advances other than to nationalised industries rose by £32 mn., the first clear response to the easing of credit restraint. Over the whole quarter net deposits rose by £57 mn. and the Liquidity Ratio to 33·4 per cent., at which level it was two points below that of September, 1957.

18th September, 1958, to 31st December, 1958

47. The main financial events in this quarter were a rapid growth of bank advances, accompanied by sales of Investments by the banks; the removal of restrictions on hire purchase; a period of hesitation in the gilt-edged market and, after recovery from this, a reduction of Bank Rate to 4 per cent; and a considerable rise in Small Savings. On the external side, sterling continued in strong demand on the exchanges and, at the end of December, Registered sterling, American Account sterling and Transferable Account sterling were unified into a single External sterling.

48. The clearing banks' advances to private borrowers and other accounts rose by £204 million during the quarter ending the 31st December, 1958. The largest previous increase in this quarter since 1951 was in the December quarter 1954, when such advances rose by £63 mn. Advances to personal borrowers and advances associated with hire-purchase finance were the largest single components of this increase, but there was a widely spread increase among business borrowers in general. It appears that in part this increase was accompanied by a reduction in trade credit outstanding and by diminished recourse to sources of finance alternative to bank accommodation.

49. In the gilt-edged market conditions changed during the quarter. Initially net sales continued; then, early in November, the market underwent a distinct set-back. In part this may have been a market reaction after the heavy rate of purchases in preceding months. There may also have been some unsettlement due to the appearance of sales of Investments by banks; but primarily it appears to have resulted from apprehension that the measures being taken to encourage economic expansion in this country, and the growth of economic activity in the United States, might be signs that the stability of prices in general was prospectively endangered. By the 19th November, however, the market had recovered considerably.

50. The fears that the measures which had been taken to relax credit conditions and to extend public capital expenditure might herald an early return of inflationary pressure had not been shared by the authorities. The need to watch for any build-up of inflationary pressures was recognised, but within the country there were indications of less pressure towards private investment and externally the strength of sterling was maintained. On balance, looking ahead, a lower Bank Rate seemed appropriate to prospective conditions and to provide increased freedom of manœuvre, in either direction. On the 20th November, 1958, Bank Rate was reduced from 4½ per cent. to 4 per cent.

51. The Treasury Bill yield fell from £3 12s. on the 14th November, 1958, to £3 9s. 3d. on the 21st November, 1958, and continued to fall until the middle of December when, partly due to the need to take advances from the Bank, the yield levelled off at around £3 3s 10d. Market purchases of Stock, including medium- and long-dated Stock, resumed but on a small scale. During December, 1958, there was, on balance, some slight fall in yields. On the 31st December, 1958, the yield on 4½ per cent. Conversion Stock, 1962, was £4 3s. 11d. on 2½ per cent. Savings Bonds, 1964-67, £4 19s. 5d.; on 3 per cent. Savings Bonds, 1965-75, £5 8s.; and on 2½ per cent. Consols, £4 16s. 8d.

52. The resumption, after the 20th November, 1958, of departmental sales of Stock was accompanied by considerable further departmental purchases of 2 per cent. Conversion Stock, 1958-59, maturing on the 15th January, 1959. On the 12th December, 1958, following announcement of an offer on the 28th November, 1958, £250 mn. out of a total of £592 mn. was converted into 4½ per cent. Conversion Stock, 1964; a larger conversion offer was not made because departmental portfolios were already adequate to meet prospective sales. Purchases of this maturing Stock considerably outweighed sales of other Stock so that over the quarter as a whole official Stock transactions caused a net outpayment to the market of £109 mn.

53. This reduction of £109 mn. in market holdings of Stock was matched by an almost equal decrease (£105 mn.) in the clearing banks' Investments in Government and Guaranteed Stock. The amounts were similar in total but not in composition. Overseas Official holdings of Stock fell further, by £31 mn., but the discount market's holdings of short-bonds rose even more than in either of the two preceding quarters. Holdings of Stock by "Other domestic, including 'unidentified overseas'" fell, on balance, by rather less than £20 mn.

54. The Exchequer Budgetary requirement in this quarter was seasonally high (£458 mn.) including extra-Budgetary funds. External transactions added a further £16 mn.; exchange reserves rose in October and November and though they declined at the end of December, this was partly offset by the capital repayment on the United States and Canadian loans. A substantial part of the total requirement was met by Small Savings (£100 mn.), which had risen rapidly, and by receipts from Tax Reserve Certificates (£91 mn.). The Fiduciary Issue rose seasonally by £150 mn. Exchequer borrowing by means of marketable debt was therefore £133 mn., almost the same as in the previous quarter and £185 mn. less than in the December quarter of 1957. This borrowing through marketable debt was made up, on the one hand, of the net departmental purchases of Stock of £109 mn. as described above (paragraph 53) and, on the other hand, of an increase in market Treasury Bills by £242 mn.

55. The clearing banks' holdings of Treasury Bills rose only by £2 mn. but there was an exceptionally large increase in their call-money (£175 mn.). The discount market acquired a very large part (£192 mn.) of the additional market Treasury Bills, as well as adding to their short-bond portfolios, and took up call-money both from the banks and from other home and overseas sources. The Banking Department's holding of Treasury Bills fell, largely seasonally, by £48 mn. Holdings of Treasury Bills by "Other domestic, including 'unidentified overseas'" rose slightly, by £10 mn. Non-official sterling holdings rose by about the same amount as in the preceding quarter and Overseas Official sterling holdings rose quite sharply; Overseas Official holdings of Treasury Bills increased by £87 mn.

56. The clearing banks increased also their holdings of Other Bills and of Cash, together by £95 mn. Their total liquid assets thus increased by £272 mn. but stood £171 mn. (6½ per cent.) below their level on the 31st December, 1957. The changes in their Advances and Other Accounts and in their Investments, as described above (paragraphs 47-49), gave rise to an increase in their non-liquid assets of £117 mn. during the quarter; they stood £417 mn. above their level at the 31st December, 1957. Net deposits increased over the quarter by £375 mn. and at the 31st December, 1958, were £243 mn. (4 per cent.) higher than a year previously. The clearing banks' Liquidity Ratio at the end of December, 1958, was 34·6 per cent., 3·8 per cent. lower than at the end of December, 1957.

May, 1959.

CAPITAL ISSUES: APPLICATIONS FOR CONSENT

Applications considered by the Capital Issues Committee in 1957

[Information submitted in response to Qn. 6200]

	Numbers of applications received			Applications allowed				Applications partly allowed				Applications refused			
				Over £50,000		£50,000 and under		Over £50,000		£50,000 and under		Over £50,000		£50,000 and under	
	Total	Over £50,000	£50,000 and under	Number	Per cent. of col. 2	Number	Per cent. of col. 3	Number	Per cent. of col. 2	Number	Per cent. of col. 3	Number	Per cent. of col. 2	Number	Per cent. of col. 3
	1	2	3	4		5		6		7		8		9	
(a) *All applications*															
Total															
1st quarter	1,081	440	641	381	*87*	540	*84*	6	*1*	9	*2*	53	*12*	92	*14*
2nd quarter	1,084	411	673	344	*84*	547	*82*	5	*1*	9	*1*	62	*15*	117	*17*
3rd quarter	1,066	441	625	372	*85*	521	*83*	10	*2*	5	*1*	59	*13*	99	*16*
4th quarter	855	348	507	292	*84*	419	*82*	11	*3*	3	*1*	45	*13*	85	*17*
YEAR	4,086	1,640	2,446	1,389	*85*	2,027	*83*	32	*2*	26	*1*	219	*13*	393	*16*
Overseas (excluding governments)															
YEAR	107	90	17	75	*83*	16	*94*	—	—	—	—	15	*17*	1	*6*
Investment trusts, finance and land mortgage companies, banks, etc.															
YEAR	243	193	50	172	*89*	48	*96*	2	*1*	—	—	19	*10*	2	*4*
Commercial and industrial issues, private mortgages, etc.															
1st quarter	997	373	624	321	*86*	525	*84*	6	*2*	9	*1*	46	*12*	90	*15*
2nd quarter	995	339	656	284	*84*	531	*81*	4	*1*	9	*1*	51	*15*	116	*18*
3rd quarter	949	345	604	287	*83*	500	*83*	9	*3*	5	*1*	49	*14*	99	*16*
4th quarter	795	300	495	250	*83*	407	*82*	11	*4*	3	*1*	39	*13*	85	*17*
YEAR	3,736	1,357	2,379	1,142	*84*	1,963	*83*	30	*2*	26	*1*	185	*14*	390	*16*
(b) *New projects*															
Total															
1st quarter	596	230	366	186	*81*	295	*81*	5	*2*	6	*1*	39	*17*	65	*18*
2nd quarter	629	209	420	157	*75*	335	*80*	4	*2*	3	*1*	48	*23*	82	*19*
3rd quarter	596	233	363	179	*77*	290	*80*	9	*4*	3	*1*	45	*19*	70	*19*
4th quarter	442	161	281	125	*78*	226	*80*	10	*6*	2	*1*	26	*16*	53	*19*
YEAR	2,263	833	1,430	647	*78*	1,146	*80*	28	*3*	14	*1*	158	*19*	270	*19*
Overseas (excluding governments)															
YEAR	101	86	15	72	*84*	15	*100*	—	—	—	—	14	*16*	—	—
Investment trusts, finance and land mortgage companies, banks, etc.															
YEAR	132	112	20	94	*84*	20	*100*	1	*1*	—	—	17	*15*	—	—
Commercial and industrial issues, private mortgages, etc.															
1st quarter	538	179	359	142	*79*	288	*80*	5	*3*	6	*2*	32	*18*	65	*18*
2nd quarter	566	157	409	116	*74*	324	*79*	4	*2*	3	*1*	37	*24*	82	*20*
3rd quarter	521	170	351	126	*74*	278	*79*	8	*5*	3	*1*	36	*21*	70	*20*
4th quarter	405	129	276	97	*75*	221	*80*	10	*8*	2	*1*	22	*17*	53	*19*
YEAR	2,030	635	1,395	481	*76*	1,111	*80*	27	*4*	14	*1*	127	*20*	270	*19*

INDEX

to the Minutes of Evidence taken before the Committee on the Working of the Monetary System

This index is intended to give the main references to the principal subjects discussed in the course of the Committee's hearings of oral evidence, not to be an exhaustive nominal index. References are to questions. Each reference (or group of references) is preceded by an indication in italic type of the name of the organisation or person to whose evidence the reader is referred. Full lists of witnesses are printed as Appendices I and II to the Committee's Report (Cmnd. 827) and reproduced at the beginning of this volume. In this index the following abbreviations have been used for the names of certain organisations to whose evidence several references are made:

ABCC Association of British Chambers of Commerce.
AHC Accepting Houses Committee.
AIT Association of Investment Trusts.
AMC Association of Municipal Corporations.
ASPF Association of Superannuation and Pension Funds.
BE Bank of England.
BFCA British Federation of Commodity Associations
BIA British Insurance Association
BOBA British Overseas Banks Association.
BOT Board of Trade
BSA Building Societies Association.
CCA County Councils Association.
CLCB Committee of London Clearing Bankers.
CSBGM Committee of Scottish Bank General Managers.
CSCC Council of Scottish Chambers of Commerce.
CSE Council of the Stock Exchange, London.
ECGD Export Credits Guarantee Department.
EGCI Export Group for the Constructional Industries.
EIA Engineering Industries Association.
FBI Federation of British Industries.
FHA Finance Houses Association.
FWO Federation of Wholesale Organisations.
HMT Her Majesty's Treasury.
IBA Industrial Bankers Association.
IHA Issuing Houses Association.
LDMA London Discount Market Association.
MSF Multiple Shops Federation.
NSC National Savings Committee and Scottish Savings Committee.
POSD Director, Post Office Savings Department.
RDA Retail Distributors Association.
TSBA Trustee Savings Banks Association.
TUC Trades Union Congress.

(30500) Wt. 2181— K13 1/60 D.L.

S.O. Code No. 63–150*